ID WATCHDOG, INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS
December 31, 2008
(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, 2008 has been prepared based on information available to us as of April 27, 2009 and is intended to be read in conjunction with our audited consolidated financial statements and the related notes for the year ended December 31, 2008. 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, 2008, of CDN$1.00 = US$0.8166.

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 two years, we increased our marketing expenditures from $1.4 million in 2007 to $8.3 million during 2008.

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."

On December 31, 2008, we had $5.1 million of cash and cash equivalents on hand.

During 2008, our first full year of commercial operations, we enrolled approximately 210,000 new customers and as of December 31, 2008, we had approximately 38,000 customers with active subscriptions, an increase of approximately 9,000 customers with active subscriptions as compared to December 31, 2007 levels.

In an effort to improve our customer retention rates and to lower our customer acquisition costs, in November 2008, we discontinued the use of one of our marketing affiliates which provided access to new customers and we established relationships with new affiliates. As a result of this shift, our new customer acquisitions declined in December to less than 1,000 which was significantly below our goal.

In November and December 2008, we began to focus our marketing efforts on additional marketing affiliate relationships and Internet affiliates and decreased our direct response campaigns. As a result, we generated over 40,000 new customers during the first quarter of 2009.

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 developed three services that we believe will benefit our customers by detecting and resolving identity theft and other consumer report data problems. Our three services, ID Watchdog^{SM}, ID SnapShot^{SM} and ID Rehab^{SM} are specifically designed to work together and are generally offered together through our ID Watchdog Plus^{SM} plan for a monthly, annual or multi-year subscription fee. Our ID Watchdog^{SM} service examines consumer databases to identify leading indicators of identity theft or manipulation. Customers are alerted upon the occurrence of events which signal that identify theft or personal identity data manipulation may be occurring. Our ID SnapShot^{SM} service provides more detailed information about a consumer's identity data to pinpoint and scope suspected data manipulation. Once a customer's identity problem is identified, our ID Rehab^{SM} identity theft resolution service is used to assist the customer in correcting and restoring records to the state before the data manipulation occurred.

(Expressed in U.S. Dollars)

Selected financial information:

Our financial information set out below is based on and derived from our audited 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 2007 and 2006 financial information was derived from the audited consolidated financial statements of ID Rehab Corporation, our predecessor company. The following selected financial information has been prepared in accordance with U.S. GAAP. For a reconciliation to Canadian generally accepted accounting principles see Note 11 to the consolidated financial statements.

	Year Ended December 31,		
	2008	2007	2006
Revenue	$ 4,688,290	$ 159,681	$ 29,962
Gross profit	3,559,495	72,693	8,881
Operating expense	(11,643,833)	(2,816,530)	(1,313,354)
Operating loss	(8,084,338)	(2,743,837)	(1,304,473)
Net loss	(8,144,754)	(3,120,374)	(1,312,399)
Dividends, deemed dividends and accretion of discount related to redeemable convertible preferred shares	(2,782,704)	—	—
Net loss applicable to ordinary shares	$ (10,927,458)	$ (3,120,374)	$ (3,12,399)
Basic and diluted net loss per share	$ (0.37)	$ (0.17)	$ (0.08)

	December 31, 2008	December 31, 2007	December 31, 2006
Balance Sheet Data:			
Cash and cash equivalents	$ 5,117,596	$ 631,665	$ 308
Total assets	$ 6,175,539	$ 1,408,385	$ 108,161
Total long-term liabilities	$ 7,854	$ 3,466,425	$ 279,343
Total liabilities	$ 4,372,283	$ 3,930,493	$ 446,435
Total shareholders' equity (deficit)	$ 1,803,256	$ (2,522,108)	$ (338,274)

Summary of quarterly results:

	2008 Quarter 4	2008 Quarter 3	2008 Quarter 2	2008 Quarter 1
Revenue	$ 1,409,959	$ 1,282,631	$ 1,104,374	$ 891,326
Net loss	$(1,782,714)	$(1,866,300)	$(2,583,736)	$(1,912,004)
Net loss applicable to ordinary shares	$(1,782,714)	$(3,364,704)	$(3,140,487)	$(2,639,553)
Basic and diluted net loss per share	$ (0.04)	$ (0.11)	$ (0.16)	$ (0.13)

