

**IP APPLICATIONS CORP.**

**Six Months Ended June 30, 2008**

**MANAGEMENT DISCUSSION AND  
ANALYSIS**

**August 27, 2008**

This Management's Discussion and Analysis ("MD&A") dated August 27, 2008 is supplementary to, and should be read in conjunction with, the financial statements for the interim period ended June 30, 2008 and the Company's MD&A and annual audited financial statements for the year ended December 31, 2007. The Company's consolidated financial statements and the notes thereto have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") on a going concern basis and do not include any adjustments to the amounts and classifications that might be necessary should the Company be unable to continue business. The interim unaudited financial statements for the six months ended June 30, 2008 have been not been reviewed by the Company's external auditors PricewaterhouseCoopers. All amounts are in Canadian dollars unless otherwise stated.

## **FORWARD LOOKING STATEMENTS**

This discussion may contain forward-looking statements that are based upon current expectations, which involves risks and uncertainties associated with our business and the economic environment in which the business operates. These uncertainties may cause the Company's actual results to differ materially from those contemplated by the forward looking statements. Factors that might cause or contribute to such differences include, among others, competitive pressures, the growth rate of the Internet and telecommunications' concerns, constantly changing technology and market acceptance of the Company's products and services. Forward-looking statements contained in the MD&A represent the Company's expectations and intentions as of August 27, 2008. The Company disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

## **BUSINESS OVERVIEW**

During the second quarter of 2008, the Company continued to allocate significant staff and cash resources in its plan to repurpose its software assets and skills into the fast growing Software as a Service ("SaaS") and Cloud Computing markets. The Company intends to transition as rapidly as possible into this fast-growing high-value market.

While the Company has delivered business process automation and customer care to independent Internet Service Providers, companies in the rapidly expanding SaaS and Cloud Computing platform are searching for technical solutions to these business problems. IP Applications' unique multi-tenant on-demand administration hub has been operating and delivering this suite of services for nearly a decade.

While the Company has traditionally marketed its services directly to enterprise customers and through Internet Service Providers in Canada and the USA, its new approach will target large enterprise software hosting companies, integration services vendors and evolving platform companies. Approximately one third of the company's customers (by revenue) use only its customer care services, one third use only its subscription management and payment processing services, and the remaining third use a combination of both.

Additional information related to the Company can be found at [www.SEDAR.com](http://www.SEDAR.com), [www.ipapplications.com](http://www.ipapplications.com) and [www.saasautomation.com](http://www.saasautomation.com).

## **2008 SECOND QUARTER OVERVIEW**

- Revenues of \$1.3M (“Million”) for the quarter ended June 30, 2008, represent a 30% decrease from the \$1.9M recognized for the quarter ended June 30, 2007. Gross margin decreased to 34% in the current quarter, as compared to 43% in 2007.
- Operating expenses decreased 15% to \$0.8M in the second quarter of 2008, as compared to \$1.0M for the period ended June 30, 2007.
- Net loss of \$0.4M for the quarter ended June 30, 2008, represents a doubling of the net loss of \$0.2M incurred in the second quarter in 2007.
- Awarded our first Software as a Service enabling contract with Logistica Solutions Inc.
- Engaged a well recognized SaaS & Cloud Computing industry analyst and received positive validation of our positioning and capabilities
- During July 2008, the Company closed a non-brokered private placement of 3.9M shares for total gross proceeds of \$0.8M.

