

# **IP Applications Corp.**

Interim Consolidated Financial Statements  
(Unaudited)

**June 30, 2007**

## **NOTICE OF NO AUDITOR REVIEW OF INTERIM FINANCIAL STATEMENTS**

Under National Instrument 51-102, Part 4, subsection 4.3(3)(a), if an auditor has not performed a review of the interim financial statements, they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor.

The accompanying unaudited interim financial statements of the Company have been prepared by and are the responsibility of the Company's management.

The Company's independent auditor has not performed a review of these financial statements in accordance with standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's audit.

# IP Applications Corp.

Consolidated Balance Sheets

As at June 30, 2007

	<b>2007</b> <b>June 30</b> <b>(Unaudited)</b>	<b>2006</b> <b>December 31</b> <b>(Audited)</b>
<b>Assets</b>		
<b>Current assets</b>		
Cash	\$ -	\$ 70,193
Restricted cash (note 4)	40,000	-
Accounts receivable	679,035	877,962
Prepaid expenses	92,936	97,038
	<hr/>	<hr/>
	811,971	1,045,193
<b>Property and equipment</b> (note 5)	667,186	911,077
	<hr/>	<hr/>
	<b>\$ 1,479,157</b>	<b>\$ 1,956,270</b>
<b>Liabilities</b>		
<b>Current liabilities</b>		
Bank indebtedness	\$ 213,095	\$ -
Accounts payable and accrued liabilities	915,901	1,292,216
Unearned revenue	9,376	42,201
Current portion of lease commitment	72,759	71,540
Current portion of leasehold inducement	29,935	29,935
Current portion of obligations under capital lease (note 7)	118,420	244,944
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	1,359,486	1,680,836
<b>Leasehold commitment</b>	18,342	55,026
<b>Leasehold inducement</b>	223,265	238,233
<b>Convertible debenture</b> (note 6)	865,046	646,379
<b>Obligations under capital lease</b> (note 7)	33,496	60,541
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	2,499,635	2,681,015
<b>Shareholders' Equity</b>		
<b>Capital stock</b> (note 8(b))	9,021,698	8,965,825
<b>Warrants</b> (note 8(c))	146,139	851,142
<b>Contributed surplus</b> (note 9)	2,218,264	1,431,968
<b>Deficit</b>	(12,406,579)	(11,973,680)
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	(1,020,478)	(724,745)
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	<b>\$ 1,479,157</b>	<b>\$ 1,956,270</b>

**Nature of operations and going concern** (note 1)

**Approved by the Board of Directors**

“Kelly Edmison” Director

“John Jacobson” Director

# IP Applications Corp.

## Consolidated Statements of Operations and Deficit (Unaudited)

	Six months ended June 30		Three months ended June 30	
	2007	2006	2007	2006
<b>Revenue</b>	\$ 4,025,312	\$ 4,758,059	\$ 1,881,816	\$ 2,334,144
<b>Direct costs</b>	2,225,196	2,798,058	1,079,824	1,457,205
	1,800,116	1,960,001	801,992	876,939
<b>Operating expenses</b>				
Amortization of intangible asset	-	357,371	-	178,685
Amortization of property and equipment	243,892	272,516	121,710	138,842
Foreign exchange loss	60,058	56,266	48,968	29,953
General and administration	755,699	820,701	345,435	397,980
Interest on capital lease obligations	8,785	24,716	3,065	11,083
Interest accretion on convertible debenture	154,554	85,988	77,277	42,994
Marketing and selling	215,615	569,761	63,340	282,684
Stock-based compensation	97,165	161,968	60,357	83,043
Technical and development	697,247	661,334	328,949	351,485
	2,233,015	3,010,621	1,049,101	1,516,749
<b>Loss for the period</b>	(432,899)	(1,050,620)	(247,109)	(639,810)
<b>Deficit - Beginning of period</b>	(11,973,680)	(9,090,227)	(12,159,470)	(9,501,037)
<b>Deficit - End of period</b>	<u>\$ (12,406,579)</u>	<u>\$ (10,140,847)</u>	<u>\$ (12,406,579)</u>	<u>\$ (10,140,847)</u>
<b>Loss per share - basic</b>	<u>(0.03)</u>	<u>(0.07)</u>	<u>(0.02)</u>	<u>(0.04)</u>
<b>Weighted average number of common shares used in the calculation of loss per share</b>	15,126,068	14,966,624	15,165,512	15,086,624