	2007 Quarter 4	2007 Quarter 3	2007 Quarter 2	2007 Quarter 1
Revenue	$ 136,293	$ 16,176	$ 5,357	$ 1,855
Net loss	$(1,475,673)	$ (928,743)	$ (358,967)	$ (356,991)
Net loss applicable to ordinary shares	$(1,475,673)	$ (928,743)	$ (358,967)	$ (356,991)
Basic and diluted net loss per share	$ (0.08)	$ (0.05)	$ (0.02)	$ (0.02)

During the fourth quarter of 2007, we transitioned from a development stage enterprise into an operating company. Our revenue increased during the four most recent fiscal quarters as a result of the ramp-up of our commercial operations.

Our quarterly net losses during the first two quarters of 2007 were mainly comprised of general and administrative expenses. During the third quarter of 2007, we began marketing our services. Our net losses increased significantly during the third quarter of 2007 through the second quarter of 2008 mainly due to increased marketing expenses during each of these four quarters. Our net loss decreased during the third quarter of 2008 as compared to the second quarter of 2008 as we reduced marketing expenditures during the third quarter of 2008 in order to conserve cash prior to the date of our IPO. Our net loss decreased during the fourth quarter of 2008 as compared to the third quarter of 2008 as we increased our marketing expenditures and general and administrative expenses subsequent to receiving cash from our IPO, and these increases were offset by the recognition of a $757,722 non-cash gain on derivative contract liabilities.

Our net loss applicable to ordinary shares increased during the first three quarters of 2008 due to our increasing net losses discussed above and as a result of dividends on redeemable convertible preferred shares, deemed dividends on redeemable convertible preferred shares and accretion of the discount related to redeemable convertible preferred shares. We incurred a total of $2,782,704 of non-cash expenses relating to our redeemable convertible preferred shares during the period January 28, 2008 through September 5, 2008, the date that our redeemable convertible preferred shares were converted into ordinary shares and warrants to purchase ordinary shares. Our net loss applicable to ordinary shares decreased during the fourth quarter of 2008 as compared to the third quarter of 2008 as we did not incur expenses related to redeemable convertible preferred shares during the fourth quarter of 2008.

Results of operations:

Revenue and gross profit

For the years ended December 31, 2008 and 2007, we recognized revenue of $4,688,290 and $159,681, respectively, from the sale of our services. Our cost of revenue for the year ended December 31, 2008, was $1,128,795 resulting in a gross profit of $3,559,495, while our cost of revenue for the year ended December 31, 2007, was $86,988 resulting in a gross profit of $72,693. Our revenue, cost of revenue and gross profit increased significantly during 2008 as compared to 2007, as we commenced commercial operations during the fourth quarter of 2007 and we have since realized a significant increase in our customer base as a result of implementing our marketing plans.

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 2008, was $8,264,961 as compared to $1,362,521 for 2007. This increase reflects the costs related to implementation of our marketing strategies and marketing efforts which began in the third quarter of 2007. We expect marketing expense to increase during 2009 as compared to 2008 as we are increasing our efforts to expand our customer base.

In January 2008, we entered into a month-to-month services agreement with Veracity Credit Consultants, LLC ("VCC"), an entity controlled by Justin Yurek, ID Watchdog's President, to provide call center facilities and call center services at prevailing market rates. We incurred $248,599 of related party call center marketing expense relating to this arrangement during 2008.

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 $3,400,000 and $1,400,000 during 2008 and 2007, respectively. This $2,000,000 increase in general and administrative expense was due in part to a $700,000 increase in consulting expense mainly related to information system maintenance and improvements and a $500,000 increase in non-marketing wages and related expense resulting from increased headcount (31 non-marketing employees at December 31, 2008 compared to 12 non-marketing employees at December 31, 2007), with the remaining $800,000 increase due to increases in office-related expenses, travel and entertainment expenses and other general and administrative expenses as a result of our increased headcount and growth of our operations.

