YANGAROO INC.

ANNUAL REPORT 2009

To Our Shareholders:

The fiscal year ended December 31, 2009 was one of great strides for YANGAROO.

Highlights of the year include the launch of our next generation DMDS 5.0 which opens new markets for television broadcast quality music video delivery, television advertising distribution, and award shows; powering the music distribution and judging processes for the 2009 JUNO Awards; receiving the grant of United States patent #7,529,712 titled “Content Distribution System and Method”; being named to the Canadian Business “The Tech 100” 2009 list; being chosen to distribute music for the GRAMMY® Awards; working with Horizon Media Inc. on a digital media workflow solution; and partnering with CMJ Network Inc., the largest organization focused on U.S. College Radio.

YANGAROO had its seventh consecutive year of revenue growth in 2009, an increase of 35%, despite the uncertain economic times. EBITDA (Earnings before interest, taxes, depreciation and amortization) for 2009, calculated as the loss for the period before amortization and interest income, improved by 23% over 2008 and the loss was reduced 14%.

Subsequent to the 2009 year end, in April 2010 the company signed a multi-year contract with MTV Networks, a division of Viacom International Inc., one of the world's leading creators of entertainment content. MTV Networks portfolio spans more than 150 television channels and 300 digital media properties in over 160 countries worldwide.

I encourage you to read the enclosed Management Discussion and Analysis and the financial statements to gain further insight into the progress made by YANGAROO in 2009. These advances were made possible by the dedication of our team members and the continued support of our shareholders and business partners, which we truly appreciate. The substantial gains that were achieved in 2009 further bolsters our confidence in the future prospects of YANGAROO.

John Heaven
President & Chief Executive Officer

Management Discussion and Analysis
<u>For the Year Ended December 31, 2009</u>

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) <u>Date of MD&A</u> April 20, 2009.

<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 Inc. is a technology company that is targeted to become the leading enabler of user-friendly and secure B2B ("business to business") 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 audio and video 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 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 television broadcasters, radio, media, retailers, award shows 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 and 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.

Record labels and artists have been delivering their new music and music videos to radio stations and television broadcasters using traditional physical media methods, and the industry is moving to digital delivery. The traditional method for music releases requires 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.

Similarly, the advantages of DMDS can be obtained for the distribution of television broadcast quality music videos and for both audio and video advertising content. DMDS can put the control of when and to whom ads and videos are distributed directly in the hands of the advertising firm or production house. DMDS can provide significant cost savings, greater efficiencies, direct control, and individual accountability compared to the distribution of ads on CD's, videotape, FTP or satellite based systems. YANGAROO has upgraded DMDS to the next generation 5.0 to enable it to distribute television broadcast quality music videos and TV commercials, as well as provide support for award shows, which offer significant additional market and revenue opportunities for the company.

3) Review of Results of Operations for the Year Ended December 31, 2009

Revenues for the year ended December 31, 2009 increased 35% over revenues for 2008, as a result of increased use of DMDS by a greater number of customers. The loss for 2009 was 14% ($447,000) lower compared to 2008. EBITDA (Earnings before interest, taxes, depreciation and amortization) for 2009, calculated as the loss for the period before amortization and interest income, improved by 23% ($673,000) over 2008.

The increase in revenues, combined with a 9% ($374,000) decrease in total expenses, accounted for the lower loss compared to the 2008. The decrease in salaries and consulting expense of $446,000 (21%) accounted for the majority of the reduction in total expenses. General and administrative expense increased 13% ($121,000), marketing and promotion expense decreased by 29% ($87,000) and technology development expense decreased 47% ($49,000), which also contributed to the lower total expenses.

A reduction in interest income of $128,000 (92%), due to lower interest rates and investment balances, partially offset the lower total expenses. An increase in amortization expense of intangible assets of $85,000 (19%) was largely a result of the commencement of amortization of deferred development costs for the investment in DMDS 5.0. Amortization of capital assets increased $12,000 (16%), because of equipment purchases in the year.

The decrease in salaries and consulting expense was primarily due to reduced human resources costs in the technology and sales and marketing departments, where this expense was lower by 45% ($278,000) and 26% ($159,000) respectively in 2009 compared to 2008. The company had bolstered its technology team with necessary human resources through 2007 and into 2008 to carry out its product development plans for the next generation of DMDS 5.0. As DMDS 5.0 development approached completion through 2009, the company reduced these expenditures. The balance of the decrease in salaries and consulting expense was in the general and administration department, where it was 8% ($55,000) lower than in 2008. These decreases were partly offset by an increase in the salaries and consulting expense for the operations department of $47,000 (29%), reflecting increased staffing to support a greater number of customers and usage of DMDS.

General and administrative expense includes expenses related to the protection of the company's Canadian and U.S. intellectual property rights, which were $480,000 in 2009 compared to $353,000 in 2008, a 36% ($127,000) increase. In 2009 these costs included the filing and prosecuting a claim for infringement of the company's United States patent #7,529,712 titled "Content Distribution System and Method" as described below. Expenditures related to enforcing the company's intellectual property rights are a non-recurring operating expense, as it is expected that these will not be necessary once the matters under litigation are resolved.

Total expenditures on technology development were $982,000 in 2009, before recognition of investment tax credits of $120,000. Of these expenditures, $100,000 of this amount was expensed as technology development, $341,000 was included in salaries and consulting expense and $541,000 was capitalized as deferred development costs. Technology development expense for 2009 decreased $49,000 (47%) from 2008 primarily due to recognition of an investment tax credit of $45,000. Deferred development costs were also reduced by recognition of an investment tax credit of $75,000 in 2009. The company met the deferral criteria for development costs under generally accepted accounting principles as the company is generating increasing revenues from the products and technology it has developed. Amortization expense for deferred development costs in the amount of $422,000 was recognized in 2009, an increase of $98,000 (30%) compared to 2008.

