

ID WATCHDOG, INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS
DECEMBER 31, 2010
(Expressed in U.S. Dollars)

The following management's discussion and analysis ("MD&A") of the consolidated operating results and financial condition of ID Watchdog, Inc. for the year ended December 31, 2010 has been prepared based on information available to us as of April 28, 2011 and is intended to be read in conjunction with our audited consolidated financial statements and related notes for year ended December 31, 2010. This MD&A contains "forward-looking information" and reference to the cautionary statement at the end of this MD&A is advised. Additional information relating to ID Watchdog, Inc. is available on SEDAR at www.sedar.com.

We prepared our consolidated financial statements and related notes in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") and, except where as noted, present our results in United States dollars.

For purposes of this discussion, we have used the foreign exchange rate in effect at December 31, 2010, of CDN\$1.00 = US\$1.0054.

Overview and recent developments:

Our business was founded in 2005 and our services provide detection and resolution solutions for identity theft and other consumer report problems. Our services monitor key data fields in consumer reports, access and analyze full reports, and resolve damage to consumer reports.

During the first half of 2007, we focused on development of our services, raising working capital, and developing marketing strategies. In the third quarter of 2007, we began marketing our services and continued to enhance our internal systems. During the fourth quarter of 2007, we transitioned from a development stage enterprise into an operating company. In the past years, we had marketing expenditures of \$1.4 million in 2007, \$8.3 million during 2008 and \$7.7 million during 2009.

During the first half of 2008, we raised \$5.0 million by completing private placements of our Series A and Series B redeemable convertible preferred shares and warrants totalling \$4.5 million (the "Series A Preferred" and the "Series B Preferred", respectively) and by completing a \$0.5 million private placement of our ordinary shares with ordinary share purchase warrants.

On September 5, 2008, we completed our initial public offering (our "IPO") raising \$8.1 million net of equity issuance costs. On September 17, 2008, the TSX Venture Exchange (the "TSXV") approved the listing of our ordinary shares and the classification of our company as a "Tier 1 Industrial or Technology Issuer." Our ordinary shares began trading on the TSXV on September 18, 2008, (the "Listing Date") under the symbol "IDW."

In November 2009, the Company completed a private placement for the sale of \$1,703,880 in Senior Extendible Deferred Convertible Notes with an interest rate of 10% (the "2009 Notes"). After underwriting expenses, the Company received \$1.342 million. Interest is paid monthly from an escrow account funded with a deduction from the proceeds of the private placement to pay the interest to the 2009 Note holders for the first year. The 2009 Notes matured on April 19, 2010 and the Company exercised the provision to extend the maturity of the 2009 Notes until September 30, 2010 by paying the 2.5% extension fee and issuing 3,315,750 additional warrants per the terms of the agreement. The 2009 Notes matured on September 30, 2010. The Company did not repay the outstanding principal amount on these 2009 Notes and at December 31, 2010 they are in payment default. Subsequent to December 31, 2010, as part of a plan to recapitalize the Company, a consent offer was made to the holders of the 2009 Notes and the 2010 Notes to exchange their notes, whereby each \$1,000 original face amount of notes will be exchanged for \$200 in cash and that number of shares of our Ordinary Shares which is equal to the

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sum of \$1,000 plus applicable accrued interest thereon as of the closing of the offer, divided by \$0.10. The offer closed on February 24, 2011 and \$1,518,254 of the 2009 Notes including accrued interest exchanged the notes into 15,182,532 Ordinary Shares of the Company. The remaining \$271,100 of note principal amount plus accrued interest was paid in cash. At February 24, 2011, all of the 2009 Notes are retired.

Purchasers of the 2009 Notes received warrants to purchase 3,315,750 ordinary shares at an exercise price \$0.2929 per share. Agents for the Company received 617,529 warrants as part of their compensation with the same terms as the warrants issued to the noteholders. These convertible Notes and warrants have anti-dilution provisions that upon the subsequent sale or issuance of securities may cause a reduction of the outstanding convertible notes' conversion price and warrants' exercise price. The 2009 Notes and warrants issued with the 2009 Notes agreement has a registration rights agreement that call for at any time during the period beginning December 31, 2011, until December 30, 2014, holders have a one-time right by written notice of no less than 50.1% of the securities and underlying securities included in the 2009 Note private placement to demand that the Company register all included and underlying securities. See Note 5 for additional information.

In March 2010, the Company completed a private placement for the sale of \$1,500,000 in convertible notes with an interest rate of 10% (the "2010 Notes"). After underwriting expenses, the Company received \$1,173,500 plus an additional amount of \$172,500 which was deposited into an escrow account to for interest payments. Interest is paid monthly from an escrow account funded by a deduction from the proceeds of the private placement to pay the interest to the 2010 Note holders for the first year. The 2010 Notes matured on August 10, 2010 and were extended to February 6, 2011 by paying the 2.5% extension fee and issuing 2,055,000 additional warrants per the terms of the agreement. The 2010 Notes can be prepaid at any time at 110% of the principal amount if on or before the maturity date and at 120% thereafter. The 2010 Notes matured on February 6, 2011 and the Company did not repaid the outstanding principal amount on the 2010 Notes but, on February 24, 2011, as part of a plan to recapitalize the Company, a private placement offer was closed which included a consent offer to the holders of the 2009 Notes and the 2010 Notes to exchange their notes, whereby each \$1,000 original face amount of notes will be exchanged for \$200 in cash and that number of shares of our Ordinary Shares which is equal to the sum of \$1,000 plus applicable accrued interest thereon as of the closing of the offer, divided by \$0.10. The offer closed on February 24, 2011 and \$1,510,625 of the 2010 Notes including accrued interest exchanged the notes into 15,106,237 Ordinary Shares of the Company. At February 24, 2011, all of the 2010 Notes are retired.

Purchasers of the 2010 Notes received warrants to purchase 2,055,000 ordinary shares at an exercise price of \$0.365 per share. Agents for the Company received 410,959 warrants as part of their compensation with the same terms as the warrants issued to the noteholders. These convertible notes and warrants have anti-dilution provisions that upon the subsequent sale or issuance of securities may cause a reduction of the outstanding convertible notes' conversion price and warrants' exercise price. The 2010 Notes and warrants issued with the 2010 Notes agreement has a registration rights agreement that call for at any time during the period beginning December 31, 2011, until December 30, 2014, holders have a one-time right by written notice of no less than 50.1% of the securities and underlying securities included in the 2010 Note private placement to demand that the Company register all included and underlying securities. See Note 5 for additional information.

In February 2011, the Company completed a private placement to recapitalize the Company which included 3,123,481 units at a price of \$1,000 per unit for aggregate gross proceeds of \$3,123,481. Each unit consists of one share of Series C Preferred Stock in the capital of the Company with an issue price of \$1,000 per share and 5,000 ordinary share purchase warrants. Each Series C Preferred Share is

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convertible into one ordinary share in the capital of the Company at a conversion price of \$0.10 per share at any time before February 24, 2016. Each warrant is exercisable into one Ordinary Share in the capital of the Company at a price of \$0.12 at any time before February 24, 2016.