# IP Applications Corp.

## Consolidated Statements of Cash Flows (Unaudited)

	Six months ended June 30		Three months ended June 30	
	2007	2006	2007	2006
<b>Cash flows from operating activities</b>				
Loss for the period	\$ (432,899)	\$ (1,050,620)	\$ (247,109)	\$ (639,810)
Items not affecting cash				
Accretion on convertible debenture	154,554	85,988	77,277	42,994
Amortization of intangible asset	-	357,371	-	178,686
Amortization of property and equipment	243,892	272,516	121,710	138,842
Reduction of loss on lease commitment	(14,968)	(14,968)	(7,483)	(7,484)
Stock based compensation	97,165	161,968	60,357	83,043
Leasehold inducement amortization	(35,465)	(47,655)	(17,733)	(17,732)
	12,279	(235,400)	(12,981)	(221,461)
Changes in non-cash working capital items				
Accounts Receivable	198,927	(107,602)	116,835	(58,171)
Prepaid expenses	4,102	11,930	29,115	14,633
Accounts payable and accrued liabilities	(376,315)	(255,400)	(366,222)	(44,819)
Deferred revenue	(32,825)	(44,546)	(7,885)	(4,839)
Customer deposits	-	(11,509)	-	(11,509)
Convertible debenture interest	64,113	30,000	35,309	15,000
	(129,719)	(612,527)	(205,829)	(311,166)
<b>Cash flows from investing activities</b>				
(Increase)/Release in restricted cash	(40,000)	300,000	-	-
Purchase of property and equipment	-	(73,692)	-	(19,547)
	(40,000)	226,308	-	(19,547)
<b>Cash flows from financing activities</b>				
Payments under capital leases	(153,569)	(159,223)	(63,367)	(68,226)
Proceeds from exercise of warrants	40,000	-	40,000	-
Proceeds from private placements	-	100,000	-	-
Capital raising costs	-	(1,254)	-	(45)
	(113,569)	(60,477)	(23,367)	(68,271)
<b>Increase / (Decrease) in cash</b>	(283,288)	(446,696)	(229,196)	(398,984)
<b>Cash - Beginning of period</b>	70,193	434,690	16,101	386,978
<b>Cash/Bank Indebtedness - End of period</b>	\$ (213,095)	\$ (12,006)	\$ (213,095)	\$ (12,006)

# **IP Applications Corp.**

Notes to Interim Consolidated Financial Statements

**June 30, 2007**

## **1 Nature of operations and going concern**

IP Applications Corp. (the Company) incorporated under the laws of British Columbia, provides outsourced Internet applications and solutions to Internet service providers (ISP), telecommunications companies or other corporate clients either to resell these applications to their customers and end users or for their own internal corporate use.

The accompanying consolidated financial statements are prepared on a going-concern basis, which assumes the realization of assets and the settlement of liabilities in the normal course of business. Certain conditions cast substantial doubt on this assumption. The Company's current level of revenues are not sufficient to solely fund operations. The Company has financed its operations principally through equity and debt financing. External financing will be required by the Company in order to fund its future operations and pursue other potential opportunities.

The ability of the Company to continue as a going concern and meet its commitments and ongoing operating expenses will depend upon raising further funds in the near term either through the issue of equity financing, pursuit of debt financing and ultimately the generation of profitable operations. There is no assurance that the Company will be successful in achieving these goals.

The consolidated financial statements do not include any adjustments, if any, relating to the recoverability and classification of recorded asset amounts or to the amounts and classification of liabilities that might be necessary should the entity not continue as a going concern.

## **2 Basis of presentation**

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and include the accounts of IP Applications Corp. and its wholly owned subsidiary, IP Applications Solutions Inc. All intercompany balances and transactions are eliminated.

It is recommended that these interim financial statements should be read in conjunction with the audited Annual Report for the year ended December 31, 2006. The accounting policies applied to the presentation of the interim financial statements are consistent with those applied to the previous financial year end.

# IP Applications Corp.

Notes to Interim Consolidated Financial Statements

June 30, 2007

## 3 Significant accounting policies

Property and equipment are amortized on a straight line basis at the following rates per annum:

Office Equipment	5 years
Computer Equipment	3 years
Computer Software	2 years

## 4 Restricted cash

Restricted cash of \$40,000 was pledged as collateral to a chartered bank for the provision of certain credit facilities.

