

**ID Watchdog, Inc.**  
**Management's Discussion and Analysis**  
**For the Three and Six Months ended June 30, 2013**

**Introduction**

The following discussion and analysis provides information that management believes is relevant to an assessment and understanding of ID Watchdog, Inc.'s (the "Company's or the "Company") consolidated results of operations and financial position. This "Management's Discussion and Analysis" ("MD&A") should be read in conjunction with the unaudited interim financial statements for the three and six months ended June 30, 2013 and the audited annual consolidated financial statements of the Company for the year ended December 31, 2012 and the notes thereto. These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") and are presented in US dollars as all of the Company's revenues and expenses are recorded in US dollars. Additional information on the Company, including the Company's audited financial statements for the year ended December 31, 2012, can be obtained from SEDAR at [www.sedar.com](http://www.sedar.com) as well as from the Company's website at [www.idwatchdog.com](http://www.idwatchdog.com) in the "Company Overview" section. Information contained in this report is qualified by reference to the discussion concerning forward-looking information and statements beginning on page 18 of this MD&A.

**Definitions Relative to Understanding our Results**

Income from Operations before Depreciation and Amortization and Stock-Based Compensation ("EBITDA")

We report on our EBITDA (operating income before depreciation and amortization and stock-based compensation) and use this metric to measure the performance of our business. EBITDA is not a performance measure defined under IFRS and is not considered an alternative to income (loss) from operations or net earnings (loss) in the context of measuring the Company's performance. EBITDA does not have a standardized meaning and is therefore not likely to be comparable with similar measures used by other publically traded companies. EBITDA should not be used as an exclusive measure of cash flow since it does not account for the impact of working capital changes, taxes, interest payments, capital expenditures, debt principal reductions and other sources and uses of cash, which are disclosed on pages 12 and 13 of this MD&A.

**International Financial Reporting Standards ("IFRS")**

The Company's unaudited interim consolidated financial statements and the financial information included in this MD&A have been prepared in accordance with IFRS as issued by the International Accounting Standards Board ("IASB") and interpretations of the International Financial Reporting Interpretations Committee ("IFRIC") that are effective as of August 27, 2013.

Except as otherwise noted, this MD&A is presented in United States dollars, which is the Company's functional currency.

**Background and Description of Business**

The Company provides a variety of identity theft detection, protection and resolution services primarily to individual customers on a subscription basis, through its wholly owned subsidiary, Identity Rehab Corporation, which was founded in 2005.

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Identity theft occurs when someone fraudulently uses personal identifying information (e.g. name, birth date, social security number, credit card number) to obtain goods or services under the identity theft victim's name. The FBI has described identity theft as one of the fastest growing crimes in the United States.

We have developed comprehensive solutions that incorporate elements from six distinct categories designed to work together to detect, diagnose, and resolve consumer identity theft and other consumer data issues as follows:

- **Identity Monitoring:** ID Watchdog's patent pending identity monitoring service will scan public and private consumer databases generating client alerts of suspicious activity associated with name, address, phone number, date of birth, and social security number.
- **Cyber Monitoring:** Our service will scan known malicious chat rooms, blogs, and underground websites for client name, credit card information, and social security number that can be bought and sold for fraudulent usage.
- **Non-Credit Loan Monitoring:** This service will monitor data feeds from non-credit loan outlets which may provide applicants a loan of up to \$1,000 while requiring only an address and proof of employment.
- **Credit Reports and Credit Scores:** We provide on-line access to credit reports and credit scores from Experian, TransUnion and Equifax to check the validity and accuracy of client account information.
- **Credit Monitoring:** We will monitor daily for changes to the customer's credit reports from Experian, Equifax, and TransUnion. There are twenty six different alert types that can detect potential fraudulent activity.
- **Resolution Services:** In cases where identity theft is detected, our resolution service will find it, stop it, and fix it before any real damage occurs. Identity theft cases are assigned to a dedicated in-house staff of identity theft resolution experts.