Each Series C Preferred Share will be entitled to one vote per share on an as-if converted basis. The board of directors of the Company may, in its discretion, declare an 8% dividend on the Series C Preferred Shares outstanding from time to time. The Series C Preferred Shares mature on February 24, 2016 and will be repaid in cash or issuance of a 90 day promissory note on the maturity date. Each Warrant is, at the option of the holder, exercisable on a cashless basis whereby the holder of the Warrant will be entitled to receive that number of Ordinary Shares equivalent to the "in-the-money" value of the Warrants divided by a minimum exercise price of \$0.12 per Ordinary Share.

In connection with the February 2011 offering, the Company solicited the holders of its 10% convertible promissory notes which are outstanding in the principal amount of \$3,203,880 (the "Existing Convertible Notes") to exchange each \$1,000 in principal amount of Existing Convertible Notes for \$200 in cash and that number of Ordinary Shares resulting from the conversion of \$1,000 in principal plus accrued and unpaid interest at a conversion rate of \$0.10 per share. The Company obtained the required 75% consent approval of the Existing Convertible Note holders and converted Existing Convertible Notes into 30,288,769 Ordinary Shares. The balance of the outstanding Existing Convertible Notes was paid to the holders in cash.

In connection with the February 2011 offering, the Company arranged to settle \$814,445 in certain vendor trade payables through the issuance of 8,144,450 Ordinary Shares at an issuance price of \$0.10 per Ordinary Share.

On December 31, 2010, we had \$99,082 of cash and cash equivalents on hand. In addition, we had \$61,057 of restricted cash available to pay the interest payments on the 2010 Notes.

During 2010, we were not able to maintain our level of customers and our customer base decreased to 18,000 at December 31, 2010 from 25,000 at December 31, 2009. An active customer is defined as a customer who has paid monthly subscription fee and is no more than 60 days past due.

Our business plan for 2011 calls for a new marketing strategy in which the Company aligns itself with anti-virus companies to offer its services as an integrated solution on the desktops of customers subscribing to anti-virus products for free credit alert features which gives the customers the opportunity to receive credit-bureau alerts directly to their desktop, free of charge. Deployment is expected in the second quarter of 2011. Based on the Company's operating plan, we expect the cash flow provided from the new marketing strategy and the cash raised in the February 2011 private placement to provide sufficient working capital to fund our 2011 business plan.

We are dependent upon our existing cash balances, along with our expected cash flow generated from gross profits to satisfy our marketing expenditures, general and administrative expenses and debt payments relating to our current operations and planned growth during the short term. Based on the Company's current operating plan, its existing working capital is sufficient to meet the cash requirements to fund the Company's operating expenses, and working capital requirements through December 31, 2011 without additional sources of cash and/or the deferral, reduction or elimination of significant planned expenditures.

Although the Company believes the business plan is achievable, should the Company fail to achieve the sales or gross margin levels anticipated, or if the Company were to incur significant unplanned cash

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outlays, it would become necessary for the Company to obtain additional sources of liquidity or make further cost cuts to fund its operations. However, there is no assurance that the Company would be able to obtain such financing on favorable terms, if at all, or to successfully further reduce costs in such a way that would continue to allow the Company to operate its business.

We believe that current economic conditions will create additional demand for our services as crime rates typically increase during economic downturns and we believe that this will cause the crime of identity theft to also increase. We also believe that increases in consumer awareness of identity theft monitoring and resolution services and increases in consumer demand for our services will offset any negative impacts to our business that may result from decreases in consumer spending as a result of current economic conditions.

Development and marketing of services:

We have observed that market forces are beginning to promote convergence among the providers of consumer-facing security software solutions and technologies such as emerging initiative to provide consumers with a comprehensive desktop and mobile phone security application that incorporates device protection, identity protection, and on-line transactional security.

The cyber crime market is dominated today by PC endpoint security solutions designed to combat malware. Short for *malicious software*, malware, is a catch-all term to describe software designed to infiltrate a computer system without the owner's informed consent. Software is considered to be malware based on the perceived intent of the creator rather than any particular features, and includes computer viruses, worms, trojan horses, spyware, dishonest adware, crimeware, most root kits, and other unwanted software. Our business plan calls for implementing a marketing strategy with anti-virus companies to launch our services along with anti-virus products, (the "New Partnering Strategy").

There are literally dozens of AV software vendors. The Company has commenced efforts to implement its New Partnering Strategy by introducing itself and its products to more than 20 AV providers for the purpose of exploring the possibilities for strategic marketing alliances and currently has agreements with several.

Over the longer term, we believe that the key to our success in the future will be to generate increased revenue and profit through the successful launch and execution of the business strategies associated with our New Strategic Partnering deals.

Selected financial information:

Our financial information set out below is based on and derived from our unaudited consolidated financial statements as of the dates and for the periods indicated and should be read in conjunction with our MD&A and the consolidated financial statements and the accompanying notes which are available on our website at www.idwatchdog.com and/or the SEDAR website at www.sedar.com. The following selected financial information has been prepared in accordance with U.S. GAAP. For reconciliation to Canadian generally accepted accounting principles see Note 11 to the consolidated financial statements.

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	Year Ended December 31,		
	2010	2009	2008
Revenue	\$ 3,329,442	\$ 5,907,602	\$ 4,688,290
Gross profit	2,933,10	4,541,501	3,559,495
Operating expense	(4,010,769)	(12,270,158)	(11,643,833)
Operating loss	(985,279)	(7,728,657)	(8,084,338)
Net loss	(2,146,402)	(8,768,122)	(8,144,754)
Dividends, deemed dividends and accretion of discount related to redeemable convertible preferred shares	—	—	(2,782,704)
Net loss applicable to ordinary shares	\$ (2,146,402)	\$ (8,768,122)	\$ (10,927,458)
Basic and diluted net loss per share	\$ (0.03)	\$ (0.15)	\$ (0.37)

	December 31, 2010	December 31, 2009	December 31, 2008
Balance Sheet Data:			
Cash and cash equivalents (including restricted cash of \$61,057 and \$171,752 at December 31, 2010 and 2009, respectively ...	\$ 160,139	\$ 660,441	\$ 5,117,596
Total assets	\$ 572,411	\$ 1,511,564	\$ 6,175,539
Total long-term liabilities	\$ 2,476	\$ 5,406	\$ 7,854
Total liabilities	\$ 5,867,711	\$ 4,711,632	\$ 4,372,283
Total shareholders' equity (deficit)	\$ (5,295,300)	\$ (3,200,068)	\$ 1,803,256

Summary of quarterly results - unaudited:

	2010 Quarter 4	2010 Quarter 3	2010 Quarter 2	2010 Quarter 1
Revenue	\$ 552,795	\$ 698,230	\$ 888,815,	\$ 1,189,602
Net loss	\$(1,107,603)	\$ (227,760)	\$ (568,251)	\$ (242,788)
Net loss applicable to ordinary shares .	\$(1,107,603)	\$ (227,760)	\$ (568,251)	\$ (242,788)
Basic and diluted net loss per share	\$ (0.02)	\$ nil	\$ (0.01)	\$ nil)
	2009 Quarter 4	2009 Quarter 3	2009 Quarter 2	2009 Quarter 1
Revenue	\$ 1,340,975	\$ 1,422,746	\$ 1,929,860	\$ 1,214,021
Net loss	\$(1,828,025))	\$(1,271,082)	\$(1,686,342)	\$(3,982,673)
Net loss applicable to ordinary shares .	\$(1,828,025)	\$(1,271,082)	\$(1,686,342)	\$(3,982,673)
Basic and diluted net loss per share	\$ (0.03)	\$ (0.02)	\$ (0.03)	\$ (0.08)