## SELECTED QUARTERLY INFORMATION

The table below details selected operating results for the past eight fiscal quarters (in \$ thousands, except per share figures)

	Jun 30 2008	Mar 31 2008	Dec 31 2007	Sep 30 2007	Jun 30 2007	Mar 31 2007	Dec 31 2006	Sep 30 2006
Revenue	1,315	1,685	1,833	1,878	1,882	2,143	2,117	2,408
Direct Costs	863	1,036	1,098	1,043	1,080	1,145	1,264	1,512
Expenses	826	787	1,015	1,032	1,049	1,184	2,214	1,368
Net Loss	(374)	(138)	(280)	(197)	(247)	(186)	(1,361)	(472)
EBITDA (Loss) <sup>(1)</sup>	(313)	(99)	(132)	(7)	(13)	25	(307)	(49)
Net Loss per share – basic	(0.01)	(0.00)	(0.01)	(0.01)	(0.02)	(0.01)	(0.09)	(0.03)

(1) - The Company reports Earnings Before Interest, Taxes, Depreciation and Amortization – and other non-cash expense items - (“EBITDA”), which is an approximate measure of operating results based on selected financial data from the Company’s income statement. EBITDA is not a measure that is governed and defined by generally accepted accounting principles. Readers are cautioned that EBITDA as calculated by the Company may not be comparable to similarly titled amounts reported by other companies. The disclosure of EBITDA is intended to add to and not replace the discussion of financial results or cash flow from operations.

## RESULTS OF OPERATIONS

*Quarter ended June 30, 2008 compared to the quarter ended June 30, 2007*

	2008 June 30 (three months)	% of Revenue	2007 June 30 (three months)	% of Revenue
Revenue	<b>\$1,315,172</b>		<b>\$1,881,816</b>	
Direct costs	862,533	66%	1,079,824	57%
<b>Gross Margin</b>	<b>452,639</b>	34%	<b>801,992</b>	43%
Amortization	45,623	3%	121,710	6%
General & administrative	357,573	27%	397,468	21%
Marketing & selling	91,532	7%	63,340	3%
Stock based compensation	40,692	3%	60,357	3%
Technical & development	290,960	22%	328,949	17%
<b>Operating Expenses</b>	<b>826,380</b>		<b>971,824</b>	
<b>Loss before other expenses</b>	<b>(373,741)</b>		<b>(169,832)</b>	
Interest accretion expense	-		77,277	
<b>Net Loss and comprehensive loss</b>	<b>\$(373,741)</b>		<b>\$(247,109)</b>	

## ***Revenue***

Revenues include fees for subscription management, provisioning, payment processing, customer care and third party products and services billed to clients. These fees are primarily recurring monthly and are earned on a per-end-user or per-minute basis. The Company also charges additional fees to clients for adding new end users and new services onto the Company's platform.

Revenues of \$1,315,172 for the three months ended June 30, 2008 represent a decrease of \$566,644 (or 30%) over the corresponding period in the prior year. The departure of one large call centre customer in March 2008 and significant attrition in the volume usage and/or user base of two others contributed \$510,610 towards this decline.

Management believes that the speed of the decline in revenue has been influenced by economic conditions in its largest market, the United States. Two new customers that had forecast significant volume with the Company delivered lower volumes than expected, and some existing customers that had predicted volume growth in 2008 have instead delivered smaller volumes.

## ***Direct Costs***

Direct costs include expenses related to providing subscription management, provisioning, payment processing, customer care and third party products and services. The majority of these costs are proportionate to connection time for third-party connection services and customer care support to the customers' subscribers.

Direct costs of \$862,533 for the three months ended June 30, 2008 represent a decrease of \$217,291 (or 20%) over the corresponding quarter in the prior year. This decrease can be broken down primarily by key component expenses: i) third-party service costs decreased by \$145,866; ii) technical support wages and related administrative costs in the Help Desk decreased by \$3,499; and iii) commissions paid to SourceNet decreased by \$67,926.

The third-party service costs decrease is directly correlated with the continuing dial-up usage decline experienced by two large customers. The commission expense reduction reflects the expiration at the end of Q1 2008, of one of two commission streams paid to Sourcenet.