Marketing and promotion expense for 2009 was $87,000 (29%) lower than for 2008 primarily because of reduced travel, advertising and public relations costs. Stock based compensation of $40,000 was included in the salaries and consulting expense for 2009, which was a decrease of 64% ($72,000) from 2008.

During the first quarter of 2009, the company's new DMDS 5.0 platform was successful at reducing costs and providing an environmentally-friendly method for distributing music and enabling the judging process for The Canadian Academy of Recording Arts and Sciences (CARAS) in association with the 2009 JUNO Awards. The initial phase of voting for The 2009 JUNO Awards was completed on February 3, 2009 with the announcement of the JUNO nominees and the final voting was completed on March 2. The results were delivered to PricewaterhouseCoopers, and were announced at the JUNO Awards show, which was broadcast live from Vancouver on March 29, 2009 by CTV.

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 over 300 judges and more than 1,700 members, eliminating the need for a third-party supplier to collect, manage and distribute in the range of 15,000 physical CDs. The judges and members were able to stream the music online or download it to be burned to CD or transferred to their iPods for review. Votes were then cast online in the specific category or categories that applied and DMDS 5.0 provided CARAS with detailed reports of the entire process.

In the second quarter of 2009 YANGAROO launched the next generation of its Digital Media Distribution System - DMDS 5.0. A significant new feature of the system is support for the delivery of television broadcast quality video, such as music videos and TV commercials. DMDS 5.0 was designed in a modular, data driven fashion utilizing a services oriented architecture (SOA) approach, so that it can be responsive to the changing needs of YANGAROO customers worldwide, and is able to adapt to opportunities for secure digital file delivery in the music and advertising industries.

In May 2009 the company was very pleased to receive the grant of United States patent #7,529,712 titled "Content Distribution System and Method". This followed the issuance in January 2009 by the United States Patent and Trademark Office of a Notice of Allowance for the patent application. This patent will be in effect until 2026. The U.S. patent for "Content Distribution System and Method" covers a method of distributing digital content, such as music and advertising, to selected individuals over the Internet, in which the uploading content provider selects the individuals that are entitled to access the content and sets release conditions, such as a time and date. Once the identities of the selected individuals have been verified at login, they are provided with access to the uploaded content if those release conditions are met. YANGAROO'S Digital Media Distribution System (DMDS) is the only such system available to the North American record, radio and advertising industries that has U.S. and Canadian patent protection for all of these essential features.

This new U.S. patent complements YANGAROO's Canadian patent number 2,407,774 of the same title that was granted in 2005, together providing a North America-wide safeguard for the company's intellectual property.

In July 2009 the company's continuation patent application no. 12/398,238 entitled "Content Distribution System and Method" was published by the United States Patent and Trademark Office under publication no. US-2009-0171966-A1. As noted above the company has already obtained U.S. and Canadian patents for its Content Distribution System and Method. A continuation patent application is a mechanism available under the U.S. patent system to pursue additional claims in a second patent application. YANGAROO's continuation patent application no. 12/398,238 contains 29 claims and benefits from the same 2002 priority date as the original patent application. In summary, the claims in the continuation patent application are directed to distributing digital music content to registered recipients who request access to the server and who are included in a distribution list specifying which registered users can access the digital music content. The system enables content providers to control which recipients are included in the distribution list for a particular digital music content file and what release conditions can be set for that file.

These "Content Distribution System and Method" patents and the U.S. continuation patent application augment YANGAROO'S intellectual property portfolio, which also includes U.S. patent number 7,003,670 titled "Biometric Rights Management System", which is pending in Canada as patent application number 2,349,797, and pending U.S. patent application number 11/854,289 titled "Media File Distribution System and Method".

The grant of the company's second U.S. patent underscores YANGAROO's status as the founding inventor in its sector and is expected to add substantial value to the company. Both the U.S. and Canadian patent offices have recognized the company's inventions as patents. The company's focus on leading through innovation continues to bring the best and most advanced solutions available to its customers. Management will continue with its program of actively protecting its technology and expects that this patent will provide a further barrier to entry against competitors in the U.S. market and add significant value to the company.

In May 2009, following the grant of U.S. patent #7,529,712, the company filed a claim for patent infringement in United States Federal District Court in Wisconsin requesting that the court issue an injunction against Destiny Media Technologies Inc. (OTC:DSNY) as well as Destiny Software Productions, Inc., and MPE Distribution, Inc. to cease the use of their system in the United States. In addition, the claim requests the payment of unspecified damages for patent infringement and other costs to be determined at trial.

Also in May 2009, Dean Ernst joined YANGAROO as a consultant to market the company's newly launched state of the art digital delivery system, DMDS 5.0. Dean was one of the original founders of what is known today as the Play MPE system and former Vice President of Operations for Destiny Media Technologies Inc. (OTC: DSNY), a competitor of the company. "DMDS 5.0 is clearly a superior product in every way," said Dean Ernst. "I visited YANGAROO's Development Center in Toronto and saw DMDS 5.0 for myself. I met their development team as well as their fine customer service people and was extremely impressed to say the least. My credibility and reputation is very important to me. I chose to work with YANGAROO because I am confident that DMDS 5.0 is the best product available for my music industry associates. It does everything I wanted Destiny's Play MPE system to do and much more. It has the added ability to deliver full broadcast quality video with all the same features currently available for audio file delivery. This will truly revolutionize the music industry. I'm happy to be a part of this outstanding team."