During the second quarter of 2009, our revenues increased as we engaged several external call centers to sell and cross-sell our services in conjunction with their inbound and outbound calls. Our revenue declined in the third quarter of 2009 as compared to the second quarter of 2009 as a result of our efforts to reduce expenditures and conserve cash. Our revenues declined in the fourth quarter of 2009 as compared to the third quarter of 2009 as we continued to reduce expenditures, however, we were able to maintain our fourth quarter gross profit at approximately \$1,060 thousand. Our revenue decreased in the first quarter of 2010 as compared to the fourth quarter of 2009 as we continued to reduce expenditures,

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including marketing expenses, to conserve cash. However, we were able to maintain gross profit at \$1,045 thousand for the first quarter 2010. Revenue declined in the second quarter 2010 as compared to the first quarter 2010 as we continued to reduce expenditures, including marketing expenses, to conserve cash. Our revenue declined in the third quarter 2010 as compared to the second quarter 2010 as our efforts to add new customers were insufficient to offset the customer loss and cancelations. Our revenue declined in the fourth quarter 2010 as compared to the third quarter 2010 as our efforts to add new customers were insufficient to offset the customer loss and cancelations.

Our net loss decreased during the second quarter 2009 as compared to the first quarter 2009 primarily due to the turnaround of the gain/loss on the derivative contract liability. The Company posted a non-cash loss of \$866,617 in the first quarter of 2009 and a gain of \$781,960 in the second quarter due to the change in the fair market value ("FMV") of our ordinary shares. The change in the FMV of our ordinary shares caused a decrease of \$1,648,577 in the net loss when comparing the 2009 second quarter to the first quarter. The increase in revenue during the second quarter and the resulting increase in gross profit primarily accounted for the remaining decrease in net loss.

Our net loss decreased during the third quarter of 2009 as compared to the second quarter 2009 primarily as a result of a \$1 million decrease in marketing expenses, a decrease in general and administrative expenses and a reduction in interest expense due to the conversion of the convertible debentures into the Company's ordinary shares during the second quarter of 2009. These third quarter decreases were offset by \$781,960 non-cash gain reported in the second quarter of 2009. Our net loss increased \$556,943 during the fourth quarter of 2009 as compared to the third quarter of 2009 mainly due to \$430,000 of additional interest expense incurred during the fourth quarter of 2009 which relates to the sale of \$1,703,880 in Senior Extendible Deferred Convertible Notes with an interest rate of 10% (the "2009 Notes"). Fourth quarter interest expense includes \$137,457 of non-cash amortization of debt offering costs and \$250,204 of non-cash amortization of debt discounts. In addition, during the fourth quarter ending December 31, 2009, we recorded a \$238,700 loss on derivative contract liabilities related to warrants denominated in Canadian dollars, the issue of warrants and a beneficial conversion feature related to our 10% senior extendible deferred convertible notes issued in the fourth quarter of 2009. An improvement in operating loss by \$210,000 in the fourth quarter 2009 as compared to 2008 offset the additional expenses from above.

Our net loss decreased during the first quarter 2010 as compared to the fourth quarter 2009 as a result of our plan to reduce expenditures in order to conserve cash. Our marketing expenses and general and administrative expenses were reduced by \$475 thousand and \$281 thousand, respectively as compared to the fourth quarter of 2009. In addition, our net loss decreased during the first quarter 2010 as compared to the fourth quarter 2009, due to a turnaround of the gain/loss on derivative contract liability which accounts for a decrease in the net loss comparison by \$1,096 thousand. The Company posted a non-cash loss of \$239 thousand in the fourth quarter 2009 and a gain of \$857 thousand in the first quarter of 2010 primarily due to the change in FMV of our ordinary shares which accounts for the \$1,096 decrease in net loss. An increase in interest expense (non-cash amount of \$249 thousand) during the first quarter of 2010 offsets the net loss decrease from above and primarily accounts for the remaining change in net loss. Interest expense increased due to the issuance of the 2010 Notes in February and March 2010 and their related amortization of non-cash debt discount and debt offering costs charged to interest expense.

Our net loss increased during the second quarter 2010 as compared to the first quarter 2010 due to the non-operating and non-cash gain of \$59 thousand in the second quarter of 2010 as compared to \$857 thousand in the first quarter of 2010. The non-operating, non-cash gain is due to the change in the fair market value of our ordinary shares resulting from the derivative contract liability associated with the warrants and beneficial conversion feature related to the 2009 Notes and the 2010 Notes. Our operating

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loss decreased in the second quarter 2010 to a loss of \$163 thousand from a loss of \$410 thousand in the first quarter of 2010 reflecting the Company's planned reduction in expenditures in order to conserve cash.

Our net loss decreased by \$340 thousand during the third quarter 2010 as compared to the second quarter 2010 as a result of our plan to reduce expenditures in order to conserve cash and other non-cash items explained below. Our marketing expenses and general and administrative expenses were reduced by \$184 thousand as compared to the second quarter of 2010. In addition, our net loss decreased during the third quarter 2010 as compared to the second quarter 2010, due to a \$79 thousand additional gain on derivative contract liability which is the result of a decrease in the FMV of our ordinary shares and decreased term of the warrants. A decrease in interest expense (non-cash amount of \$248 thousand) during the third quarter of 2010 primarily accounts for the remaining change in net loss. Interest expense decreased due to the completion of the amortization of the non-cash debt discount and debt offering costs related to the issuance of the 2010 Notes.

Our net loss increased by \$880 thousand during the fourth quarter 2010 as compared to the third quarter 2010 primarily as a result of increased interest expense due to accounting for a 20% premium payment and increased interest rate to the holders of the 2009 and 2010 Notes. As the 2009 Notes matured and were not repaid the interest rate accelerated to a default rate of 15%. The net loss also increased as a result of our declining revenue and related gross profits due to our declining customer base.

Our quarterly net loss applicable to ordinary shares does not differ from our net loss.

Results of operations:

Comparison of the year ended December 31, 2010 to the year ended December 31, 2009

Revenue and gross profit

For the years ended December 31, 2010 and 2009, we recognized revenue of \$3,329,442 and \$5,907,602, respectively, from the sale of our services. Our cost of revenue for the year ended December 31, 2010, was \$395,832 resulting in a gross profit of \$2,933,610, while our cost of revenue for the year ended December 31, 2009, was \$1,366,101 resulting in a gross profit of \$4,541,501. Our revenue, cost of revenue and gross profit decreased during 2010 as compared to 2009, as our revenue declined due to our declining customer base resulting from our reduced marketing expense and insufficient working capital to acquire new customers.

Marketing expense

Our marketing expense includes marketing agents' commissions, advertising and production costs, website design and development costs and marketing and call center staff wages and related expenses. Our marketing expense for 2010 was \$1,359,505 as compared to \$7,659,983 for 2009. This decrease reflects the Company's plans to decrease marketing expenses in 2010 in order to conserve cash.