The largest factor contributing to the deterioration of gross margin quarter over quarter (from 42% in Q2 2007 to 34% in Q2 2008) stems from the technical support wages in the customer care Help Desk. There was only a modest decrease in wages quarter over quarter despite the departure of our single largest call center customer near the end of Q1 2008. Management was aware the Company was carrying a surplus of Vancouver call center staff, but there were strong reasons to believe the recently lost support minutes were going to be largely replaced by the imminent arrival of two new customers. Unfortunately one of those customers did not materialize and the other has fallen far short of expectations. The surplus headcount situation has since been largely addressed.

## ***Operating Expenses***

*Amortization* - Amortization expense decreased \$76,087 (or 63%) during the quarter ended June 30, 2008 relative to the quarter ended June 30, 2007. This is largely because several capital assets financed under capital leases were completely amortized by December 31, 2007.

*General & administrative* – These costs include general office expenses, rent and occupancy fees, insurance, bad debt expense, regulatory costs, director's fees, consulting fees, professional fees and salaries paid to finance and administration staff of the Company.

The decrease of \$39,899 (or 10%) during the three months ended June 30, 2008, relative to the corresponding period in the prior year, can primarily be attributed to: i) decreases in debenture interest and professional fees were largely offset by increases in general office expenditures and administrative salaries; and ii) much of the improvement stems from a \$42,033 reduction in foreign exchange translation loss quarter over quarter.

*Marketing & selling* – These costs include travel, attendance and participation at trade shows, printed material, external consultants and salaries and commissions paid to sales and marketing staff of the Company.

The net increase in costs of \$28,192 (or 45%) during the three months ended June 30, 2008 relative to the corresponding period in the prior year, is a combination of i) reduced salaries and wages in Q2 2008 of 16,425 given there were more commissions and contractors paid in Q2 2007; and ii) a sizeable increase of approximately \$41,000 in travel, trade show attendance and consulting costs reflecting our initiatives to better understand and effectively penetrate the SaaS and Cloud Computing markets.

*Technical & development* – Salaries related to development and IT personnel comprise the bulk of these costs. The net decrease of \$37,989 (or 12%) for the quarter ended June 30, 2008 effectively reflects the net reduction of 3 employees and contractors from Q2 2007.

*Stock based compensation* – These costs represent the expense associated with stock options granted to employees, directors and consultants. The amount recorded in a particular period is directly related to the number of options that have vested with recipients during that period. Stock-based compensation expense recognized during the quarter ended June 30, 2008 was \$40,692, a decrease of \$19,665 (or 33%) over the 2007 quarter due to no longer recording an expense associated with a large number of outstanding options that had fully vested after June 30, 2007.

*Interest accretion expense* - The Company completed two financings of convertible debentures in Q4 in each of 2005 and 2006 aggregating to \$960,130. The fair value of the common share conversion feature was valued at \$463,661 and was being accreted on a straight line basis over the term of the debt. Effective October 2007, holders of the convertible debenture agreed to convert the principal and accrued interest in exchange for common shares of the Company. As a result, the accretion was fully expensed by December 31, 2007, and thus no further accretion expense is recognized beyond January 1, 2008.

## RESULTS OF OPERATIONS

*Six months ended June 30, 2008 compared to the six months ended June 30, 2007*

	<b>2008</b>	<b>% of Revenue</b>	<b>2007</b>	<b>% of Revenue</b>
Revenue	<b>\$3,000,178</b>		<b>\$4,025,312</b>	
Direct costs	1,898,364	63%	2,225,196	55%
<b>Gross Margin</b>	<b>1,101,814</b>	37%	<b>1,800,116</b>	45%

Amortization	90,745	3%	243,892	6%
General & administrative	698,235	23%	824,542	20%
Marketing & selling	172,610	6%	215,615	5%
Stock based compensation	60,580	2%	97,165	2%
Technical & development	591,196	20%	697,247	17%
<b>Operating Expenses</b>	<b>1,613,366</b>		<b>2,078,461</b>	
<b>Loss before other expenses</b>	<b>(511,552)</b>		<b>(278,345)</b>	
Interest accretion expenses	-		154,554	
<b>Net Loss and comprehensive loss</b>	<b>\$(511,552)</b>		<b>\$(432,899)</b>	

### *Revenue*

Revenues include fees for subscription management, provisioning, payment processing, customer care and third party products and services. These fees are primarily recurring monthly and are earned on a per-end-user or per minute basis. The Company also charges additional fees to clients for adding new end-users and new services onto the Company's platform.