### **Marketing of Services**

We utilize strategic partner distribution channels to assist us in selling our identity theft protection services to our partners' customer bases. These channels include the following:

- **Employee Benefit Channel.** A significant portion of our existing customers were acquired through relationships with entities that focus on designing and negotiating customized employee benefit programs for their employer clients ("Benefit Brokers"). In this channel, our Benefit Broker partners promote our services to their employers clients who then offer our services as a voluntary employee benefit as part of their employee benefit program (the "**Employee Benefit Channel**"). We are seeking to expand this sales channel and ultimately our customer base by significantly expanding the number of these Benefit Broker relationships. We commenced these expansion efforts in the second quarter of 2012 and we are in the early stages of building a nationwide network of Benefit Brokers.

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- **Tech Support Channel.** In this channel our partners, who provide personal computer performance enhancement services, sell our services as an add-on product offering directly to their customers (the **Tech Support Channel**).
- **Anti-Virus Channel.** The Company has partnered with certain anti-virus and other desktop software providers to provide its identity theft protection services as a complimentary add-on product offering directly to the partners' end-users through their customers' desktops (the **"Anti-Virus Channel"**). In early 2011, the Company began to develop the Anti-Virus Channel and has partnering agreements with four anti-virus software companies and one desktop software company. As of July 2012, the Company had integrated and launched its services with all of its partners.

The Company is offering "free alerts", which are comprised of personal alerts based upon changes to the individual's credit report, as well as generic informational alerts. These "free alerts" we believe, over the long-term, will form a foundation upon which the Company will seek to upgrade users from "free alerts" to a premium identity theft protection product. While the Company will not be paying for access to market to our partners' customers, we will be sharing in the revenue from each sale with our partners

**Consumer Marketing Channel.** In the past the Company utilized direct consumer advertising, telemarketing and on-line affiliate marketing programs to sell its services (the **"Consumer Marketing Channel"**). While these marketing tactics generated significant new customer growth, we determined that high customer acquisition costs, in addition to consuming cash resources, delayed the break-even point to unacceptably long periods. While the Company no longer utilized these strategies to sell its services, we still provide services to a significant number of subscribers that were sold through the Consumer Marketing Channel.

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**Results of Operations**

The financial information set out below is based on and derived from our unaudited interim consolidated statements of operations for the three months ended June 30, 2013 and 2012.

	<b>For the Three Months ended June 30,</b>	
	<b>2013</b>	<b>2012</b>
	(unaudited)	(unaudited)
Revenue .....	\$528,196	\$ 470,320
Gross profit.....	339,882	170,601
Gross profit margin.....	64.3%	36.3%
Operating expenses		
General and Administrative .....	365,326	427,741
Marketing expense .....	115,794	121,102
Stock – based compensation expense .....	43,655	110,838
Depreciation and amortization expense .....	22,778	22,965
Operating Loss.....	(207,671)	(512,045)
EBITDA.....	(141,238)	(378,242)
Net income (loss) and comprehensive loss applicable to ordinary shares .....	\$ (385,278)	\$ (499,884)
Basic and diluted net income (loss) per share applicable to ordinary shares .....	\$ (0.00)	\$ (0.00)

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	<b>For the Six Months ended June 30,</b>	
	<b>2013</b>	<b>2012</b>
	(unaudited)	(unaudited)
Revenue .....	\$1,082,684	\$ 914,377
Gross profit .....	746,117	328,648
Gross profit margin.....	68.9%	35.9%
Operating expenses		
General and Administrative .....	748,230	854,013
Marketing expense .....	243,172	213,179
Stock – based compensation expense .....	101,055	342,171
Depreciation and amortization expense .....	44,582	46,899
Operating Loss.....	(390,922)	(1,127,614)
EBITDA.....	(245,285)	(738,544)
Net income (loss) and comprehensive loss applicable to ordinary shares .....	\$ (875,470)	\$ (1,113,703)
Basic and diluted net income (loss) per share applicable to ordinary shares .....	\$ (0.01)	\$ (0.01)

**Summary of Quarterly Results**

(Amounts presented in U.S. Dollars)