We have a month-to-month services agreement with Veracity Credit Consultants, LLC ("VCC"), an entity controlled by certain executives of the Company, to provide call center facilities and call center services at prevailing market rates. We incurred \$132,749 and \$262,469 of related party call center marketing expense relating to this arrangement during 2010 and 2009, respectively. This reduction in expenses reflects the Company's plans to decrease expenses in 2010 in order to conserve cash.

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General and administrative expense

General and administrative expense includes non-marketing salaries, non-marketing benefits, consultants' fees, rent, telephone, insurance, depreciation, other general and administrative expense and related party consulting expense.

Our general and administrative expense amounted to \$2,651,264 and \$4,610,175 during 2010 and 2009, respectively. This \$1,958,911 decrease in general and administrative expense is due to our plans to reduce expenses in 2010 in order to conserve cash. We reduced the expenses from the 2009 expense levels which primarily relate to a \$1,106,355 decrease in consulting expense related to information system maintenance and improvements and a \$134,137 decrease in non-marketing wages and related expense resulting from decreased headcount and decreased compensation expense. Also, during 2010, legal and accounting expense decreased \$402,967 over 2009 resulting from decreased consulting expenses and \$17,918 decrease information systems network expense as we decreased expenses to conserve cash. Other office-related general and administrative expenses decreased by \$297,534 for the remaining 2010 change.

During 2010, we incurred related party consulting expense of \$248,141 as compared to \$339,569 during 2009, a decrease of \$91,428. During 2010, we incurred \$189,158 of consulting expense for services from Daryl Yurek, our Chairman and CEO, as compared to \$199,664 in 2009. This decrease was a result of a decrease in compensation rates. During 2010, we discontinued consulting services from a director, consulting services from VCC and certain services from Bolder Venture Partners, and entity controlled by Daryl Yurek, the Chief Executive Officer of the Company, which reduced expenses by \$139,905.

Interest expense

In November 2009, we completed a private placement for the sale of \$1,703,880 in Senior Extendible Deferred Convertible Notes (the "2009 Notes") that bear interest at 10% per annum and matured on September 30, 2010. We did not repay the outstanding principal amount on the 2009 Notes and at December 31, 2010 they are in payment default, however, subsequent to December 31, 2010, as part of a plan to recapitalize the Company, the notes were retired. In March 2010, we completed a private placement for the sale of \$1,500,000 in Extendible Deferred Convertible Notes (the "2010 Notes") that bear interest at 10% per annum and their maturity date was extended to February 6, 2011. For both the 2009 Notes and the 2010 Notes, the interest rates escalates to 12.5% with the event to extend the maturity date and to 15% upon a payment default.

Interest expense during the years ended December 31, 2010 and 2009 totalled \$2,130,056 and \$837,458, respectively. These amounts included non-cash amortization of debt offering costs of \$455,188 and \$297,529 during the years ended December 31, 2010 and 2009, respectively. Interest expense also included non-cash amortization of debt discount of \$595,896 and \$334,419 during each of the periods in 2010 and 2009, respectively. Interest expense for the year ending December 31, 2010 also includes a 20% premium payment due upon the maturity on the Notes. The non-cash amortization of debt offering costs and the non-cash amortization of debt discount includes amounts from both the 2009 Notes and the 2010 Notes.

Loss on derivative contract liabilities

During 2010 and 2009, we recorded a \$1,054,501 gain on derivative contract liabilities related to the issue of warrants and beneficial conversion feature related to the 2010 and 2009 Notes and a loss of \$223,418, respectively as explained below.

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We have recorded the fair value of our warrants denominated in Canadian dollars, the warrants issued with our 2010 Notes, warrants issued with our 2009 Notes and any beneficial conversion features as a derivative contract liability in accordance with U.S. GAAP. Each period, we adjust the estimated fair value of these derivative financial instruments through a charge or credit to earnings until such time as the instruments are exercised, expire or are permitted to be classified in shareholders' equity. During the year ended December 31, 2010, we incurred a non-cash gain of \$1,054,501 as compared to a non-cash loss of \$223,418 during the year ended December 31, 2009 related to the change in fair value of our derivative contract liabilities. The decrease in the fair value of our derivative contract liabilities was mainly a result of a decrease in the market price of our ordinary shares from \$0.38 at December 31, 2009 to \$0.04 per share at December 31, 2010 and, in addition, the decrease in the time span before the expiration date of the related warrants resulted in a decrease to the fair value of the derivative contract liabilities.

We have recorded the fair value of our warrants issued in the first quarter of 2010, the fourth quarter of 2009 and with our IPO in September 2008 as a derivative contract liability in accordance with U.S. GAAP. Each period, we adjust the estimated fair value of these derivative financial instruments as explained above. The detachable warrants and placement agent warrants have been valued separately at fair value using the Black-Scholes methodology. As of March 2010 and October 2009, the fair value calculations assumed a risk-free interest rate of 2.35% and 2.3%, respectively, estimated expected volatility of 50% and 38%, respectively and no dividends. The value assigned to the detachable warrants and placement agent warrants during March 2010 and October 2009 was \$211,780 and \$310,530, respectively using the Black-Scholes option-pricing model and is included in derivative contract liabilities on the Company's consolidated balance sheets. The warrants are adjusted, at each reporting period end, with any increase or decrease in the fair value being recorded in results of operations as an adjustment to fair value of derivatives. At December 31, 2010, the fair value of these derivative instruments is \$35,000 which resulted in a gain of \$741,501 for the year ended December 31, 2010.

The 2009 Notes were determined to have a beneficial conversion feature because the conversion price was less than the market value of the Company's ordinary shares at the time of issuance. The intrinsic value assigned to the beneficial conversion feature during October 2009 is \$323,790 and is included in derivative contract liabilities on the Company's consolidated balance sheets. The beneficial conversion feature is adjusted to reflect fair value, using the Black-Scholes option-pricing model, at each reporting period end, with any increase or decrease in the fair value being recorded in results of operations as an adjustment to fair value of derivatives. At December 31, 2010, the fair value of these derivative instruments is \$2,000 which resulted in a gain of \$313,000 for the year ended December 31, 2010.

Expense applicable to redeemable convertible preferred shares

We did not incur expense applicable to redeemable convertible preferred shares during the year ended December 31, 2010.

Liquidity and capital resources:

Recent financings

Private Placement – 10% Senior Extendible Deferred Convertible Notes, (the 2009 Notes)

In November 2009, the Company completed a private placement for the sale of \$1,703,880 in Senior Extendible Deferred Convertible Notes with an interest rate of 10% (the "2009 Notes"). After underwriting expenses, the Company received \$1.342 million. Interest is paid monthly from an escrow

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account funded with a deduction from the proceeds of the private placement to pay the interest to the 2009 Note holders for the first year. The 2009 Notes matured on April 19, 2010 and the Company exercised the provision to extend the maturity of the 2009 Notes until September 30, 2010 by paying the 2.5% extension fee and issuing 3,315,750 additional warrants per the terms of the agreement. The 2009 Notes matured on September 30, 2010. The Company did not repay the outstanding principal amount on these 2009 Notes and at December 31, 2010 they are in payment default. Subsequent to December 31, 2010, as part of a plan to recapitalize the Company, a consent offer was made to the holders of the 2009 Notes and the 2010 Notes to exchange their notes, whereby each \$1,000 original face amount of notes will be exchanged for \$200 in cash and that number of shares of our Ordinary Shares which is equal to the sum of \$1,000 plus applicable accrued interest thereon as of the closing of the offer, divided by \$0.10. The offer closed on February 24, 2011 and \$1,518,254 of the 2009 Notes including accrued interest exchanged the notes into 15,182,532 Ordinary Shares of the Company. The remaining \$271,100 of note principal amount plus accrued interest was paid in cash. At February 24, 2011, all of the 2009 Notes are retired.