During 2008, we incurred related party consulting expense of $262,784 as compared to $346,082 during 2007, a decrease of $83,298. During 2008, we incurred $162,288 of consulting expense for services from Daryl Yurek, our Chairman and CEO, as compared to $100,000 in 2007. This increase was a result of an increase in compensation rates. Consulting services provided by one of our directors increased to $93,000 in 2008 from $43,000 in 2007 and consulting services provided by VCC increased to $7,496 in 2008 from nil in 2007. These increases reflect increased compensation rates and increased levels of service provided by this individual and our affiliate.

These increases were offset by decreases resulting from our discontinuance of incurring related party consulting expense ($39,000 during 2007) for consulting services provided by Justin Yurek, our President, who became an employee in the third quarter of 2007, and effective January 1, 2008, our discontinuance of classifying Advisory Board member fees (which included fees from our former President) and share-based employee compensation expense ($129,440 and $34,642, respectively, during 2007) as related party consulting expense. These fees and expenses are now included in other components of our general and administrative expense in 2008.

Interest expense

In June and July 2007, we issued $3,725,291 of convertible debentures that bear interest at 9% per annum and mature two years from the date of issuance.

Interest expense during the years ended December 31, 2008 and 2007, totalled $843,098 and $422,338, respectively. These amounts included non-cash amortization of debt offering costs of $326,738 and $140,826 during 2008 and 2007, respectively. Interest expense also included non-cash amortization of debt discount of $184,632 and $91,356 during 2008 and 2007, respectively.

During 2007, we incurred $17,890 of related party interest expense applicable to convertible notes that we owed to VCC. These notes were paid in full during the third quarter of 2007. We did not incur related party interest expense in 2008.

Expense applicable to redeemable convertible preferred shares

During the year ended December 31, 2008, we issued $3,500,000 and $995,000 of Series A and Series B Preferred shares, respectively. On September 5, 2008, all Series A Preferred and Series B Preferred shares outstanding and all related accrued dividends payable were converted into IPO Units, each Unit consisting of one ordinary share and one-half of one ordinary share purchase warrant ("IPO Units") in accordance with the terms of the automatic conversion rights included in our Amended and Restated Articles of Association.

During 2008, we recorded $285,388 of dividends on redeemable convertible preferred shares in our consolidated statements of operations.

The original discount of $2,497,316 associated with these securities represented the fair value of the detachable warrants ($420,265) and the fair value of the beneficial conversion features ($2,077,051) on the dates that these securities were issued. This discount was amortized as accretion of discount related to redeemable convertible preferred shares and deemed dividends on redeemable convertible preferred shares, respectively, in our consolidated statements of operations up until the date of conversion. On September 5, 2008, the remaining unamortized discount applicable to the detachable warrants ($123,237) and the unamortized discount applicable to the beneficial conversion features ($762,515) was charged to accretion of discount related to redeemable convertible preferred shares and deemed dividends on redeemable convertible preferred shares, respectively. Together, with the write-off of the remaining unamortized discounts, the accretion of discount related to redeemable convertible preferred shares and deemed dividends on redeemable convertible preferred shares totalled $420,265 and $2,077,051, respectively, during 2008.

Liquidity and capital resources:

Past financings

Historically, we have funded our operations primarily through private placements of equity and debt, including loans and contributions from our founders. During the period from inception (July 27, 2005) through December 31, 2007, we raised $4.9 million, net of related issuance costs, through the private placement of ordinary shares, convertible debt and warrants to purchase ordinary shares. Through December 31, 2008, we used $4.5 million of this initial capital to develop and market our services and $0.4 million to repay debt.

Recent financings

On January 28, 2008, we issued 1,750,000 Series A Preferred shares and detachable five-year warrants to purchase 3,000,000 of our ordinary shares at an exercise price of $0.35 per share for gross proceeds of $3.5 million. During May and June 2008, we issued 497,500 Series B Preferred shares and detachable five-year warrants to purchase 425,860 of our ordinary shares at an exercise price of $0.60 per share for gross proceeds of $1.0 million. On June 24, 2008, we completed a private placement of 1,041,667 ordinary shares and detachable warrants to purchase 734,374 of our ordinary shares at exercise prices ranging from $0.60 to $0.90 for gross proceeds of $0.5 million. We used the $5.0 million proceeds from these offerings to develop and market our services during 2008.