	<b>June 30, 2013</b>	<b>March 31, 2013</b>	<b>December 31, 2012</b>	<b>September 30, 2012</b>
Revenue .....	\$ 528,196	\$ 554,488	\$ 460,093	\$ 434,052
Operating (loss)	\$ (207,671)	\$ (183,251)	\$ (346,382)	\$ (466,127)
EBITDA.....	\$ (141,238)	\$ (104,047)	\$ (250,493)	\$ (340,466)
Net loss .....	\$ (385,278)	\$ (490,192)	\$ (390,311)	\$ (646,990)
Net loss applicable to ordinary shares.....	\$ (385,278)	\$ (490,192)	\$ (390,311)	\$ (646,990)
Basic and diluted net loss per share .....	\$ (0.00)	\$ (0.00)	\$ (0.00)	\$ (0.01)

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	<u>June 30, 2012</u>	<u>March 31, 2012</u>	<u>December 31, 2011</u>	<u>September 30, 2011</u>
Revenue .....	\$ 470,320	\$ 444,057	\$ 477,552	\$ 446,817
Operating (loss).....	\$ (512,045)	\$ (615,569)	\$ (410,588)	\$ (777,046)
EBITDA.....	\$ (378,242)	\$ (360,302)	\$ (221,080)	\$ (466,018)
Net income (loss) .....	\$ (499,884)	\$ (613,819)	\$ 484,200	\$ 709,174
Net income (loss) applicable to ordinary shares.....	\$ (499,884)	\$ (613,819)	\$ 484,200	\$ 709,174
Basic net income (loss) per share applicable to ordinary shares.....	\$ (0.00)	\$ (0.01)	\$ 0.00	\$ 0.01
Diluted net income (loss) per share applicable to ordinary shares.....	\$ (0.00)	\$ (0.01)	\$ 0.00	\$ 0.00

	<u>As of June 30, 2013</u>	<u>As of December 31, 2012</u>
Cash and cash equivalents .....	\$ 529,496	\$ 319,073
Total Assets.....	971,887	690,835
Total long term liabilities .....	3,784,529	3,126,659
Total liabilities .....	4,923,890	3,928,423
Total Shareholders' deficit .....	\$ (3,952,003)	\$ (3,237,588)

The above quarterly information has been prepared by management in accordance with IFRS.

Revenues fluctuated moderately throughout the quarters, as the revenues associated with our Consumer Marketing Channel continued to decline and were only partially offset by an increase in revenue generated from customers through our Employee Benefit, Tech Support and Anti-Virus Channels. Revenues grew significantly beginning in the first quarter of 2013, as a result of the addition of the ISecurity customers.

Operating loss and EBITDA loss have generally improved quarter to quarter as we have benefited from improving gross margins and reduced operating expenses.

Our net income (loss) changed significantly from quarter to quarter primary due to the recognition of gain (loss) on warrant liabilities and to a lesser extent from generally declining gross margin due to lower levels of revenues.

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## **Results of Operations**

### **Revenues**

Revenue increased \$57,876, or 12.3%, from \$470,320 for the second quarter of 2012 to \$528,196 for the second quarter of 2013.

During the second quarter of 2013, revenue from our Employee Benefits, Tech Support and Anti-virus channels, contributed \$88,562 to the total increase in revenues and revenues from the iSecurity customers contributed \$24,864 to the total increase in revenues. These increases were partially offset by a \$55,550 decrease in revenues from our Consumer Marketing Channel.

Revenue increased \$168,307, or 18.4%, from \$914,377 for the six month period ended June 30, 2012 to \$1,082,684 for the six month period ended June 30, 2013. Revenue from our Employee Benefits, Tech Support and Anti-virus channels, contributed \$216,218 to the total increase in revenues and revenues from the iSecurity customers contributed \$96,121 to the total increase in revenues. These increases were partially offset by a \$144,032 decrease in revenues from our Consumer Marketing Channel.

On February 12, 2013, IDR entered into a services agreement with iSecurity, Inc ("iSecurity"), a Michigan based company in order to provide identity theft protection and resolution services to iSecurity's customers until the earlier of the closing of the purchase of the Customer Assets (as defined below) or February 28, 2014. On March 4, 2013, IDR, an indirect wholly owned subsidiary of the Company, entered into a definitive agreement to acquire approximately 1,800 identity theft protection customers and related assets (the "Customer Assets") from iSecurity. The acquisition of the Customer Assets closed on May 8, 2013 (the "Closing Date").