Purchasers of the 2009 Notes received warrants to purchase 3,315,750 ordinary shares at an exercise price \$0.2929 per share. Agents for the Company received 617,529 warrants as part of their compensation with the same terms as the warrants issued to the noteholders. These convertible Notes and warrants have anti-dilution provisions that upon the subsequent sale or issuance of securities may cause a reduction of the outstanding convertible notes' conversion price and warrants' exercise price. The 2009 Notes and warrants issued with the 2009 Notes agreement has a registration rights agreement that call for at any time during the period beginning December 31, 2011, until December 30, 2014, holders have a one-time right by written notice of no less that 50.1% of the securities and underlying securities included in the 2009 Note private placement to demand that the Company register all included and underlying securities. See Note 5 in the consolidated financial statements for additional information.

Private Placement – 10% Extendible Convertible Notes, (the 2010 Notes)

In March 2010, the Company completed a private placement for the sale of \$1,500,000 in convertible notes with an interest rate of 10% (the "2010 Notes"). After underwriting expenses, the Company received \$1,173,500 plus an additional amount of \$172,500 which was deposited into an escrow account to for interest payments. Interest is paid monthly from an escrow account funded by a deduction from the proceeds of the private placement to pay the interest to the 2010 Note holders for the first year. The 2010 Notes matured on August 10, 2010 and were extended to February 6, 2011 by paying the 2.5% extension fee and issuing 2,055,000 additional warrants per the terms of the agreement. The 2010 Notes can be prepaid at any time at 110% of the principal amount if on or before the maturity date and at 120% thereafter. The 2010 Notes matured on February 6, 2011 and the Company did not repay the outstanding principal amount on the 2010 Notes but, on February 24, 2011, as part of a plan to recapitalize the Company, a private placement offer was closed which included a consent offer to the holders of the 2009 Notes and the 2010 Notes to exchange their notes, whereby each \$1,000 original face amount of notes will be exchanged for \$200 in cash and that number of shares of our Ordinary Shares which is equal to the sum of \$1,000 plus applicable accrued interest thereon as of the closing of the offer, divided by \$0.10. The offer closed on February 24, 2011 and \$1,510,625 of the 2010 Notes including accrued interest exchanged the notes into 15,106,237 Ordinary Shares of the Company. At February 24, 2011, all of the 2010 Notes are retired. See Note 5 in the consolidated financial statements for additional information.

Purchasers of the 2010 Notes received warrants to purchase 2,055,000 ordinary shares at an exercise price of \$0.365 per share. Agents for the Company received 410,959 warrants as part of their compensation with the same terms as the warrants issued to the noteholders. These convertible notes and warrants have anti-dilution provisions that upon the subsequent sale or issuance of securities may cause a reduction of

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the outstanding convertible notes' conversion price and warrants' exercise price. The 2010 Notes and warrants issued with the 2010 Notes agreement has a registration rights agreement that call for at any time during the period beginning December 31, 2011, until December 30, 2014, holders have a one-time right by written notice of no less than 50.1% of the securities and underlying securities included in the 2010 Note private placement to demand that the Company register all included and underlying securities.

Cashflows

As of December 31, 2010, we had total cash on hand of \$99,082 and \$61,057 in restricted cash designated to pay the interest payments on the 2010 and 2009 Extendible Deferred Convertible Notes and a working capital deficit of \$2,292,081.

During the year ended December 31, 2010 and 2009, we had cash outflows from operations of \$1,689,589 and \$5,752,608, respectively. This decrease was a result of reduced 2010 expenses related to marketing efforts and general and administrative expenses and from increased marketing expense in 2009.

Cash flows used for investing activities increased to \$76,703 during 2010 from \$52,721 during 2009.

Cash flows from financing activities increased to \$1,376,685 during 2010 from \$1,177,918 during 2010 as a result of the following financings:

	Year Ended December 31,	
	2010	2009
Proceeds from issuance of 10% senior extendible deferred convertible notes and warrants (2009 Notes).....	\$ —	\$ 1,703,880
Proceeds from issuance of 10% extendible deferred convertible notes (2010 Notes).....	1,500,000	—
Change in restricted cash.....	110,695	(171,752)
Proceeds from exercise of warrants and stock options, net	—	9,803
Deferred private placement costs.....	(231,080)	(361,566)
All other, net	(2,930)	(2,447)
Net cash provided by financing activities	<u>\$ 1,376,685</u>	<u>\$ 1,177,917</u>

Commitments

In July 2009, the Company entered into a five year exclusive data agreement with a major supplier of nationwide public record information to supply the Company with its data for its identity theft monitoring and resolution services. The agreement calls for minimum spending commitments by the Company for the data information.

In addition to the commitment for data information, the Company has committed to spend monies on marketing and promotion expenses on an annual amount beginning per the terms of the agreement in order to maintain an exclusive arrangement and corresponding with the contract year of the agreement.

The agreement has certain cancelation provisions if the commitments are not met. The Company did not meet its minimum spending commitments for data information or marketing and promotion expense annual commitment and therefore, may lose its exclusive arrangement. The Company's relationship with its supplier is good and there have not been any adverse repercussions from the commitment deficiencies.

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Capital resources

On December 31, 2010, we had stock options outstanding denominated in U.S. dollars to purchase 3,485,417 ordinary shares. In addition, we had stock options outstanding denominated in Canadian dollars to purchase 985,000 ordinary shares as of December 31, 2010. If exercised, these stock options would generate approximately \$1.5 million and CDN\$0.6 million in additional cash, respectively, however, it is unlikely that we will receive any of potential total cash proceeds from the exercise of these options if they are exercised due to the cashless exercise provisions contained in the option agreements.

At December 31, 2010, we had 31,147,441 warrants outstanding denominated in U.S. dollars that contain cashless exercise provisions, which, upon certain conditions, permit the holder to exercise their warrants on a net cash exercise basis and receive ordinary shares without payment of any cash consideration. It is unlikely that we will receive any of the approximately \$10.9 million potential total cash proceeds from the exercise of these warrants if they are exercised due to the aforementioned cashless exercise provisions.

Our business plan for 2011 calls for a new marketing strategy in which the Company aligns itself with anti-virus companies to offer its services as an integrated solution on the desktops of customers subscribing to anti-virus products for free credit alert features which gives the customers the opportunity to receive credit-bureau alerts directly to their desktop, free of charge. Deployment is expected in the second quarter of 2011. Based on the Company's operating plan, it expects the cash flow provided from the new marketing strategy and the cash raised in the February 2011 private placement will provide sufficient working capital to fund its 2011 business plan.