IPO

On September 5, 2008, we completed our IPO consisting of 17,000,000 Units, each Unit consisting of one ordinary share and one-half of one ordinary share purchase warrant. Each whole warrant entitles the holder to purchase one additional ordinary share at a price of CDN$0.90 per share for a period of 24 months from the Listing Date. Net proceeds were $8.1 million and we have used $2.9 million of these proceeds to develop and market our services through December 31, 2008.

A comparison of the expected net proceeds and use of proceeds from the IPO and our revised estimate of the same at December 31, 2008 follows:

	Previously Reported[1]		Revised Estimate as of December 31, 2008	
Expected net proceeds	$	8,342,000	$	8,144,000
Direct response advertising	$	4,652,000	$	1,952,000
Commissions to marketing agents		1,962,000		4,714,000
Call center marketing operations		1,126,000		252,000
Other marketing expenses		424,000		1,110,000
Working capital		178,000		116,000
Total	$	8,342,000	$	8,144,000

[1]Expected net proceeds and expected use of proceeds were previously reported in CDN$ in our long form prospectus dated August 14, 2008. Those amounts were converted into U.S. dollars here using an exchange rate in effect at August 14, 2008 of CND $1.00 equals U.S.$0.9416.

Our actual net proceeds were approximately $198,000 less than our initial expectations as our actual cash expenses relating to our IPO exceeded our initial estimates by this amount (mainly as a result of additional legal fees). During the fourth quarter of 2008 and during the first quarter of 2009, we modified our marketing plans and began to focus our marketing activities on additional affiliate relationships, Internet affiliates and decreased our direct response TV campaigns. We also increased our in-house marketing staff which resulted in increases to our previously reported estimate of "other" marketing expenses.

Cashflows

As of December 31, 2008, we had total cash on hand of $5,117,596 and working capital of $1,070,012.

During 2008 and 2007, we had cash outflows from operations of $7,860,966 and $2,369,205, respectively. This increase was a result of increased marketing efforts and increased general and administrative expense resulting from our growth during the past year.

Cash flows used for investing activities increased to $535,532 during 2008 from $151,488 during 2007 mainly as a result of increased expenditures for information technology systems designed and implemented to handle our increased customer base.

Cash flows from financing activities increased to $12,882,429 during 2008 from $3,152,050 during 2007 as a result of the following financings:

	Year Ended December 31, 2008	Year Ended December 31, 2007
Proceeds from convertible debentures and warrants	$ —	$ 3,177,483
Proceeds from issuance of Series A Preferred shares and warrants	3,500,000	—
Proceeds from issuance of Series B Preferred shares and warrants	995,000	—
Proceeds from issuance of ordinary shares and warrants	500,000	—
Proceeds from IPO, net of IPO, Series A and Series B shares and warrants issuance costs	7,621,710	—
Proceeds from exercise of warrants and stock options, net	268,154	—
All other, net	(2,435)	(25,433)
Net cash provided by financing activities	$ 12,882,429	$ 3,152,050

Commitments

Except for our interest payments of approximately $187,000 and our $186,978 of expense relating to operating and capital lease commitments, our other expenditures, including marketing expenditures, are discretionary in nature. This gives us the ability to adjust our spending if our gross profits are insufficient to fund planned expenditures.

Capital resources

On December 31, 2008, we had stock options outstanding denominated in U.S. dollars to purchase 3,375,000 ordinary shares. In addition, we had stock options outstanding denominated in Canadian dollars to purchase 647,000 ordinary shares as of December 31, 2008. If exercised, these stock options would generate approximately $1.5 million and CDN$0.4 million in additional cash, respectively.