In June 2009 the company signed a commercial agreement with a U.S. based multi-national, NYSE-listed Fortune 500 company to use DMDS to securely deliver pre-release music and audio files from the company's television shows to custom lists of internal recipients and external destinations. For each show or segment of a show, DMDS will allow a custom group of recipients, including producers, editors, choreographers, dancers, actors, and others, to be selected and securely sent music and/or audio from specific segments or scenes. These recipients can then either stream or download the audio for preparation, pre-production, production, or post-production. The use of DMDS in television show production opens an attractive new market for the company.

In July 2009 the company was named to the Canadian Business "The Tech 100" 2009 list, an annual list ranking Canada's 100 leading technology companies. Canadian Business' key criteria for including a company in the Tech 100 are:

- conducts own meaningful advanced technology R&D
- develops advanced hardware or software technology of its own for an end market
- provides advanced IT services or manufactures advanced IT products
- business model rests on a value proposition of in-house advanced technological knowledge and ingenuity
- headquartered in Canada

The top 100 companies that meet these criteria are then ranked by factors including performance measures, such as sales growth and one-year total return figures, and market capitalization to provide a more rounded perspective of the contribution the selected firms make to Canada's technology sector. The full list appears in the July 20, 2009 print edition of the magazine and is available online at: www.canadianbusiness.com/tech100.

In August 2009 the company announced that Horizon Media Inc. will acquire warrants to purchase 750,000 YANGAROO common shares. The warrants will become exercisable after various phases of a digital media workflow solution are successfully completed. At the end of 2009, half of these warrants had become exercisable. These warrants have an exercise price of $0.10 and an expiry date of five years from the date of issuance. Founded in 1989, Horizon Media, Inc. is the largest U.S. independent media services company with estimated billings of $2 billion and is the fastest growing agency in the industry. Headquartered in New York City with a full service office in Los Angeles, Horizon also has offices in San Diego, and Amsterdam, Netherlands.

In August 2009 the company announced that it had delivered the first full broadcast-quality music video utilizing DMDS 5.0 in Canada. Sony Music Entertainment Canada used DMDS to successfully deliver the video for Shakira's "She Wolf" to Montreal-based MusiquePlus (an Astral Media Television Network) in a full, broadcast-ready format. YANGAROO's team worked closely with both Sony Music and MusiquePlus to refine the process for digitally distributing television broadcast-quality music videos utilizing DMDS 5.0. DMDS 5.0 enables the file for online availability for streaming and a frame-accurate preview quality version of the file with time-code burned in. The DMDS delivered file can be easily integrated into Online Editing Suites, On-Air Playback Servers and stored in a Digital Archive Server. The files are 50mbit IMX in an MXF OP1a container that maintain both time-code and closed captioning for the underlying video.

Also in August 2009 the company delivered the first full broadcast-quality music video utilizing DMDS 5.0 in the United States. E1 Entertainment in New York (AIM: ETO), a leading international entertainment content and distribution business, successfully delivered the Arkaea "Locust" video to major music video broadcasters in the U.S. This was another significant milestone in YANGAROO's technology program to digitize broadcast media delivery workflows and reduce reliance on the physical delivery of DVDs and Beta SP tapes.

In September 2009 the company designated New York based Devlin Video International as the first "Certified Sender" for DMDS 5.0. Devlin Video International is a leading video production and distribution facility with major clients that include ABC Sports, BBC, CBS Networks, Comedy Central, Estee Lauder Companies, Goldman Sachs, and HBO Sports among many others. YANGAROO is working with a select group of video production houses and content owners to establish a network of DMDS Certified Senders. This network of professionals will make it faster and easier for video content owners to have their files digitally delivered to their chosen industry destinations by DMDS and will ensure that uploaded files meet rigorous DMDS and broadcast quality standards. Devlin and other Certified Senders can utilize DMDS to distribute broadcast and preview quality videos (including music videos, advertising and various other short form content) to both domestic and international destinations.

During September 2009 a Federal Court in Wisconsin had ruled in YANGAROO'S favour on a Motion to Dismiss brought by Defendant Destiny Media Technologies Inc. (OTC:DSNY). YANGAROO is suing Destiny for patent infringement in the United States and seeks an injunction against the sale and use of Destiny's PlayMPE system and requests the payment of unspecified damages for patent infringement and other costs to be determined at trial. YANGAROO filed the infringement claim following the grant of its United States patent #7,529,712, titled "Content Distribution System and Method" in May 2009, which is described above.

In October 2009 the company entered into a multi-year agreement with The Recording Academy®, the organization responsible for the world's leading music award show, the GRAMMY® Awards. The Academy will utilize YANGAROO's patented Digital Media Distribution System (DMDS) to distribute music submitted for GRAMMY Award consideration to the more than 12,000 voting members of The Academy throughout the U.S. By using this technology, submitted music will be digitally ingested into DMDS and The Academy will then use the system to securely distribute the music to voting members, allowing them to stream the music online for review. "For quite some time now, we have been working diligently to move the entire GRAMMY voting process to a digital platform, and DMDS provides the proven and tested solution we have been looking for," said Neil Portnow, President/CEO of The Recording Academy. "We are pleased to partner with an industry leader like YANGAROO as we streamline our operations and move closer to our digital strategy goals, which include providing an online listening function for our voting members." The nominees were announced live at 8 p.m. ET on December 2 in a one-hour special on CBS, and the 52nd GRAMMY Awards telecast took place at STAPLES Center in Los Angeles on January 31, 2010.

Also in October 2009 the company partnered with CMJ Network Inc., the largest and most influential multi-media organization focused on U.S. College Radio and emerging music, to enable associated record labels, managers, indie promoters, and other parties to access DMDS for distributing music to the over 500 college radio stations throughout the United States. DMDS enables the distribution of entire albums to the most accurate and comprehensive college radio contact lists in the business. College radio executives benefit by having a central repository for new music, which they can preview and download in the file format and quality of their preference. Albums released on DMDS will automatically be linked on the CMJ New Music Report Charts, the industry's most important college radio charts, for radio programmers to stream or download and add to their playlists.