We are dependent upon our existing cash balances, along with our expected cash flow generated from gross profits to satisfy our marketing expenditures, general and administrative expenses and debt payments relating to our current operations and planned growth during the short term. Based on the Company's current operating plan, its existing working capital is sufficient to meet the cash requirements to fund the Company's operating expenses, and working capital requirements through December 31, 2011 without additional sources of cash and/or the deferral, reduction or elimination of significant planned expenditures.

Although the Company believes the business plan is achievable, should the Company fail to achieve the sales or gross margin levels anticipated, or if the Company were to incur significant unplanned cash outlays, it would become necessary for the Company to obtain additional sources of liquidity or make further cost cuts to fund its operations. However, there is no assurance that the Company would be able to obtain such financing on favorable terms, if at all, or to successfully further reduce costs in such a way that would continue to allow the Company to operate its business.

The Company has \$99 thousand of cash and cash equivalents on hand at December 31, 2010. In February 2011, the Company completed a private placement to recapitalize the Company which included 3,123,481 units at a price of \$1,000 per unit for aggregate gross proceeds of \$3,123,481. Each unit consists of one share of Series C Preferred Stock in the capital of the Company with an issue price of \$1,000 per share and 5,000 ordinary share purchase warrants. Each Series C Preferred Share is convertible into one ordinary share in the capital of the Company at a conversion price of \$0.10 per share at any time before February 24, 2016. Each warrant is exercisable into one Ordinary Share in the capital of the Company at a price of \$0.12 at any time before February 24, 2016.

Each Series C Preferred Share will be entitled to one vote per share on an as-if converted basis. The board of directors of the Company may, in its discretion, declare an 8% dividend on the Series C

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Preferred Shares outstanding from time to time. The Series C Preferred Shares mature on February 24, 2016 and will be repaid in cash or issuance of a 90 day promissory note on the maturity date. Each Warrant is, at the option of the holder, exercisable on a cashless basis whereby the holder of the Warrant will be entitled to receive that number of Ordinary Shares equivalent to the "in-the-money" value of the Warrants divided by a minimum exercise price of \$0.12 per Ordinary Share.

In connection with the February 2011 offering, the Company solicited the holders of its 10% convertible promissory notes which are outstanding in the principal amount of \$3,203,880 (the "Existing Convertible Notes") to exchange each \$1,000 in principal amount of Existing Convertible Notes for \$200 in cash and that number of Ordinary Shares resulting from the conversion of \$1,000 in principal plus accrued and unpaid interest at a conversion rate of \$0.10 per share. The Company obtained the required 75% consent approval of the Existing Convertible Note holders and converted Existing Convertible Notes into 30,288,769 Ordinary Shares. The balance of the outstanding Existing Convertible Notes was paid to the holders in cash.

In connection with the February 2011 offering, the Company arranged to settle \$814,445 in certain vendor trade payables through the issuance of 8,144,450 Ordinary Shares at an issuance price of \$0.10 per Ordinary Share.

Outstanding share data:

We are authorized to issue up to 450,000,000 ordinary shares and up to 450,000,000 preferred shares. As of April 28, 2011, we have the following equity securities outstanding:

- 101,348,330 ordinary shares.
- 51,113,327 warrants, each of which is exercisable for one ordinary share at prices ranging from \$0.12 to \$0.60.
- 4,410,000 stock options, each of which is exercisable for one ordinary share at prices ranging from \$0.15 to \$0.60 per share.
- 985,000 stock options, each of which is exercisable for one ordinary share at CDN\$0.60 per share.

Off-balance sheet arrangements:

We did not have off-balance sheet arrangements during 2010 or as of December 31, 2010.

Transactions with related parties:

Except for the transactions described above, we have not been a party to any transactions with related parties during the period ended December 31, 2010.

Fourth quarter 2010:

Revenue and gross profit

Our fourth quarter 2010 revenues and gross profit decreased to \$552,795 and \$460,469, respectively, as compared to fourth quarter 2009 revenues and gross profits of \$1,340,975 and \$1,057,358, respectively. The decrease was a result of our declining customer base resulting from our reduced marketing expense and insufficient working capital to acquire new customers.

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Marketing expense

Our fourth quarter 2010 marketing expense decreased to \$146,158 as compared to fourth quarter 2009 marketing expense of \$1,122,266. This decrease reflects the Company's plans to decrease marketing expenses in 2010 in order to conserve cash.

General and administrative expense

Our general and administrative expense amounted to \$668,894 and \$1,090,135 during the fourth quarters of 2010 and 2009, respectively. This \$421,241 decrease in general and administrative expense is due to our plans to reduce expenses in 2010 in order to conserve cash. We reduced the expenses from the 2009 fourth quarter expense levels which primarily relate to a \$224,412 decrease in consulting expense related to information system maintenance and improvements and a \$101,837 decrease in non-marketing wages and related expense resulting from decreased headcount and decreased compensation expense. Also, during the fourth quarter of 2010, legal and accounting expense decreased \$116,178 over the same period in 2009 as we decreased expenses to conserve cash. The decrease in expenses were offset by an increase in travel related expenses as we incurred cost to establish relationships with potential anti-virus companies related to our business plan and New Partnering Strategy.

Interest expense

Interest expense, net of interest income was \$753,021 during the fourth quarter of 2010 as compared to \$434,282 during the fourth quarter 2009. These amounts included non-cash amortization of debt offering costs of nil and \$137,457 during the fourth quarters ended December 31, 2010 and 2009, respectively. Interest expense includes non-cash amortization of debt discount of nil and \$250,204 during fourth quarters ended December 31, 2010 and 2009, respectively. Interest expense during the fourth quarter ending December 31, 2010 also includes a 20% premium payment due upon the maturity on the 2010 and 2009 Notes. The non-cash amortization of debt offering costs and the non-cash amortization of debt discount includes amounts from both the 2009 Notes and the 2010 Notes.

Loss on derivative contract liabilities

During the fourth quarter ending December 31, 2010, we did not record a gain or loss on derivative contract liabilities related to warrants denominated in Canadian dollars, the issue of warrants and a beneficial conversion feature related to our 2010 and 2009 Notes as explained below. During the fourth quarter ending December 31, 2009, we recorded a \$238,700 loss on derivative contract liabilities related to warrants denominated in Canadian dollars, the issue of warrants and a beneficial conversion feature related to our 2009 Notes issued in the fourth quarter of 2009.

We have recorded the fair value of our warrants issued in the first quarter of 2010, the fourth quarter of 2009 and with our IPO in September 2008 as a derivative contract liability in accordance with U.S. GAAP. Each period, we adjust the estimated fair value of these derivative financial instruments as explained above. The detachable warrants and placement agent warrants have been valued separately at fair value using the Black-Scholes methodology. As of March 2010 and October 2009, the fair value calculations assumed a risk-free interest rate of 2.35% and 2.3%, respectively, estimated expected volatility of 50% and 38%, respectively and no dividends. The value assigned to the detachable warrants and placement agent warrants during March 2010 and October 2009 was \$211,780 and \$310,530, respectively using the Black-Scholes option-pricing model and is included in derivative contract liabilities on the Company's consolidated balance sheets. The warrants are adjusted, at each reporting period end, with any increase or decrease in the fair value being recorded in results of operations as an adjustment to

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fair value of derivatives. At December 31, 2010, the fair value of these derivative instruments is \$35,000 which resulted in no gain or loss for the quarter ended December 31, 2010.