While the new customers from our Employee Benefit, Tech Support and Anti-virus channels generate a lower net revenue per customer as compared to the rates we receive from our Consumer Marketing Channel, these new customers are acquired at a much lower cost per customer and we believe they will also subscribe to our services for longer periods as compared to the Consumer Marketing Channel customers.

### **Cost of Revenue**

Cost of revenue consists primarily of the following:

- Fees paid to a credit bureau and for other data providers;
- Cost of personnel and other related costs incurred for customer identity monitoring and resolution; and
- Costs for credit card processing.

Cost of revenue for the second quarter of 2013 was \$188,314, resulting in a gross profit of \$339,882, while our cost of revenue for the second quarter of 2012, was \$299,719, resulting in a gross profit of \$170,601. The gross margin for the second quarter of 2013 and 2012 was 64.3% and 36.3%, respectfully.

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The decrease in cost of revenue is primarily the result of a \$78,935 decrease data services expenses and a \$38,650 decrease in personnel related expenses to provide our identity theft protection services.

Cost of revenue for the six month period ended June 30, 2013 was \$336,567, resulting in a gross profit of \$746,117, while our cost of revenue for the similar period in 2012, was \$585,729, resulting in a gross profit of \$328,648. The gross margin for the six month periods ended June 30, 2013 68.9% and 35.9%, respectfully.

The decrease in cost of revenue is primarily the result of a \$163,892 decrease data services expenses and a \$94,082 decrease in personnel related expenses to provide our identity theft protection services.

The Company entered in to a new data agreement, which was effective January 1, 2013, and significantly reduced the minimum monthly fee the Company is required to pay for these services, as compared to the minimum fee in the prior data agreement with this provider. The reduced fees paid to this provider generated substantially all of the data cost savings described above.

### **General and Administrative Expense**

General and administrative expense consists primarily of the following:

- All salaries and related benefits (excluding marketing salaries, related benefits and stock – based compensation);
- Professional services expenses including legal fees, accounting fees and other professional services;
- Office rent and other office related costs; and
- Other administrative expenses.

General and administrative expense decreased \$62,415, or 14.6%, from \$427,741 for the second quarter of 2012 to \$365,326 during the second quarter of 2013. This decrease was primarily the result \$102,865 decrease in personnel related expenses, which were partially offset by \$29,354 of expenses incurred to manage the iSecurity customers under the services agreement with iSecurity.

General and administrative expense decreased \$105,783, or 12.4%, from \$854,013 for the six month period ended June 30, 2012 to \$748,230 for the six month period ended June 30, 2013. The significant items contributing to this decrease are as follows:

- A \$112,356 decrease in personnel related expenses resulting from a reduction in the number of personnel and a reduction in recruiting fees;
- A \$48,255 decrease in professional services expenses, primarily legal and accounting fees; and
- A \$24,316 decrease in travel and entertainment expenses.

These decreases were partially offset by \$84,498 of expenses incurred to manage the iSecurity customers under the services agreement with iSecurity.

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### **Marketing Expense**

Marketing expense consists primarily of the following:

- Salaries, commissions and benefits of sales and marketing personnel;
- Benefit brokers' commissions;
- Marketing and promotional materials; and
- Other marketing expenses

Sales and Marketing expense for the second quarter of 2013 totaled \$115,794 as compared to \$121,102 during the similar period in 2012, a decrease of \$5,308, or 4.4%. This decrease was primarily the result of a \$32,039 decrease in salaries, commissions and benefits expense due to a reduction in sales and management personnel, which was partially offset by a \$21,668 increase in sales commissions due to an increase in revenues, including commissions paid on ISecurity customer revenues, and a \$7,740 increase in telecommunications expenses.

Sales and Marketing expense for the for the six month period ended June 30, 2013 totaled \$243,172 as compared to \$213,179 during the similar period in 2012, an increase of \$29,993, or 14.1%. This increase was primarily the result of a \$32,446 increase in sales commissions due to increased revenues, including commissions paid on ISecurity customer revenues and a \$14,098 increase in telecommunications expenses. These increases were partially offset by a decrease in salaries, commissions and benefits expense due to a reduction in sales and management personnel.