In the fourth quarter of 2009 the company introduced DMDS support for 24bit audio, the highest sound quality available and the format preferred by audiophiles. For years, DMDS has been the only digital music delivery solution providing users with uncompressed WAV files. Other systems provide downloads in a proprietary compressed format that can be 'exported' to WAV, others are MP3 only. DMDS now offers support for digital audio in 24bit, 48/96 kHz (CD is 16bit, 44.1kHz). For music industry users that value audio quality, DMDS is the music delivery system of choice.

In April 2010 the company signed a multi-year contract with MTV Networks (MTVN), a division of Viacom International Inc. (NYSE: VIA, VIA.B), which is one of the world's leading creators of entertainment content. MTVN's portfolio spans more than 150 television channels and 300 digital media properties in over 160 countries worldwide, and includes music video channels MTV, MTV2, VH1, VH1 Classic, VH1 Soul, and Country Music Television (CMT) and CMT Pure (see www.mtvnetworks.com). MTVN will immediately begin utilizing YANGAROO's Digital Media Distribution System (DMDS) for delivery of music videos and other artist and music-related audiovisual content and will integrate DMDS into MTVN's internal workflow. Commencing in the U.S., the agreement provides for expansion to MTVN's international operations. The company believes this agreement, and the endorsement of MTV Networks, establishes DMDS 5.0 as the world standard for the delivery of television broadcast quality video content via the internet and will provide an important new revenue stream for YANGAROO. “By implementing YANGAROO’s cutting-edge DMDS 5.0 platform, we hope to enhance the efficiency and cost-effectiveness of our music video delivery process while significantly reducing its environmental impact,” said Emilienne Gray, Sr. Vice President, MTV360 & VH1 Music Programming and Strategy.

Television broadcast outlets that can receive music videos via DMDS include:

- MTV Networks
- CTV Networks
- MUCHMUSIC
- MUCHMORE
- PUNCHMUCH
- MUCHVIBE
- MUCHLOUD
- MUCHMORERETRO
- MTV Canada
- ETalk Now
- MusiquePlus
- BPMTV
- Glassbox
- AUX TV
- BITE TV
- Global TV Networks
- Entertainment Tonight Canada
- SunTV
- CMT Canada

DMDS 5.0 is now the "one stop shop" for music labels, artists and production houses to distribute their new broadcast quality audio and video releases. No other solution provides this convenience, quality and flexibility for the music industry.

With the launch of DMDS 5.0, YANGAROO is now pursuing the new market opportunities for television broadcast quality music video delivery, television advertising distribution, and award shows.

4) Review of Operations for the Fourth Quarter Ended December 31, 2010

Revenues for the fourth quarter ended December 31, 2009 grew 27% over revenues for the fourth quarter of 2008, as a result of increased use of DMDS by a greater number of customers. The loss for the fourth quarter of 2009 was 23% ($175,000) higher compared to the fourth quarter of 2008. EBITDA (Earnings before interest, taxes, depreciation and amortization) for the fourth quarter of 2009, calculated as the loss for the quarter before amortization and interest income, was 17% ($111,000) lower than for the same period in 2008.

The increase in total expenses of 21% ($196,000) in the fourth quarter was the primary reason for the higher loss compared to the fourth quarter of 2008. The increase in general and administrative expenses for the fourth quarter of $207,000 accounted for most of the increase in total expenses in the quarter. This increase was primarily the result of several months of work for the protection of the company's Canadian and U.S. patent rights being billed in the quarter. These costs included prosecuting a claim for infringement of the company's United States patent #7,529,712 titled "Content Distribution System and

Method" in United States Federal District Court in Wisconsin requesting that the court issue an injunction against Destiny Media Technologies Inc. (OTC:DSNY), Destiny Software Productions, Inc., and MPE Distribution, Inc. ("Destiny") to cease the use of their system in the United States. The claim also requests the payment of unspecified damages for patent infringement and other costs to be determined at trial. During the third quarter of 2009 a Federal Court in Wisconsin ruled in the company's favour on a Motion to Dismiss brought by Destiny. This U.S. action is in addition to the ongoing prosecution of the Canadian suit including Destiny in which the company has claimed $15 million in damages for infringement of the company's Canadian patent #2,407,774, also titled "Content Distribution System and Method". Expenditures related to enforcing the company's intellectual property rights are a non-recurring operating expense, as it is expected that these will not be necessary once the matter under litigation is resolved.

The increase in amortization of intangible assets by 40% ($44,000) and amortization of capital assets of 16% ($3,000), plus decreased interest income of $17,000 (94%) also contributed to the increase in the loss. The increase in amortization of intangible assets expense was largely a result of the commencement of amortization of deferred development costs for the investment in DMDS 5.0.

Marketing and promotion expense for the fourth quarter of 2009 was lower by $25,000 (36%) and technology development expenses decreased by $25,000 (104%) compared to the fourth quarter of 2008. Marketing and promotion expense decreased primarily because of lower travel and public relations costs. Technology development expense was lower because of recognition of an investment tax credit of $28,000 in the period. Salaries and consulting expense in the fourth quarter of 2009 was essentially unchanged from 2008 as lower technology development salaries and consulting expenses were offset by higher salaries and consulting expenses in the operation and sales and marketing department.

Total expenditures on technology development were $249,000 in the fourth quarter of 2009, before recognition of investment tax credits of $82,000. Of these expenditures, $27,000 was expensed as technology development, $118,000 was included in salaries and consulting expense and $104,000 was capitalized as deferred development costs. During the fourth quarter of 2009 technology development expense decreased $25,000 (104%) over the same period in 2008, primarily due to recognition of investment tax credits. 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.