The 2009 Notes were determined to have a beneficial conversion feature because the conversion price was less than the market value of the Company's ordinary shares at the time of issuance. The intrinsic value assigned to the beneficial conversion feature during October 2009 is \$323,790 and is included in derivative contract liabilities on the Company's consolidated balance sheets. The beneficial conversion feature is adjusted to reflect fair value, using the Black-Scholes option-pricing model, at each reporting period end, with any increase or decrease in the fair value being recorded in results of operations as an adjustment to fair value of derivatives. At December 31, 2010, the fair value of these derivative instruments is \$2,000 which resulted in no gain or loss for the quarter ended December 31, 2010.

Contingencies:

The Company is involved in various other claims and legal actions in the ordinary course of business. In the opinion of management, the ultimate disposition of all of these matters will not have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows.

Recently adopted accounting pronouncements:

Accounting Standards Updates:

In March 2010, an update was made to "*Derivatives and Hedging*". This update provides clarification and related additional examples to improve financial reporting by resolving potential ambiguity about the breadth of the embedded credit derivative scope exception. This update is effective for each reporting entity at the beginning of the first fiscal quarter beginning after June 15, 2010. We have adopted the provisions of this update as of June 30, 2010 and there was no material impact to our consolidated financial statements.

In April 2010, an update was made to "*Revenue Recognition — Milestone Method*". This update provides amendments to provide guidance on the criteria that should be met for determining whether the milestone method of revenue recognition is appropriate. A vendor can recognize consideration that is contingent upon achievement of a milestone in its entirety as revenue in the period in which the milestone is achieved only if the milestone meets all criteria to be considered substantive. This update is effective on a prospective basis for milestones achieved in fiscal years, and interim periods within those years, beginning on or after June 15, 2010. Earlier adoption is permitted. We have adopted the provisions of this update as of June 30, 2010 and there was no material impact to our consolidated financial statements.

In September 2009, an update was made to "*Fair Value Measurement and Disclosures — Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*", which permits entities to measure the fair value of an investment that is within the scope of the amendments in this update on the basis of net asset value per share of the investment (or its equivalent) if the net asset value of the investment (or its equivalent) is calculated in a manner consistent with the measurement principles of "*Financial Services — Investment Companies*" as of the reporting entity's measurement date, including measurement of all or substantially all of the underlying investments of the investee in accordance with "*Fair Value Measurements and Disclosures*" guidance. This update also requires disclosure by major category of investment about the attributes of investments within the scope of the update. This update is effective for interim and annual periods ending after December 15, 2009. We adopted the provisions of this update as of January 1, 2010 and it did not have a material impact to our condensed consolidated financial statements.

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In June 2009, an update was made to “*Consolidation — Consolidation of Variable Interest Entities*”, to replace the calculation for determining which entities, if any, have a controlling financial interest in a variable interest entity (“VIE”) from a quantitative risk based calculation, to a qualitative approach that focuses on identifying which entities have the power to direct the activities that most significantly impact the VIE’s economic performance and the obligation to absorb losses of the VIE or the right to receive benefits from the VIE. The update requires ongoing assessment as to whether an entity is the primary beneficiary of a VIE, modifies the presentation of consolidated VIE assets and liabilities, and requires additional disclosures about a company’s involvement in VIEs. This update is effective for annual periods beginning after November 15, 2009, for interim periods within the first annual reporting period and for interim and annual periods thereafter. Earlier application is prohibited. We adopted the provisions this update as of January 1, 2010 and it did not have an impact to our condensed consolidated financial statements.

Accounting Standards Updates Not Yet Effective:

In April 2010, an update was made to “*Compensation — Stock Compensation*”. This update provides amendments to clarify that an employee share-based payment award with an exercise price denominated in the currency of a market in which a substantial portion of the entity’s equity securities trades should not be considered to contain a condition that is not a market, performance, or service condition. Therefore, an entity would classify such an award as a liability if it otherwise qualifies as equity. This update is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2010. Earlier adoption is permitted. We will adopt the provisions of this update and do not anticipate a material impact to our consolidated financial statements.

In January 2010, an update was made to “*Fair Value Measurements and Disclosures*”. This update requires new disclosures of transfers in and out of Levels 1 and 2 and of activity in Level 3 fair value measurements. The update also clarifies the existing disclosures for levels of disaggregation and about inputs and valuation techniques. This update is effective for interim and annual reporting periods beginning after December 15, 2009, except for disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements, which are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. We will adopt the provisions of this update and do not anticipate a material impact to our consolidated financial statements.

In October 2009, an update was made to “*Revenue Recognition — Multiple-Deliverable Revenue Arrangements*”. This update amends the criteria in “*Multiple-Element Arrangements*” for separating consideration in multiple-deliverable arrangements and replaces the term fair value in the revenue allocation guidance with selling price to clarify that the allocation of revenue is based on entity-specific assumptions rather than assumptions of a marketplace participant. This update establishes a selling price hierarchy for determining the selling price of a deliverable, eliminates the residual method of allocation and significantly expands the disclosures related to a vendor’s multiple-deliverable revenue arrangements. This update is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. We are currently in the process of evaluating the impact on our condensed consolidated financial statements.

In February 2008, the Accounting Standards Board announced that Canadian GAAP will cease to apply and will be replaced by IFRS, as published by the International Accounting Standards Board. Canadian publicly accountable enterprises will be required to adopt IFRS on or by January 1, 2011. The Company will continue to report its consolidated financial statements under U.S. GAAP and will prepare a reconciliation to IFRS, including comparative information, for the quarter ended March 31, 2011. The Company will also provide a comparative

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reconciliation from U.S. GAAP to IFRS basis, including an opening balance sheet as of January 1, 2011. The Company is currently evaluating the impact of the conversion on the Company's consolidated financial statements.

Financial instruments and other instruments:

We use various types of financial instruments to fund our business capital requirements, including convertible debt and redeemable convertible preferred shares indexed to the market price of our ordinary shares. We evaluate these financial instruments to determine whether derivative features embedded in host contracts require bifurcation and fair value measurement. As a result of our evaluation, our convertible debentures and our redeemable convertible preferred shares did not require bifurcation and fair value measurement of derivative features. In November 2009, we completed a private placement for the sale of senior extendible deferred convertible notes (the, "2009 Notes") that were determined to have a beneficial conversion feature because the conversion price was less than the market value of the Company's ordinary shares at the time of issuance.

We incurred debt offering costs related to the issuance of the 2010 and 2009 Notes and these costs are capitalized as debt offering costs on the consolidated balance sheets and are charged to interest expense using the straight-line method which approximates the effective interest method over the life of the 2010 and 2009 Notes. During the year ended December 31, 2010, we recognized non-cash interest expense of \$455,188 relating to amortization of the debt offering costs related to the 2010 and 2009 Notes. Unamortized debt offering costs were nil and \$384,116 at December 31, 2010 and 2009, respectively.