## 5 Property and equipment

	<b>June 30, 2007</b>		
	<b>Cost</b>	<b>Accumulated amortization</b>	<b>Net</b>
Computer equipment	\$ 1,219,331	\$ 1,010,898	\$ 208,433
Office equipment	52,867	23,944	28,923
Computer software	124,758	103,623	21,135
Leasehold improvements	428,431	19,736	408,695
	<b>\$ 1,825,387</b>	<b>\$ 1,158,201</b>	<b>\$ 667,186</b>

  

	<b>December 31, 2006</b>		
	<b>Cost</b>	<b>Accumulated amortization</b>	<b>Net</b>
Computer equipment	\$ 1,219,331	\$ 788,992	\$ 430,339
Office equipment	52,867	18,815	34,052
Computer software	124,758	93,217	31,541
Leasehold improvements	428,431	13,286	415,145
	<b>\$ 1,825,387</b>	<b>\$ 914,310</b>	<b>\$ 911,077</b>

# IP Applications Corp.

Notes to Interim Consolidated Financial Statements

June 30, 2007

## 6 Convertible debenture

Effective September 18, 2006, the Company completed a convertible debt financing totalling \$960,130. This financing consisted of a) \$411,144 in cash and b) a roll-over of the \$548,986 owing under the debentures issued on December 19, 2005.

This convertible debenture is due in 18 months from the date of issue with an interest rate of 12% per annum calculated and paid quarterly in cash. At the holders' option, the debentures may be converted into units consisting of one common share and one-sixth of a common share purchase warrant anytime after April 1, 2007. The conversion price is at the lesser of: a) market price at the time of conversion (not less than \$0.25); b) the price of a Qualifying Financing; or c) \$0.40. Each full warrant is exercisable into one common share at a price of \$0.50 for a period of 12 months from issuance and at a price of \$0.55 for the period 13-24 months from issuance.

The 1,250,000 share purchase warrants associated with the December 2005 debenture will remain outstanding, with an expiry of December 19, 2007 and exercisable at \$0.55 per share.

The Company has recorded the proceeds of the debenture between debt and equity based on the relative fair values of the debt and conversion option. The fair value of the debt component was \$183,951, and the fair value of the conversion option was \$227,193. This latter amount was booked to contributed surplus and is being accreted on a straight line basis over the term of the debt.

Balance – December 31, 2006	\$ 646,379
Interest expense	64,113
Accretion of interest	154,554
Convertible debenture	<u>-</u>
Balance – June 30, 2007	<u>\$ 865,046</u>

# IP Applications Corp.

Notes to Interim Consolidated Financial Statements

June 30, 2007

## 7 Obligations under capital lease

	June 30, 2007	December 31, 2006
Lease payable in monthly instalments of \$12,094 including interest at an imputed rate of 6.44% until October 1, 2006, secured by a charge over equipment. The buyout on October 1, 2006, was further financed in monthly instalments of \$7,737 including interest at an imputed rate of 3.70% until September 1, 2007.	\$ 23,248	\$ 68,808
Lease payable in monthly instalments of \$9,507 including interest at an imputed rate of 12.0% until September 13, 2007, secured by a charge over equipment	40,291	93,151
Lease payable in two instalments of \$3,084 and \$29,834 including interest at an imputed rate of 12.0% by February 16, 2007, secured by a charge over equipment	-	27,908
Lease payable in monthly instalments of \$3,286 including interest at an imputed rate of 3.9% until December 1, 2008, secured by a charge over equipment	70,692	88,790
Lease payable in monthly instalments of \$1,686 including interest at an imputed rate of 6.0% until March 1, 2008, secured by a charge over equipment	17,685	26,828
	<u>151,916</u>	<u>305,485</u>
Less: Current portion	<u>(118,420)</u>	<u>(244,944)</u>
	<u>\$ 33,496</u>	<u>\$ 60,541</u>

Future minimum lease payments for the respective period ends based on the fiscal year-end are as follows:

2007	\$ 94,045
2008	<u>61,949</u>
	155,994
Less: Imputed interest	<u>(4,079)</u>
	<u>\$ 151,915</u>