Equity based compensation of $19,000 was included in the salaries and consulting expense for the fourth quarter of 2009, a decrease of 11% ($2,000) from the same period in 2008.

5) Summary of Quarterly Results

The following table sets out 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: 2009 2008

($)	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
	2009				2008			
Sales	175,613	218,211	204,842	181,386	138,023	175,767	137,946	127,077
Loss for the period	935,452	545,626	725,650	610,021	760,455	675,672	1,020,724	807,192
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, 2009 were $260,000 compared to $3,030,000 as at the December 31, 2008 fiscal year end. The main reason for this change was the cash used in operating activities, which decreased by 18% ($467,000) during the year compared to 2008. During the 2009 the company invested $541,000 in deferred development costs for DMDS 5.0, $56,000 in property plant and equipment, and $40,000 in patents. The decrease in cash during 2009 was lower by 20% ($696,000) than in 2008.

Subsequent to the 2009 year end the company raised $818,000 gross proceeds from an issue of convertible debentures. See Note 19 to the accompanying financial statements for a description of this transaction. 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 will need to source additional funds in order to fulfil its business objectives.

7) Share Capital

At December 31, 2009 the company had 75,517,615 common shares and 3,595,000 options and 750,000 warrants outstanding. At December 31, 2008 YANGAROO had 75,517,615 common shares, 3,769,000 options, and 2,800,000 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 16(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 quarter ended December 31, 2009 , and have evaluated the design of the Company's ICFRs for the quarter ended December 31, 2009 ; 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, 2009; 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 Policy</u>

Effective January 1, 2009 the Company adopted CICA Handbook Section 3064, Goodwill and Intangible Assets, which replaced Section 3062, Goodwill and Other Intangible Assets and Section 3450, Research and Development Costs. Section 3064 establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets. On adoption of this section, management has determined that previously capitalized costs in the amount of $78,030, relating to the trade name and related marketing intangibles no longer meet the definition of an intangible asset. Therefore, management has applied CICA 3064 retrospectively and has recorded an adjustment to the opening deficit of $78,030. There was no other impact on adoption of this standard.

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.

The company has developed a three phase plan to adopt IFRS by January 1, 2011:

(i) This first phase involves the identification of differences between IFRS and existing Canadian GAAP, and an assessment of their applicability and the expected impact on the company.

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.

(ii) The second phase includes the detailed review, documentation and selection of accounting policy choices relating to each IFRS standard. This phase will also include assessing the impact of the conversion on business activities, including the effect on information technology and data systems, income tax, internal controls over financial reporting, and disclosure controls. In this phase, accounting policies will be finalized, first-time adoption exemptions and exceptions will be considered, and draft financial statements and note disclosures will be prepared. The Audit Committee and management of the Company plan to engage the company's auditors to conduct an IFRS impact assessment in 2010.

The CICA has been updating its current standards to more closely align with IFRS prior to 2011. The CICA issued new CICA Handbook Section 3064, Goodwill and Intangible Assets, which replaced Section 3062, Goodwill and Other Intangible Assets and Section 3450, Research and Development Costs. Section 3064 establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets. The company adopted this policy effective January 1, 2009. The result of adoption of this policy was that previously capitalized costs in the amount of $78,030, relating to the trade name and related marketing intangibles no longer meet the definition of an intangible asset. The company reviewed this new policy with respect to other intangibles such as deferred development costs and concluded that it was consistent with the current treatment.

(iii) The final phase involves the actual implementation of IFRS standards. This phase will involve the finalization of IFRS conversion impacts, approval and implementation of accounting policies, implementation and testing of new processes, systems and controls, and the execution of detailed training where required.

As at December 31, 2009, the first phase of the company's IFRS plan was complete and Phase two was in progress. Phase 3 is expected to be completed by September 30, 2010.

YANGAROO Inc.

Financial Statements

For the Years Ended December 31, 2009 and 2008

Collins Barrow
Chartered Accountants

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Suite 2100, P.O. Box 2014
Toronto, Ontario
M4R 1K8 Canada

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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, 2009 and 2008 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, 2009 and 2008 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

Licensed Public Accountants
Chartered Accountants
March 19, 2010 (except for Note 19, which is as of April 12, 2010)
Toronto, Ontario

YANGAROO Inc.
Balance Sheets
As at December 31, 2009 and 2008

		2009		2008
Assets				
Current				
Cash and cash equivalents	**$**	**259,603**	$	3,030,099
Accounts receivable		**193,581**		157,798
Prepaid and sundry assets		**196,204**		50,418
		649,388		3,238,315
Capital assets (Note 4)		**133,345**		166,136
Patents (Note 5)		**138,438**		105,855
Investment in technology (Note 6)		**356,209**		452,330
Deferred development costs (Note 7)		**1,343,238**		1,300,433
	$	**2,620,618**	$	5,263,069
Liabilities				
Current				
Line of credit (Note 8)	**$**	**5,000**	$	-
Accounts payable and accrued liabilities		**538,666**		443,453
Deferred revenue		**17,134**		14,989
		560,800		458,442
Shareholders' Equity				
Capital stock (Note 9)		**21,043,889**		21,043,889
Contributed surplus (Note 11)		**1,413,871**		868,384
Warrants capital (Note 12)		**31,883**		505,428
Deficit		**(20,429,825)**		(17,613,074)
		2,059,818		4,804,627
	$	**2,620,618**	$	5,263,069

Going Concern (Note 1)

Commitments and Contingencies (Note 16)

Subsequent Event (Note 19)

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

See accompanying notes

YANGAROO Inc.
Statements of Operations and Deficit
Years Ended December 31, 2009 and 2008