The detachable warrants and placement agent warrants issued with the 2009 Notes have been valued separately at fair value using the Black-Scholes methodology. The fair value calculations assumed a risk-free interest rate of 2.3%, estimated expected volatility of 38% and no dividends. The value assigned to the detachable warrants and placement agent warrants during October 2009 is \$310,530 using the Black-Scholes option-pricing model and is included in derivative contract liabilities on the Company's consolidated balance sheets.

The detachable warrants and placement agent warrants issued with the 2010 Notes have been valued separately at fair value using the Black-Scholes methodology. The fair value calculations assumed a risk-free interest rate of 2.35%, estimated expected volatility of 50% and no dividends. The value assigned to the detachable warrants and placement agent warrants during February 2010 is \$211,780 using the Black-Scholes option-pricing model and is included in derivative contract liabilities on the Company's consolidated balance sheets.

Original debt discount of \$211,780 and \$310,530 associated with our outstanding 2010 and 2009 Notes represents the original fair value of the detachable warrants that were issued in conjunction with the notes. This debt discount is amortized using the straight-line method, which approximates the effective interest method, as interest expense over the life of each of the 2010 and 2009 Notes. During the year ended December 31, 2010, we recognized non-cash interest expense applicable to discount amortization of \$399,835.

The 2009 Notes were determined to have a beneficial conversion feature because the conversion price was less than the market value of the Company's ordinary shares at the time of issuance. The intrinsic value assigned to the beneficial conversion feature during October 2009 is \$323,790 and is included in derivative contract liabilities on the Company's consolidated balance sheets. This debt discount is amortized using the straight-line method, which approximates the effective interest method, as interest expense over the life of the 2009 Notes. During the year ended December 31, 2010, we recognized non-cash interest expense applicable to discount amortization of \$196,061.

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We have limited exposure to credit risk as sales to customers are usually immediately paid by credit card. Our reserve for refunds and credit card charge backs was \$3,472 at December 31, 2010 and our accounts receivable balance was \$72,892 at December 31, 2010. Currently, we do not have significant credit risk exposure due to the small magnitude of these balances and the nature of our operations.

Currently, our interest rate risk exposure is limited as all our outstanding debt at December 31, 2010 has fixed interest rates and the impact of interest rate changes on our other financial instruments (mainly derivative contract liabilities) would be minimal.

The fair market value of our derivative contract liabilities is very sensitive to the market price of our ordinary shares and our estimate of share price volatility. Our consolidated audited financial statements for the year ended December 31, 2010 and related MD&A contains additional information regarding our derivative contract liabilities. Additional information may be found in these reports.

Outlook:

We are a start-up company. As such, key statistics such as customer retention rates, cost of customer acquisition, and lifetime revenue per customer are not yet well established.

Our future revenues depend on the successful marketing of our services. Our marketing campaigns have to attract sufficient business to produce revenue that will enable us to meet our operating expenses and fund our future growth plans. As of December 31, 2010, we had approximately 18,000 customers with active subscriptions. Our active customer count is down at December 31, 2010 as compared to 25,000 at December 31, 2009. An active customer is defined as a customer who has paid monthly subscription fee and is no more than 60 days past due.

We are also facing new and existing competitors engaged in providing solutions for identity theft. Our future operations will require monitoring the marketplace for items such as service pricing, service innovations and marketing strategies.

Our business plan for 2011 calls for a new marketing strategy in which the Company aligns itself with anti-virus companies to offer its services as an integrated solution on the desktops of customers subscribing to anti-virus products for free credit alert features which gives the customers the opportunity to receive credit-bureau alerts directly to their desktop, free of charge. Deployment is expected in the second quarter of 2011. Based on the Company's operating plan, we expect the cash flow provided from the new marketing strategy and the cash raised in the February 2011 private placement to provide sufficient working capital to fund our 2011 business plan.

Because we have been in commercial operation for a short period of time, our revenue, cost of revenue, gross profit and net loss reported for the year ended December 31, 2010, may not be indicative of future results. We have invested in our infrastructure in order to make the delivery of our services highly automated and, therefore, if we grow our customer base, we expect that our gross profits will improve as our revenue growth expands. We are dependent upon our existing cash balances, along with our expected cash flow generated from gross profits to satisfy our marketing expenditures, general and administrative expenses, and cash interest payments relating to our current operations and planned growth during the short term. However, if we are not successful in acquiring and retaining customers at anticipated rates we will need additional financing to continue, grow and sustain our business.

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Forward-looking statements:

Our MD&A contains “forward-looking information” that is based on ID Watchdog, Inc.’s expectations, estimates and projections as of the dates as of which those statements were made. This forward-looking information includes, among other things, statements with respect to ID Watchdog, Inc.’s business and marketing strategies, plans, outlook, services, projections, targets and expectations as to future revenue, gross profit margins, liquidity and cash flow from operations, working capital requirements, projections regarding new customers, active customers and customer retention rates, currency exchange rates, expectations regarding industry trends, and competitive position in the marketplace. Generally, this forward-looking information can be identified by the use of forward-looking terminology such as “outlook”, “anticipate”, “project”, “target”, “believe”, “estimate”, “expect”, “intend”, “should”, “scheduled”, “will”, “plan” and similar expressions. Forward-looking information is subject to known and unknown risks, uncertainties and other factors that may cause ID Watchdog, Inc.’s actual results, level of activity, performance or achievements to be materially different from those expressed or implied by such forward-looking information, including but not limited to:

- Uncertainties related to and our limited operating history;
- Uncertainties associated with sufficient operating income and future losses;
- Uncertainties associated with marketing studies and strategies;
- Uncertainties associated with market acceptance of our services;
- Uncertainties associated with market competition;
- Uncertainties over future products we envisage from our new Acxiom relationship may never achieve market acceptance;
- Risks related to operating in consumer information services regulated by federal and state laws of consumer data and consumer advertising;
- Risks related to a responsibility to secure active and former customer data from any potential data breach and any costs to compensate the customer for such breach;
- Uncertainties associated with general economic conditions;
- Uncertainties related to our dependence upon outside suppliers to provide us databases which enable us to provide our services to customers;
- Reliance upon merchant banks to process credit card payments;
- Risks related to credit card payment processing rules and restrictions relating to excessive chargebacks;
- Uncertainties pertaining to our ability to protect our intellectual property including service marks, trademarks and patents;
- Uncertainties relating to claims from others that our intellectual property has infringed on the proprietary right of others;
- Changes in laws that allow consumers to access personal information records and give consumers the right to request correction of inaccurate records;
- Interpretations of insurance and credit services regulations that would cause our services to be subject to such regulations;
- Uncertainties related to obtaining additional funding;

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- Uncertainties related to fluctuations in Canadian and US dollar exchange rates;
- Uncertainties related to adequacy or effectiveness of internal controls;
- Reliance on key personnel; and
- Uncertainties related to legal proceedings.

A discussion of these and other factors that may affect our actual results, performance, achievements or financial position is contained in our filings with the Canadian provincial securities regulatory authorities. This list is not exhaustive of the factors that may affect our forward-looking information. These and other factors should be considered carefully and readers should not place undue reliance on such forward-looking information. Forward-looking statements contained in this MD&A are based on the beliefs, expectations and opinions of management on the date the statements are made, and the company does not assume any obligation to update forward-looking statements if circumstances or management's beliefs, expectations or opinions should change, except as required by law.