Revenues of \$3.0 million for the six months ended June 30, 2008 represent a decrease of \$1.0 million (or 25%) over the corresponding period in the prior year. The negative revenue impact from the departure of the large call center customer in March 2008 was modest when comparing the six month period ended June 30, 2008 with the first six months of 2007. The significant majority of revenue decline stems from the deteriorating user base situation of several long-time customers coupled with price breaks afforded to a number who agreed to have their technical call center support activity moved to our offshore partner. The pattern of declining subscriber base for services and products continues unabated for many of our customers. This trend is expected to continue and the Company will continue to make the cost adjustments necessary to maintain margins during our transition to a SaaS based revenue model.

### *Direct Costs*

Direct costs include expenses related to providing subscription management, provisioning, payment processing, customer care and third party products and services. The majority of these costs are proportionate to connection time for third-party connection services and customer care support to the customers' subscribers.

Direct costs of \$1.9 million for the six months ended June 30, 2008 represent a decrease of \$0.3 million (or 15%) over the corresponding prior six months. This decrease can be primarily broken down by key category expenses: i) third-party service costs decreased by \$367,530; ii) commissions paid to SourceNet decreased by \$113,007; offset by iii) an increase in technical support wages of \$164,503.

The decrease in third party service costs is a reflection of both a decline in dial-up users and the cost reduction strategies consummated during the last half of 2007. Commissions also declined due to the reduced dial-up revenue, but also due to the expiration, at the end of Q1 2008, of one of two commissions streams paid to Sourcenet.

The largest factor contributing to the deterioration of gross margin six month period over six-month period (from 45% in 2007 to 37% in 2008) is due to the increase in technical support wages in the customer care Help Desk. While overall customer support minutes during the two periods were virtually identical, overall wage costs were greater by \$164,503 in 2008. The

Company carried surplus staff during the period of February through to May 2008 because: i) our largest call center customer departed mid-March 2008 and the Company fully expected the available capacity would be largely consumed in the immediate term by new customers; and ii) the migration of our second largest call centre customer to our lower cost offshore partner during February 2008 required a temporary overlap of staff. These two coincident events sharply reduced the efficiency and cost effectiveness of the Vancouver Help Desk.

### ***Operating Expenses***

*Amortization* – Amortization expense decreased \$153,147 (or 63%) during the six months ended June 30, 2008 relative to 2007. This is largely because several capital assets financed under capital leases were completely amortized by December 31, 2007.

*General & administrative* – These costs include general office expenses, rent and occupancy fees, insurance, bad debt expense, foreign exchange loss, regulatory costs, director's fees, consulting fees, professional fees and salaries paid to finance and administration staff of the Company.

The net decrease of \$126,307 (or 15%) during the six months ended June 30, 2008 relative to the prior year, can be primarily explained by: i) decreases in bad debt expense and professional fees were largely offset by increases in general office expenditures and administrative wages and benefits; ii) reduction of \$65,322 in foreign exchange translation losses; and iii) with the elimination of debt in November 2007, a reduction in debenture interest of \$59,966.

*Sales and Marketing* – These costs include travel, attendance and participation at trade shows, printed materials, and salaries and commissions paid to sales and marketing staff of the Company.

The decrease in costs of \$43,005 or (20%) during the six months ended June 30, 2008 relative to the prior year is explained by a combination of i) a reduction in salaries and commissions of approximately \$89,000 between comparative periods due to a major departmental restructuring in Q1 2007 whereby a net of three sales and marketing staff were terminated; mitigated by ii) an increase of approximately \$48,000 in travel, trade show attendance and consulting costs associated with our efforts to understand and repurpose of corporate strategy towards the growing SaaS and Cloud Computing markets..