	2009	2008
Revenue	**$ 780,051**	$ 578,813
Expenses		
Salaries and consulting	**1,680,707**	2,126,210
Marketing and promotion	**209,501**	296,652
General and administrative	**1,047,145**	926,597
Technology development	**55,305**	104,479
Write-off of investment	**-**	10,000
Amortization of intangibles	**526,295**	441,402
Amortization of capital assets	**88,923**	76,746
	3,607,876	3,982,086
Loss before the undernoted items and income taxes	**(2,827,825)**	(3,403,273)
Other income (expenses)		
Interest revenue	**11,074**	139,230
Net loss	**(2,816,751)**	(3,264,043)
Deficit, beginning of year	**(17,613,074)**	(14,271,001)
Transition adjustment (Note 2)	**-**	(78,030)
Deficit, end of year	**$(20,429,825)**	$(17,613,074)

Loss per share (Note 14)		
Basic and diluted	**$ (0.04)**	$ (0.04)

See accompanying notes

YANGAROO Inc.
Statements of Cash Flows
Years Ended December 31, 2009 and 2008

	2009	2008
Cash provided by (used in)		
Operations		
Net loss	**$ (2,816,751)**	$ (3,264,043)
Items not affecting cash		
Amortization	**615,218**	518,148
Write-off investment	**-**	10,000
Loss (gain) on disposal of capital assets	**(762)**	1,876
Stock-based compensation	**40,059**	111,888
Warrants issued for services/compensation	**31,883**	-
	(2,130,353)	(2,622,131)
Net changes in non-cash working capital		
Accounts receivable	**(35,783)**	(16,306)
Prepaids and sundry assets	**(70,401)**	7,017
Accounts payable and accrued liabilities	**95,213**	20,139
Deferred revenue	**2,145**	5,188
	(2,139,179)	(2,606,093)
Investing		
Purchase of capital assets	**(56,499)**	(136,157)
Proceeds from sale of capital assets	**1,129**	2,270
Patents	**(40,374)**	(52,931)
Deferred development costs	**(540,573)**	(663,553)
Investment	**-**	(10,000)
	(636,317)	(860,371)
Financing		
Operating loan (repayment)	**5,000**	-
Net change in cash	**(2,770,496)**	(3,466,464)
Cash, beginning of year	**3,030,099**	6,496,563
Cash, end of year	**$ 259,603**	$ 3,030,099

Supplemental Disclosure		
Cash (bank overdraft)	**$ 257,352**	$ (1,288)
Cash equivalents	**2,251**	3,031,387
Total cash and cash equivalents	**$ 259,603**	$ 3,030,099

See accompanying notes

1. GOING CONCERN

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.

The Company will have to raise additional capital to fund operations until such point that revenues from their technology are able to fund operations. If the Company is not able to raise sufficient capital then there is the risk that the Company will not be able to realize the value of its assets and discharge its liabilities. These financial statements do not give effect to adjustments that would be necessary to the carrying values and classification of assets and liabilities should the going concern assumption not be appropriate. To date the Company has been successful raising capital and subsequent to the year end (Note 19), the Company raised gross proceeds of $818,000 by way of convertible debentures that is expected to fund the Company until the end of the second quarter.

2. CHANGE IN ACCOUNTING POLICIES

(a) Effective January 1, 2009, the Company adopted the new CICA issued Section 3064, “Goodwill and Intangible Assets”, which replaces Section 3062, “Goodwill and Other Intangible Assets”. On adoption of this section, management has determined that previously capitalized costs in the amount of $78,030, relating to the tradename and related marketing intangibles no longer meet the definition of an intangible asset. Therefore, management has applied CICA 3064 retrospectively and has recorded an adjustment to the opening deficit of $78,030. There was no other impact on adoption of this standard.

(b) 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 17.

(c) 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 18.

(d) 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.

2. CHANGE IN ACCOUNTING POLICIES (Cont'd)

(e) 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.

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.

Financial Instruments

All financial instruments are 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, except for equity instruments without a quoted market price which are measured at cost.

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.

3. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

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
Line of credit	Other liabilities

The Company's financial instruments measured at fair value on the balance sheet consist of cash and cash equivalents and are measured at level 1 of the fair value hierarchy. There are three levels of the fair value hierarchy as follows:

Level 1: Values based on unadjusted quoted prices in active markets that are accessible at the measurement date for identical assets or liabilities.

Level 2: Values based on quoted prices in markets that are not active or model inputs that are observable either directly or indirectly for substantially the full term of the asset or liability.

Level 3: Values based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement.

Comprehensive Income

Comprehensive income measures net earnings for the period plus other 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. 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 other comprehensive income has not been presented.

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.

3. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

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 6 and the asset described in Note 7.

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. In 2007, the Company signed a license agreement expiring on June 28, 2013 as disclosed in Note 16(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.

Investment Tax Credits ("ITCs") earned as a result of incurring Scientific Research and Experimental Development ("SRED") expenditures are recorded as a reduction of the related current period expense, the related deferred development costs or related capital assets. Management records ITC's when there is reasonable assurance of collection. Included in prepaid and sundry assets as at December 31, 2009, management has recorded approximately $120,400 relating to ITC's of which approximately $75,400 has been recorded as a reduction to deferred development costs and $45,000 has been recorded as a reduction to technology development expense.

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.

3. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

Share Issuance Costs

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

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

(a) 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.

(b) The CICA has recently issued CICA Handbook section 1582, Business Combinations,section 1601, Consolidated Financial Statements, and section 1602, Non-Controlling Interests. These new sections replace the currently existing standards in CICA Handbook section 1581, Business Combinations, and section 1600, Consolidated Financial Statements. These new standards are effective for fiscal periods beginning on or after January 1, 2011, however, early adoption is permitted. Once adopted, these standards will be harmonized with international financial reporting standards.