# IP Applications Corp.

Notes to Interim Consolidated Financial Statements  
June 30, 2007

## 8 Capital stock

a) Authorized

100,030,000 common shares without par value

b) Issued

	Number of shares	Amount
<b>Balance – December 31, 2006</b>	<b>15,086,624</b>	<b>\$ 8,965,825</b>
Warrants exercised (note 8(c), (v))	100,000	55,873
<b>Balance – June 30, 2007</b>	<b><u>15,186,624</u></b>	<b><u>\$ 9,021,698</u></b>

c) Warrants

At June 30, 2007, the following share purchase warrants are outstanding:

Number of warrants outstanding and exercisable	Exercise price	Expiry Date
1,250,000	0.55	November 19, 2007
200,000	0.40	February 6, 2008
<u>100,000</u>	0.53 - 0.70	July 14, 2010
<u>1,550,000</u>		

# IP Applications Corp.

## Notes to Interim Consolidated Financial Statements

June 30, 2007

Balance - December 31, 2006	\$ 851,142
Warrants expired (note 8 (c), (i))	(136,501)
Warrants expired (note 8 (c), (ii))	(204,750)
Warrants expired (note 8 (c), (iii))	(85,023)
Warrants expired (note 8 (c), (iv))	(262,857)
Warrants exercised (note 8 (c), (v))	<u>(15,872)</u>
Balance – June 30, 2007	<u>\$ 146,139</u>

- i) During the year ended March 31, 2005, the Company completed a non-brokered private placement for 1,000,000 units at \$1.00 per unit for gross proceeds of \$1,000,000. Each unit consists of one common share, one-half call warrant and one cashless put warrant. Each full call warrant entitles the holder to acquire one additional common share at a price of \$1.00 per share up to December 23, 2006. The fair value of the put and call warrants issued was \$255,050 and was estimated on the issuance date using the Black-Scholes valuation model. During the period ended December 31, 2005, all cashless put warrants were exercised; the fair value of these warrants was \$118,549. The remaining fair value of \$136,501 relating to the call warrants expired during the quarter ended December 31, 2006.
- ii) During the year ended March 31, 2005, the Company completed a non-brokered private placement for 750,000 units at \$1.00 per unit for gross proceeds of \$750,000. Each unit consists of one common share and one share purchase warrant entitling the holder to acquire one additional common share at a price of \$1.00 per share up to December 23, 2006. The fair value of the warrants issued was \$204,750 and was estimated on the issuance date using the Black-Scholes valuation model. The warrants expired during the quarter ended December 31, 2006.
- iii) During the nine months ended December 31, 2005, the Company completed a non-brokered private placement for 2,424,242 common shares at \$0.33 per share for total gross proceeds of \$800,000. A total of 2,205,150 warrants held by participants in the private placement were surrendered for cancellation on a one-to-one basis with each new warrant entitling the holder to acquire one additional common share at a price of \$0.35 per share for the first twelve months and \$0.40 in the second twelve months. The fair value of the warrants issued was \$85,023 and was estimated on the issuance date using the Black-Scholes valuation model. The warrants expired during the quarter ended June 30, 2007.
- iv) During the nine months ended December 31, 2005, the Company completed a non-brokered private placement for 1,999,998 units at \$0.45 per unit for gross proceeds of \$900,000. Each unit consists of one common share, one-half of one warrant, with each full warrant entitling the holder to acquire one additional common share at a price of \$0.50 per share in the first twelve months and at \$0.55 per share for the second twelve months from the closing date. The fair value of the warrants issued was \$262,857 and was estimated on the issuance date using the Black-Scholes valuation model. The warrants expired during quarter ended June 30, 2007.

# IP Applications Corp.

## Notes to Interim Consolidated Financial Statements

June 30, 2007

- v) During the year ended December 31, 2006, the Company completed a non-brokered private placement for 300,000 units at \$0.33 per unit for gross proceeds of \$100,000. Each unit consists of one common share and one warrant. Each warrant entitles the holder to purchase an additional common share at a price of \$0.40 during the 24 month period from closing. The fair value of the warrants issued was \$47,616 and was estimated on the issuance date using the Black-Scholes valuation model. On April 20, 2007, 100,000 warrants were exercised at a price of \$0.40 per share, for a total of \$40,000. The fair value of the respective warrants exercised was \$15,872 using the Black-Scholes valuation model with the assumptions noted below.