*Operations & Development* – Salaries related to operations and development personnel comprise the bulk of these costs. There was a net decrease of \$106,051 (or 15%) for the six months ended June 30, 2008, relative to the prior year. The significant portion of this decrease represent the net savings of a reduced staff and contractor headcount by four.

*Stock-based compensation* – These costs represent the compensation expense associated with stock options granted to employees, directors and consultants. The amount recorded in a particular period is directly related to the number of options that have vested with recipients during that period. Stock-based compensation expense recognized during the six months ended June 30, 2008 was \$60,580, a decrease of \$36,585 (or 38%) as compared to the prior year. This is due to no longer recording an expense associated with outstanding options that had fully vested after June 30, 2008.

*Interest accretion* – The Company completed two financings of convertible debentures in Q4 of each of 2005 and 2006 aggregating to \$960,130. The fair value of the common share conversion feature was valued at \$463,661 and was being accreted on a straight line basis over the term of the debt. Effective October 2007, holders of the convertible debenture agreed to convert the principal and accrued interest in exchange for common shares of the Company. As a result, the

accretion had been fully expensed by December 31, 2007, and thus no further accretion expense will be recognized beyond January 1, 2008.

### Divisional Segmentation

The Company has long performed subscription management and billing support for customers including AOL, Bell Mobility and Amway and presently derives approximately 20% of its consolidated revenue from this source. In effect, for some time, the Company has provided those services as Software as a Service (“SaaS”). The Company believes that strong growth is possible within this high margin segment of its business.

In January 2008, the Company began assessing and developing the opportunity to expand its subscription management and billing business by enhancing and marketing these services to other emerging SaaS companies. Throughout the year-to-date, the Company has collaborated with industry experts, attended a number of SaaS conferences, updated and broadened its website content and developed new product plans and capabilities.

As a result, the Company has chosen to focus on SaaS as the primary creator of shareholder value. Multiples and valuations of successful SaaS companies are many times higher than conventional help desk and hosted applications providers. In order to show quarterly progress in the development of our SaaS segment, the Company has decided to add an analysis of its estimated expenses and revenues derived from its subscription management services and billing support SaaS services.

The following table estimates the proportion of the Company’s activities for the first six-months of 2008 attributable to SaaS subscription management and billing services, compared with those related to the rest of its operations. Expenses have been largely apportioned based on an estimate of the time spent on SaaS related pursuits by various company personnel. Given that management of the Company is largely focused on understanding and developing this new value creation opportunity, a disproportionate amount of operating expenses (relative to revenue) have been allocated to SaaS related endeavors.

	SaaS	Help Desk & Hosted Applications	Consolidated Operations Six-Months to June 30, 2008
Revenue	540,000	2,460,178	3,000,178
Direct Costs	57,000	1,841,365	1,898,365
<b>Gross Margin</b>	<b>483,000</b>	<b>618,813</b>	<b>1,101,813</b>
Amortization	45,372	45,373	90,745
General & administrative	286,276	411,959	698,235
Marketing and selling	150,170	22,440	172,610
Stock-based compensation	30,290	30,290	60,580
Technical and development	311,809	279,387	591,196
<b>Operating Expenses</b>	<b>823,917</b>	<b>789,449</b>	<b>1,613,366</b>
<b>Net Loss</b>	<b>(340,917)</b>	<b>(170,636)</b>	<b>(511,553)</b>

As with most early stage SaaS companies, significant losses will be incurred and we would expect them to continue for some time. We don't expect appreciable revenue growth to materialize for 2-4 quarters after finalizing and executing our sales and marketing strategy. As well, expenses will not diminish, as a majority of personnel and operating costs will continue to be focused on advancing our SaaS products and customer base.