At December 31, 2008 we had warrants outstanding denominated in Canadian dollars which are exercisable for 15,183,528 ordinary shares and which, if exercised, would generate approximately CDN$13.3 million in additional cash. In addition, at December 31, 2008, we had 19,898,284 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 $7.9 million potential total cash proceeds from the exercise of these warrants if they are exercised due to the aforementioned cashless exercise provisions.

We are seeking to convert our outstanding convertible debentures into ordinary shares on or before their maturity dates in June and July 2009. We believe that one large shareholder and another entity, Bolder Venture Partners, which is controlled by the Company's CEO, will convert their outstanding debentures totalling $2.0 million into ordinary shares. We also believe that other debenture holders will convert their debentures into ordinary shares as the recent market price of our ordinary shares has been significantly higher than the $0.28 per share conversion price of the convertible debentures. However, we may be required to immediately redeem our convertible debentures outstanding for an amount equal to 130% of the principal balance upon the occurrence of certain events, including a change in control of our company. In this event, we could be required to expend up to $4.6 million in cash to redeem our convertible debentures. If none of our convertible debentures remaining outstanding at December 31, 2008 are converted into ordinary shares prior to their maturity dates in June and July 2009, we would then be required to repay the aggregate principal amount of $3,566,200 plus accrued and unpaid interest in cash.

If either of these events were to occur, we might be required to curtail marketing expenditures or raise additional funds.

Our 2009 business plan calls for significant growth in the number of new customers during the year and growth in the number of active customers at year end. We plan to hold gross margins steady in 2009 and plan to hold general and administrative expenses in line with fourth quarter 2008 levels. Our 2009 business plan calls for us to achieve positive monthly cash flows and profitability during the second half of 2009.

We believe that our existing cash balances, along with our expected cash flow to be generated from gross profits, will allow us to satisfy our marketing expenditures, general and administrative expenses, and cash interest payments relating to our current operations and planned growth during both the short term and long term.

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 27, 2009, we have the following equity securities outstanding:

- 50,088,375 ordinary shares.
- 19,898,284 warrants, each of which is exercisable for one ordinary share at prices ranging from $0.35 to $0.90.
- 15,183,528 warrants, each of which is exercisable for one ordinary share at prices ranging from CDN$0.60 to CDN$0.90.
- 3,223,750 stock options, each of which is exercisable for one ordinary share at prices ranging from $0.15 to $0.60 per share.
- 1,442,000 stock options, each of which is exercisable for one ordinary share at CDN$0.60 per share.
- convertible debentures convertible into 12,647,144 ordinary shares.

Off-balance sheet arrangements:

We did not have off-balance sheet arrangements during 2008 or as of December 31, 2008.

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, 2008.

Fourth quarter 2008:

Our fourth quarter 2008 revenues and gross profit increased to $1,409,959 and $1,088,797, respectively, as compared to fourth quarter 2007 revenues and gross profits of $136,293 and $62,311, respectively, as a result of our significant growth in 2008.

Our fourth quarter 2008 marketing expense increased to $2,112,435 as compared to fourth quarter 2007 marketing expense of $948,435 as a result of our significant growth in 2008.

Our general and administrative expense amounted to $1,304,270 and $409,834 during the fourth quarters of 2008 and 2007, respectively. This $894,436 increase in general and administrative expense was due to a

$422,618 increase in consulting expense mainly related to information system maintenance and improvements and a $226,779 increase in non-marketing wages and related expense resulting from increased headcount (31 non-marketing employees at December 31, 2008 compared to 12 non-marketing employees at December 31, 2007), with the remaining $245,039 increase due to increases in office-related expenses, travel and entertainment expenses and other general and administrative expenses as a result of our increased headcount and growth of our operations.

Interest expense, net of interest income was $177,334 during the fourth quarter of 2008 as compared to $179,715 during the fourth quarter 2007.

During the fourth quarter of 2008 we recognized a non-cash gain on derivative liabilities of $757,722 as compared to nil during the fourth quarter of 2007. This gain resulted from marking our derivative contract liabilities (warrants denominated in Canadian dollars) to a market value of $21,983 on December 31, 2008 from the original fair value of $779,705 recorded upon issuance of the warrants during the third quarter of 2008. The decrease in the fair value of our derivative contract liability was mainly due to the decrease in the market price of our ordinary shares.