Section 1582 amends the standards for measurement, presentation and disclosure of a business combination. A number of changes are specified, including an expanded definition of a business, a requirement to measure all business acquisitions at fair value, a requirement to measure non-controlling interests at fair value, and a requirement to recognize acquisition-related costs as expenses.

These standards will require a change in the measurement and presentation of noncontrolling interest. As a result of these changes, net earnings will include 100% of the subsidiary's results and non-controlling interest will be presented as part of shareholders' equity on the balance sheet.

The Company is currently assessing the impact of these new accounting standards on its financial statements.

4. CAPITAL ASSETS

December 31, 2009

	Cost	Accumulated Amortization	Net
Office furniture and equipment	**$ 32,824**	**$ 23,270**	**$ 9,554**
Computer equipment	**362,775**	**283,086**	**79,689**
Computer software	**56,588**	**23,797**	**32,791**
Leasehold improvements	**14,791**	**7,017**	**7,774**
Website and other technology	**14,980**	**11,443**	**3,537**
	$ 481,958	**$ 348,613**	**$ 133,345**

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

5. PATENTS

	2009	2008
Balance at beginning of year	**$ 105,855**	$ 60,869
Additions	**40,374**	52,931
Less: Amortization	**(7,791)**	(7,945)
Balance at end of year	**$ 138,438**	$ 105,855

As at December 31, 2009 the total cost of the patents is $154,173 (2008 - $113,801) and the accumulated amortization is $15,735 (2008 - $7,945).

6. INVESTMENT IN TECHNOLOGY

		2009		2008
Balance at beginning of year	**$**	**452,330**	$	561,379
Less: Amortization		**(96,121)**		(109,049)
Balance at end of year	**$**	**356,209**	$	452,330

As at December 31, 2009 the total cost of the investment in technology is $1,189,217 (2008 - $1,189,217) and the accumulated amortization is $833,008 (2008 - $736,887). The Company has entered into a license agreement relating to the investment in technology (see Note 16(a)).

7. DEFERRED DEVELOPMENT COSTS

		2009		2008
Opening balance	**$**	**1,300,433**	$	961,288
Additions		**465,188**		663,553
Less: Amortization		**(422,383)**		(324,408)
Ending balance	**$**	**1,343,238**	$	1,300,433

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, 2009, the total cost of the deferred development is $2,465,075 (2008 - $1,999,887) and the accumulated amortization is $1,121,837 (2008 - $699,454).

8. OPERATING LINE OF CREDIT

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, 2009, the Company had drawn $5,000 (2008 - $NIL) on this line of credit.

9. CAPITAL STOCK

Authorized

an unlimited number of common shares.

Issued and outstanding

	Number of Shares	Value
Balance, December 31, 2008 and 2009	**75,517,615**	**$ 21,043,889**

10. STOCK OPTIONS AND WARRANTS

(a) 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:

	2009		2008	
	Number of Options	**Weighted Average Exercise Price**	Number of Options	Weighted Average Exercise Price
Outstanding, beginning of year	**3,769,000**	**$ 0.35**	3,321,000	$ 0.42
Granted	**750,000**	**$ 0.11**	760,000	$ 0.13
Cancelled	**(224,000)**	**$ 0.32**	-	$ -
Forfeited	**-**	**$ -**	(9,000)	$ 0.31
Expired	**(700,000)**	**$ 0.57**	(303,000)	$ 0.62
Outstanding, end of year	**3,595,000**	**$ 0.25**	3,769,000	$ 0.35
Exercisable	**2,804,500**	**$ 0.30**	3,081,000	$ 0.39

10. STOCK OPTIONS AND WARRANTS (Cont'd)

(a) Stock Options (Cont'd)

The Company had the following stock options outstanding at December 31, 2009:

Number of Options	Exercise Price	Expiry Date
500,000 [(i)]	$ 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
65,000	$ 0.20	August 16, 2011
120,000	$ 0.24	November 21, 2011
60,000	$ 0.35	April 12, 2012
400,000	$ 0.32	May 24, 2012
50,000	$ 0.27	June 25, 2012
120,000	$ 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
25,000	$ 0.13	April 17, 2014
25,000	$ 0.10	August 19, 2014
700,000	$ 0.11	November 18, 2014
3,595,000		

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

10. STOCK OPTIONS AND WARRANTS (Cont'd)

(b) Warrants

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

	2009		2008	
	Number of Warrants	**Weighted Average Exercise Price**	Number of Warrants	Weighted Average Exercise Price
Outstanding, beginning of year	**2,800,000**	**$ 0.25**	6,725,400	$ 0.28
Issued	**750,000**	**$ 0.10**	-	$ -
Expired	**(2,800,000)**	**$ 0.25**	(3,925,400)	$ 0.30
Outstanding, end of year	**750,000**	**$ 0.10**	2,800,000	$ 0.25
Exercisable	**375,000**	**$ 0.10**	2,800,000	$ 0.25

The Company had the following warrants outstanding at December 31, 2009:

Number of Warrants	**Exercise Price**	**Expiry Date**
750,000 (i)	$ 0.10	August 24, 2014
750,000		

(i) These warrants were issued for services related to digital media workflow solutions. The warrants will become exercisable after various phases of digital media workflow solution are completed.

11. CONTRIBUTED SURPLUS

	2009	2008
Contributed surplus beginning of year	**$ 868,384**	$ 737,170
Expiry of warrants	**505,428**	19,326
Stock-based compensation expense (Note 13)	**40,059**	111,888
	$ 1,413,871	$ 868,384

12. WARRANT CAPITAL

		2009		2008
Warrant capital beginning of year	**$**	**505,428**	$	524,754
Value of warrants expired in the year		**(505,428)**		(19,326)
Value of warrants issued in the year		**31,883**		-
	$	**31,883**	$	505,428

The fair value of each warrant issued in the year ended December 31, 2009 has been estimated at the measurement date using the Black-Scholes pricing model with the following weighted-average assumptions: (a) dividend yield of 0%; (b) expected volatility of 130%; (c) risk-free interest rate of 2.30% and; (d) expected life of 4.7 years.