The loss in the Help Desk and Hosted Applications activity stems largely from the surplus headcount situation experienced by the Vancouver technical call center during the period. We anticipate that recent efforts to begin shifting a larger proportion of our technical support customers to our lower cost offshore partner, will maximize margins in the call center business and soon result in a return to a positive cash flow performance.

## LIQUIDITY AND CAPITAL RESOURCES

For additional detail, see the Consolidated Statements of Cash Flows in the financial statements for the periods ended June 30.

Cash received from (used for) :	2008	2007
Operating Activities	(421,505)	(129,719)
Investing Activities	(50,652)	(40,000)
Financing Activities	(44,691)	(113,569)

As at June 30, 2008, the Company had cash and short term investments totaling \$210,135, down from \$486,284 at March 31, 2008. As at the date of this MD&A, the Company had not drawn against its credit facilities during the year-to-date. The Company's cash position deteriorated by \$276,149 during Q2 2008 and was largely due to the increased operational burn stemming from the temporary surplus and inefficiencies in call center personnel.

### *Operating Activities:*

For the quarter ended June 30, 2008, the Company's negative cash flow from operating activities was \$237,181, as compared to a negative cash flow of \$205,829 for the corresponding quarter in 2007. The net increase of \$31,352 stems primarily from a significant decline in operating performance during Q2 2008, largely offset by a significant reduction in payments against accounts payable and accrued liabilities.

For the six month period ended June 30, 2008, the Company's negative cash flow from operating activities was \$421,505 as compared to net cash usage of \$129,719 for the six months ended June 30, 2007. The components most affecting this cash flow deterioration of \$291,786 are: i) the Company incurred an EBITDA loss of \$411,879 during the current year to date versus EBITDA earnings of \$12,279 experienced during the corresponding period in 2007; partially offset by ii) a \$192,995 reduction in the amount of payments made against accounts payable and accrued liabilities.

***Investing Activities:***

Expenditures on capital equipment totalled \$14,911 for the quarter ended June 30, 2008; no capital equipment investments were made in the quarter ended June 30, 2007.

During the six months ended June 30, 2008, expenditures on capital equipment purchases aggregated to \$50,652; no capital equipment investments were made in the six months ended June 30, 2007. There was an increase in restricted cash in the period ended June 2007 due to the requirement for collateral against new credit facilities.

***Financing Activities:***

The Company traditionally financed its cash requirements through the issuance of common shares, debt instrument or capital lease.

For the quarter ended June 30, 2008, capital lease payments amounted to \$21,057. In the same quarter of 2007, funds were raised through the exercise of warrants for \$40,000 and capital lease payments totaled \$63,367.

During the six months ended June 30, 2008, capital lease payments amounted to \$41,691. During the six months ended June 30, 2007, the Company raised gross proceeds of \$40,000 through the exercise of warrants and payments towards capital leases totaled \$153,569.

***Financial Condition:***

As at June 30, 2008, the Company had current assets of \$742,845 and current liabilities of \$728,281 for a working capital surplus of \$14,564 as compared to a surplus of \$481,569 at December 31, 2007. This degradation in working capital of \$467,005 is primarily attributed to: i) the net decrease in cash position of \$516,848, ii) a reduction of \$168,763 in accounts receivable; offset by iii) reduction of \$183,320 in accounts payable and accrued liabilities; and iv) a reduction of \$36,684 in the current portion of the lease commitments.

The Company encountered several adverse business conditions during the first six months of 2008. The loss of our largest technical support customer at the end of Q1; a continuing trend of a declining user base among many of our significant customers; and new customer growth falling short of expectations combined to negatively impact the top-line.

Two key cost factors also served to exacerbate the negative operating performance. Firstly, through a combination of relatively simultaneous events, the Company carried surplus technical support staff in its Vancouver call center. Secondly, the Company began to incur greater travel, marketing and consulting costs during the period as a result of the strategic decision to enter and focus on the SaaS and Cloud computing markets.