Expected dividend yield	0%
Stock price volatility	92.62%
Risk-free interest rate	4.10%
Expected life of warrants	2 years

d) Stock options

The Company's fixed Stock Option Plan (the Plan) allows for 18% of the issued share capital to reserved for issuance to executive officers and directors, employees and consultants. The Board of Directors of the Company may terminate the Plan at any time provided that the termination does not alter the terms or conditions of any option or impair the right of any shareholder. Vesting provisions of the Plan provide for 25% of the options upon the Grant Date and 12 ½% every quarter thereafter until fully vested. The current number of shares reserved for issuance under the Plan is 2,624,935. As at June 30, 2007, 694,435 options are available for future grant.

Stock option transactions for the six-month period ended June 30, 2007 and the year ended December 31, 2006 are summarized as follows:

	<u>June 30, 2007</u>		<u>December 31, 2006</u>	
	<b>Number outstanding</b>	<b>Weighted average exercise price</b>	<b>Number outstanding</b>	<b>Weighted average exercise price</b>
Opening balance	1,929,900	\$ 0.41	1,002,500	\$ 0.56
Granted	150,000	0.28	1,285,600	0.33
Exercised	-	-	-	-
Expired	-	-	(3,600)	0.55
Forfeited	(149,400)	0.42	(354,600)	0.52
Closing balance	<u>1,930,500</u>	<u>\$ 0.40</u>	<u>1,929,900</u>	<u>\$ 0.41</u>

# IP Applications Corp.

Notes to Interim Consolidated Financial Statements

June 30, 2007

At June 30, 2007, the following stock options are outstanding:

Number of stock options outstanding	Exercise price	Expiry date	Number of stock options exercisable
50,000	\$ 0.55	June 16, 2008	50,000
6,000	0.55	September 8, 2008	6,000
4,000	0.55	November 15, 2008	4,000
74,000	0.55	February 27, 2009	74,000
150,000	0.55	May 27, 2009	150,000
307,800	0.55	May 2, 2010	232,560
41,700	0.55	September 22, 2010	41,700
1,047,000	0.33	February 28, 2011	919,875
75,000	0.34	April 20, 2011	56,250
25,000	0.34	April 20, 2011	25,000
<u>150,000</u>	0.28	April 30, 2012	<u>37,500</u>
<u>1,930,500</u>			<u>1,596,885</u>

## 9 Contributed surplus

	June 30, 2007	December 31, 2006
Opening balance	\$ 1,431,968	\$ 906,799
Stock-based compensation	97,165	297,976
Warrants expired (note 8 (c), (i))	136,501	-
Warrants expired (note 8 (c), (ii))	204,750	-
Warrants expired (note 8 (c), (iii))	85,023	-
Warrants expired (note 8 (c), (iv))	262,857	-
Equity component of convertible debenture	-	227,193
	<u>2,218,264</u>	<u>1,431,968</u>
Closing balance	\$ 2,218,264	\$ 1,431,968

# IP Applications Corp.

Notes to Interim Consolidated Financial Statements

June 30, 2007

## 10 Leasehold inducements

	June 30, 2007	December 31, 2006
Opening balance	\$ 268,168	\$ 298,103
Additions	-	-
Amortization	(14,968)	(29,935)
	<hr/>	<hr/>
	253,200	268,168
Less: Current portion	(29,935)	(29,935)
	<hr/>	<hr/>
	\$ 223,265	\$ 238,233
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During the period ended December 31, 2005, the Company entered into a lease agreement for new office premises. In connection with the lease, the Company received lease inducements of \$299,350 relating to leasehold improvements. These inducements are being amortized over the initial ten year term of the lease.

## 11 Loss on Lease commitment

	June 30, 2007	December 31, 2006
Opening balance	\$ 126,566	\$ 209,687
Additions	-	-
Reduction	(35,465)	(83,121)
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	91,101	126,566
Less: Current portion	(72,759)	(71,540)
	<hr/>	<hr/>
	\$ 18,342	\$ 55,026
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During the period ended December 31, 2006, the Company entered into a sublease agreement for its former office space in New Westminster. As at December 31, 2005, the Company recorded a loss of \$209,687 representing the difference paid to the landlord and received from the subtenant during the period of January 1, 2006 to the expiration of both lease and sublease agreements on September 30, 2008.