13. STOCK-BASED COMPENSATION

The total stock compensation expense relating to options recognized in the year was $40,059 (2008 - $111,888).

The fair value of each option granted in the year ended December 31, 2009 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: (a) dividend yield of 0% (2008 - 0%); (b) expected volatility of 129% (2008 - 104%); (c) risk-free interest rate of 2.59% (2008 - 2.92%) and; (d) expected life of 5 (2008 - 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, 2009 was $0.11 (2008 - $0.07).

14. 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 (2008 - 75,517,615).

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:

	2009	2008
Options	**3,595,000**	3,769,000
Warrants	**750,000**	2,800,000

15. INCOME TAXES

(a) 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:

	2009	2008
Loss before income taxes	**$ (2,816,751)**	$ (3,264,043)
Statutory rate	**33.0%**	33.5%
Expected income tax recovery	**$ (929,528)**	$ (1,093,454)
Amounts not deductible for tax and other	**24,148**	52,654
Change in valuation allowance	**217,600**	637,400
Change in expected tax rate and other	**550,780**	131,900
Expiration of non-capital losses	**137,000**	271,500
Income tax expense	**$ -**	$ -

(b) Future Income Taxes

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

	2009	2008
Amounts related to tax loss and credit carryforwards	**$ 4,679,300**	$ 3,974,000
Share issuance costs	**109,400**	216,800
Capital and intangible assets	**98,600**	478,900
Net future tax asset	**4,887,300**	4,669,700
Less: Valuation allowance	**(4,887,300)**	(4,669,700)
	$ -	$ -

The Company has non-capital losses of approximately $15,748,000 available to apply against future taxable income. If not utilized, the non-capital losses will expire as follows:

2010	$ 1,770,000
2014	2,630,000
2015	1,389,000
2026	1,861,000
2027	3,053,000
2028	2,472,000
2029	2,573,000
	$ 15,748,000

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

16. 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 (Notes 6 and 7). 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 additional annual maintenance fee based on the number of annual users, which at the Company's current usage results in a 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 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.

(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 counter claim seeking $15 million in damages for infringement from the competitor and its partners. Examinations for discovery were conducted in 2007 into 2008 followed by motion appearances before the Court seeking orders compelling answers to questions refused. The Company was successful in obtaining a number of rulings in its favour including a ruling requiring the competitor to produce its software source code on a strict confidential basis for review by the Company's experts. The second round of examinations for discovery are complete, and are pending further answers motions and any follow up questions.

16. COMMITMENTS AND CONTINGENCIES (Cont'd)

(c) Patent Infringement (Cont'd)

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.

On June 22, 2007, the Company filed a claim against a customer of the above competitor, requesting a declaration that the Company's Canadian patent, Content Distribution System and Method patent number 2,407,774 is valid and infringed by the use of the competitors technology and is seeking $2 million in damages. In November 2007, a defence and counterclaim was filed seeking a declaration that the use of the competitor's technology does not infringe the patent and the patent is valid.

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 2,404,774, registered in Canada. In addition, in May 2009, the Company received a grant from the United States Patent and Trademark Office for US patent #7,529,712 titled Content Distribution System and Method. The Company also filed a patent infringement claim in May 2009 in the United States requesting that the court issue a permanent injunction prohibiting use of the competitor's system in the United States and payment of damages and legal costs. In August 2009 a Federal Court in Wisconsin ruled in the Company’s favour on a motion to dismiss that was brought by the competitor and the claim is proceeding. Defendants have filed a motion for summary judgment claiming that because certain steps of their method are performed outside of the United States, Yangaroo's claim should be dismissed. Yangaroo is opposing this motion. The matter is fully briefed and the parties expect a ruling from the Court in a matter of months.

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:

2010	$	112,634
2011		98,234
2012		52,075
	$	**262,943**

17. CAPITAL RISK MANAGEMENT

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, 2009.

18. FINANCIAL RISK MANAGEMENT

The Company is exposed to a variety of financial risks by virtue of its activities: market risk (including currency risk and interest rate risk), credit 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, 2009 are as follows:

	USD$
Accounts receivable	$ 77,600
Accounts payable and accrued liabilities	$ 116,500

18. FINANCIAL RISK MANAGEMENT (Cont'd)

(ii) 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 and its line of credit incurs 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 0.3% of total expenses. A 1.0% change in interest rates would not have a significant impact on the interest income.

(b) 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, 2009, approximately 22% (December 31, 2008 - 37%) of accounts receivable and 23% (December 31, 2008 - 41%) of revenue are from two customers (2008 - three customers).

(c) 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, 2009, the Company has accounts payable and accrued liabilities of $538,666 due within 12 months and has cash and cash equivalents and accounts receivable of $453,184 to meet its current obligations. As disclosed in Note 1, the Company will have to raise additional capital to fund further development of their product and operations.

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

19. SUBSEQUENT EVENT

Subsequent to the year end the Company raised by way of convertible debentures 818 Units at $1,000 per Unit for gross proceeds of $818,000. The Debentures mature on March 31, 2012, have interest payable semi-annually at 12% per annum, are secured by a general security agreement over the assets of the Company and are convertible into common shares of the Company at $0.10 per share. In addition, each unit consists of 7,500 warrants exercisable until March 22, 2012, with each whole Warrant entitling the holder to purchase one common share at $0.10. The Company paid the agents $50,800 and granted them non-transferable options to acquire 508,000 common shares of the Company at $0.10 per share until March 22, 2012.

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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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DMDS

Digital Media Distribution System