During the first two months of Q3 2008, the Company made key decisions to address the challenges represented by the first half performance. The issue of cost inefficiencies in our Vancouver and offshore call centers has been carefully examined and several steps initiated to rectify the problem in the near term. Further, a private placement raising gross proceeds of \$775,000 was closed in July 2008. We anticipate returning to a near break-even operating performance by early Q4 whilst retaining sufficient funds from the financing to further penetrate the SaaS market and enable us to create an improved user interface and expanded marketing campaign around our billing and subscription management product.

## OUTSTANDING SHARE DATA

For additional detail, see Note 7 to the financial statements for the six months ended June 30, 2008.

		<b>Number Outstanding June 30 2008</b>	<b>Number Outstanding December 31 2007</b>
Common Shares issued		31,753,238	31,753,238
Options to purchase Common Shares		3,158,500	3,133,500
Warrants to purchase Common Shares		-	200,000
		<b>34,911,738</b>	<b>35,086,738</b>

## OFF BALANCE SHEET ARRANGEMENTS

The company has not engaged in off-balance sheet arrangements.

## TRANSACTIONS WITH RELATED PARTIES

Pender Growth Fund (VCC) Inc. (“PGF”) is a shareholder owing approximately 40% of the shares of the Company. PGF participated in the private placement of Units completed on July 29, 2008 whereby they acquired 1,250,000 shares and 625,000 warrants of the Company at a price of \$0.20 per Unit, the same price offered to independent investors. A Director of the Company is a Director and Chairman of PGF. Another Director of the Company is a director and President of PGF.

## CHANGES IN ACCOUNTING POLICIES

### Adoption of new accounting standards

On January 1, 2007, the Company adopted four new accounting standards issued by the Canadian Institute of Chartered Accountants (“CICA”); Section 3855, “Financial instruments - recognition and measurement”, Section 3861, “Financial instruments - disclosure and presentation”, Section 3251, “Equity” and Section 1530, “Comprehensive income”. These standards were adopted on a prospective basis and as such, prior periods have not been restated.

### Financial instruments

CICA Handbook Sections 3855, 3861 and 3251 require among other things, that all financial assets, except those classified as held to maturity and derivative financial instruments, must be measured at fair value. All financial liabilities must be measured at fair value when they are classified as held for trading; otherwise, they are measured at amortized cost and establish how gains and losses are to be recognized and presented. For the period ended June 30, 2008, the adoption of these policies had no material impact.

## Comprehensive income

Under CICA Handbook Section 1530, comprehensive income is the change in the Company's net assets that results from transactions, events and circumstances from sources other than the Company's shareholders and includes items that would not normally be included in the statement of operations such as unrealized gains or losses on available-for-sale investments. For the period ended June 30, 2008, the Company did not have other comprehensive income or loss, therefore comprehensive loss for the period was equal to the loss for the period and accumulated other comprehensive income is nil.

### **Recent Canadian GAAP announcements**

#### CICA Handbook Section 1535, Capital Disclosures

In December, 2006, the CICA issued Handbook Section 1535, Capital Disclosures. The new standard requires disclosure of qualitative and quantitative information that enables users of financial statements to evaluate the company's objectives, policies and processes for managing capital. These recommendations are effective for the company's interim and annual reporting periods beginning after October 1, 2007. The company has not evaluated the impact of this standard on the company's consolidated financial statements.

#### CICA Handbook Section 3862, Financial Instruments - Disclosures and Section 3863, Financial Instruments - Presentation

In December 2006, the CICA issued Handbook Sections 3862, Financial Instruments - Disclosures, and 3863, Financial Instruments - Presentation, which will replace Section 3861, Financial Instruments - Disclosure and Presentation. The new disclosure standard increases the emphasis on the risks associated with both recognized and unrecognized financial instruments and how those risks are managed. The new presentation standard carries forward the former presentation requirements and is effective for the company's interim and annual reporting periods beginning after October 1, 2007. The company has not evaluated the impact of this standard on the company's consolidated financial statements.