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:

Effective January 1, 2008, we adopted SFAS No. 157, "Fair Value Measurements" ("SFAS 157"), for all financial instruments and non-financial instruments accounted for at fair value on a recurring basis. SFAS 157 provides a definition of fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. Our valuation methods used in 2008 were consistent with those used in prior years and, therefore, the adoption of SFAS 157 did not have an impact on the our consolidated financial statements.

SFAS 157 establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

Level 1 – inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 – inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3 – inputs to the valuation methodology are unobservable and significant to the fair value measurement.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

(Expressed in U.S. Dollars)

The following table presents information about our liabilities measured at fair value on a recurring basis as of December 31, 2008, and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value:

	Fair Value	Level 1	Level 2	Level 3
Derivative contract liabilities – warrants	$ 21,983	$ —	$ 21,983	$ —

Effective January 1, 2008, we also adopted SFAS No. 159, "Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS 159"). Under SFAS 159, entities may choose to measure at fair value certain financial instruments and other items at fair value that are not currently required to be measured at fair value. The adoption of this pronouncement did not have any effect on our consolidated financial statements, because we did not elect the fair value methodology permitted under SFAS 159 for any financial instruments or other items that are not currently required to be measured at fair value.

Effective January 1, 2007, we adopted the Financial Accounting Standards Board's ("FASB") Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an Interpretation of the Financial Accounting Standard Board's ("FASB") Statement No. 109" ("FIN 48") which prescribes a comprehensive model for how we should recognize, measure, present and disclose our uncertain tax positions taken or expected to be taken on a tax return. We have evaluated our tax positions and have determined that the adoption of FIN 48 did not have an impact on our consolidated financial statements.

Recently issued accounting pronouncements:

In June 2008, the FASB's Emerging Issues Task Force ("EITF") reached a consensus on EITF Issue No. 07-5, "Determining Whether an Instrument (or Embedded Feature) is Indexed to an Entity's Own Stock" ("EITF 07-5") and establishes a two-step process for making such determination. EITF 07-5 will be effective for fiscal years beginning after December 15, 2008. We are currently evaluating the impact of EITF 07-5 and we have not yet determined the impact on our financial statements.

In May 2008, the FASB issued Staff Position APB 14-1, "Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)" ("FSP APB 14-1"). FSP APB 14-1 specifies that issuers of convertible debt instruments that may be settled in cash upon conversion should separately account for the liability and equity components in a manner that will reflect the entity's nonconvertible debt borrowing rate. This FSP is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early adoption is not permitted. FSP APB 14-1 is to be applied retrospectively. Our convertible debt does not have cash settlement conversion features and therefore the adoption of FSP APB 14-1, effective January 1, 2009, will not have an impact on our consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities - an Amendment of FASB Statement No. 133" ("SFAS 161") which enhances the disclosure requirements about derivatives and hedging activities. SFAS 161 requires additional narrative disclosure about how and why an entity uses derivative instruments, how they are accounted for under SFAS 133, and what impact they have on financial position, results of operations and cash flows. SFAS 161 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after November 15, 2008. As SFAS 161 only enhances disclosures, the adoption of SFAS 161, effective January 1, 2009, will not have an impact on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements — An Amendment of ARB No. 51" (SFAS 160). SFAS 160 requires that accounting and reporting for minority interests be recharacterized as noncontrolling interests and classified as a component of equity. The standard is effective for our fiscal year 2009 and must be applied prospectively. We do not expect the adoption of SFAS 160 will have a material impact on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (Revised 2007), "Business Combinations" ("SFAS 141R"). SFAS 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. The statement also establishes disclosure requirements that will enable users to evaluate the nature and financial effects of the business combination. FAS 141R is effective for our fiscal year 2009 and must be applied prospectively to all new acquisitions closing on or after January 1, 2009. Early adoption of this standard is not permitted. We do not expect the adoption of FAS 141R will have a material impact on our 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.