#### International Financial Reporting Standards

In January 2006, the CICA AcSB adopted a strategic plan for the direction of accounting standards in Canada. As part of that plan, accounting standards in Canada for public companies are expected to converge with IFRS by the end of 2011. The impact of the transition to IFRS on the company's consolidated financial statements has not yet been determined.

### **CAPITAL RESOURCES**

At the date of this MD&A, the Company has made no material commitments for capital expenditures in 2008, nor drawn upon an available \$400,000 line of credit facility.

### **INTERNAL CONTROLS OVER FINANCIAL REPORTING**

Management is responsible for designing such internal controls over financial reporting, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP.

No changes were made in the Company's internal control over financial reporting during the six months ended June 30, 2008 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## **FINANCIAL INSTRUMENTS**

### **Fair values**

The fair values of the Company's cash, accounts receivable, restricted cash, accounts payable and accrued liabilities approximate their carrying amounts because of the immediate or short-term maturity of these financial instruments.

### **Interest and foreign exchange rate risk**

The Company is required to make certain payments in US dollars and has not entered into forward currency contracts or other financial derivatives in relation to this currency risk. To mitigate exchange risk, the Company maintains US dollar bank accounts for all US dollar sales and payments.

## **RISKS AND UNCERTAINTIES**

Though the Company has a working capital surplus of \$14,564 as at June 30, 2008, it has incurred significant losses in recent years. It is expected that operating results will continue to moderately fluctuate into the foreseeable future due to a variety of factors, including but not limited to:

- While management is of the opinion that sufficient working capital exists (and more can be obtained from external sources) to meet the Company's liabilities and commitments over the medium term, there is a risk that additional financing may not be available on a timely basis or on terms acceptable to the Company. If the Company is unable to obtain additional funds when needed, its ability to continue to operate and grow the business could be impeded;
- the Company's business could be adversely affected by changes in general economic conditions and specific market conditions in the telecommunications and Internet industries;
- the Company obtains approximately 81% of its monthly revenue in US dollars. Significant variations in exchange rates may have an adverse impact on operating results;
- the Company's business could be adversely affected if the Company's current and future competitors will be able to develop infrastructure expertise comparable or superior to those developed and offered by the Company or if they may adapt more quickly than the Company to new technologies, third party offerings, evolving industry standards or customer requirements;
- the timing and magnitude of operating expenses, capital expenditures and expenses related to the expansion of sales, development, operations and acquisitions;
- the Company's business could be adversely affected if key customer contracts are cancelled or not renewed upon expiry;
- the Company's business could be adversely affected if key customers experience financial difficulties resulting in collection delays and/or loss of business;
- the Company's business could be adversely affected if key suppliers of third-party services experience financial and/or technical difficulties resulting in service disruptions to the Company's customers; Further, if the Company is denied access to premises,

- electricity supply or communications services due to circumstances beyond its control and it is unable to secure replacement services on a timely basis, it could incur indefinite delays in providing services to its customers;
- the Company's product lines and customer base are not broadly diversified and the Company derives the majority of its revenue from sales of a narrow range of services and capabilities to a small number of customers. The Company's business and operating results would be adversely affected by factors within this range of products and customers that could not be offset with diversification;
  - competition within the Company's markets may reduce its ability to win new contracts, reduce sales and reduce margins on sales made;
  - the Company's future success will depend on its ability to maintain its existing products and services and to develop new products and services that attain market acceptance;
  - the Company depends on the recruitment and retention of qualified personnel. If it cannot attract and retain staff, it could hamper its ability to provide products and services under existing contracts and to new contracts;
  - the Company's business could be adversely affected if it fails to manage its growth effectively;
  - third parties may claim that the Company infringes their proprietary rights; and
  - the Company may not be able to protect its proprietary information.

Any of the foregoing factors could have a material adverse effect on the Company's business, results of operations or financial condition.