At December 31, 2008, we had $3,566,200 of convertible debentures outstanding. These financial instruments are included in our consolidated balance sheets under the caption convertible debentures at an amortized cost of $3,481,677 which approximates fair value. Original debt discount of $345,115 associated with our outstanding convertible debentures represents the original fair value of the detachable warrants that were issued in conjunction with our convertible debentures. This debt discount is being amortized using the straight-line method, which approximates the effective interest method, as interest expense over the two-year life of the convertible debentures, which are due in June and July 2009. During the years ended December 31, 2008 and 2007, we recognized non-cash interest expense applicable to discount amortization of $184,632 and $91,356, respectively.

In addition, we incurred $627,754 of debt offering costs associated with the issuance of our convertible debentures and these costs are included in our consolidated balance sheets under the caption debt offering costs, net. Our debt offering costs are being amortized as interest expense over the two-year life of the convertible debentures using the straight-line method which approximates the effective interest method. During the years ended December 31, 2008 and 2007, we recognized non-cash interest expense of $326,738 and $140,826, respectively, relating to amortization of our debt offering costs. Unamortized debt offering costs were $160,072 and $486,810 at December 31, 2008 and December 31, 2007, respectively.

During 2008, we issued $4,495,000 of 12% redeemable convertible preferred shares along with warrants to purchase ordinary shares. All of these shares and all accrued dividends payable applicable to these shares converted into IPO Units on September 5, 2008.

The fair value of the warrants in the amount of $420,265 and the fair value of the beneficial conversion feature in the amount of $2,077,051 associated with these shares were initially recorded as discounts to redeemable convertible preferred shares and these discounts were amortized to expense during the period that these shares were outstanding. We also accrued dividends payable of $285,388 during the period that these shares were outstanding.

During the year ended December 31, 2008, we recognized $2,782,704 of non-cash expense applicable to our redeemable convertible preferred shares.

During 2008, we issued 15,183,528 two-year detachable warrants to purchase our ordinary shares at exercise prices ranging from CND$0.60 to CND$0.90. Since these warrants are denominated in a currency that is different from our functional currency (the U.S. dollar) the fair value of these warrants are recorded as a derivative contract liability and the fair value is re-measured at the end of each reporting period with any change in fair value recorded as a gain or loss on derivative contract liability in our consolidated statements of operations. The fair value of the derivative contract liabilities is measured using the Black-Scholes valuation model.

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 $21,628 at December 31, 2008 and our accounts receivable balance was $71,665 at December 31, 2008. Currently, we do not have significant credit risk exposure due 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, 2008 has fixed interest rates and the impact of interest rate changes on our other financial instruments (mainly derivative contract liabilities) would be minimal. At December 31, 2008 we had $244,978 of cash and cash equivalents denominated in Canadian dollars. A 10% decrease in the exchange rate between the US dollar and the Canadian dollar would result in a foreign currency exchange loss of approximately $24,000.

The fair market value of our derivative contract liabilities at December 31, 2008 is very sensitive to the market price of our ordinary shares and our estimate of share price volatility. For example, if our December 31, 2008 share price was $0.47 as compared to the actual share price of $0.237, the value of our derivative contract liability would be approximately $550,000 as compared to our book value of $21,983 on December 31, 2008. Similarly, if our estimate of share price volatility at December 31, 2008 were 76% as opposed to the 38% estimated volatility used, the value of our derivative contract liability would be approximately $390,000 as compared to our book value of $21,983 on December 31, 2008. If both the share price and estimated share price volatility were increased to $0.47 and 76% at December 31 2008, respectively, the fair value of our derivative contract liability would be approximately $1.9 million as compared to our book value of $21,983 on December 31, 2008.

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. During the year ended December 31, 2008, we enrolled approximately 210,000 new customers and as of December 31, 2008, we had approximately 38,000 customers with active subscriptions.

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.

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, 2008, 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.

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 marketing studies and strategies;
- Uncertainties associated with market acceptance of our services;
- Uncertainties associated with market competition;
- 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 servicemarks, trademarks and patents;
- 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;

- 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.