### **EBITDA**

EBITDA improved by \$237,004 to \$(141,047) during the three months ended June 30, 2013, as compared with \$(378,242) for the similar period in 2012. The improvement in EBITDA is due to a \$169,281 improvement in gross margin as described above and a \$67,723 decrease in total operating expenses (excluding depreciation and amortization and stock-based compensation).

For the six month period ended June 30, 2013, EBITDA improved by \$493,259 to \$(245,285) as compared with \$(738,544) for the similar period in 2012. The improvement in EBITDA is due to a \$249,162 improvement in gross margin as described above and a \$75,790 decrease in total operating expenses (excluding depreciation and amortization and stock-based compensation).

### **Stock-based Compensation**

Stock-based compensation expense for the second quarter of 2013 totaled \$43,655 as compared to \$110,838 for the similar period in 2012, a decrease of \$67,183, or 60.6%. Stock-based compensation expense for the six month period ended June 30, 2013 totaled \$101,055 as compared to \$342,171 for the similar period in 2012, a decrease of \$241,116, or 70.5%.

Stock compensation expense will vary from quarter to quarter based on the number and timing of stock option grants, the fair value of the stock options granted and the vesting terms of the stock option grants, among other factors. Stock options granted during the six months ended June 30, 2013 and 2012 were 0 and 4,072,000, respectively.

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**Interest Expense**

Interest expense includes dividends on the Series C Preferred shares, which accrue at 8% per annum, amortization of the liquidation preferences on the Series C Preferred shares, amortization of the offering costs incurred in the offering of the Series C Preferred shares, amortization of Credit Facility costs and interest on the Company's capitalized lease obligations and Credit Facility.

Interest expense during the three and six months ended June 30, 2013 and 2012 consisted of the following:

	<b>Three Months Ended June 30,</b>	
	<b>2013</b>	<b>2012</b>
Accrued dividends on Series C Preferred .....	\$ 61,302	\$ 61,798
Amortization of Series C Preferred liquidation preference .....	42,894	43,136
Amortization of fair value of Series C Preferred detachable warrants .....	46,957	47,223
Amortization of offering costs .....	28,648	28,811
Amortization of Credit Facility fee.....	7,796	—
Interest expense on Credit Facility and financing leases .	10,835	3,359
	<u>\$ 198,432</u>	<u>\$ 184,327</u>

	<b>Six Months Ended June 30,</b>	
	<b>2013</b>	<b>2012</b>
Accrued dividends on Series C Preferred .....	\$ 121,929	\$ 124,268
Amortization of Series C Preferred liquidation preference .....	85,317	86,872
Amortization of fair value of Series C Preferred detachable warrants .....	93,399	95,102
Amortization of offering costs .....	56,982	58,022
Amortization of Credit Facility fee.....	9,019	—
Interest expense on Credit Facility and financing leases	18,083	6,955
	<u>\$ 384,729</u>	<u>\$ 371,219</u>

**Gain (Loss) on Warrant Liabilities**

Certain of our warrants contain anti-dilution provisions, which if triggered by the issuance by the Company of equity securities below certain levels as outlined in the individual warrant agreements, would result in a reduction of the exercise price of the warrants. We have recorded these warrants as warrant liability at fair value in the accompanying consolidated statements of financial position. Each period, we adjust the estimated fair value of these

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warrants 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 three months ended June 30, 2013 and 2012, we recognized non-cash gains from the change in the fair value of these warrants of \$20,819 and \$195,316, respectively. During the six months ended June 30, 2013 and 2012, we recognized a non-cash gain (loss) from the change in the fair value of these warrants of \$(99,829) and \$380,519, respectively.

These gains (losses) are the result of decreases (increases) in the fair value of these warrants driven primarily by changes in the share price of the Company's Ordinary Shares, shortening of the remaining terms of the warrants and other factors.

### **Liquidity and Capital Resources**

#### **Recapitalization of the Company and Issuance of Series C Convertible Preferred Shares**

The Company has incurred significant losses from operations and has funded these losses primarily through funds raised in its 2008 Initial Public Offering ("IPO") and from private placements of debt and equity securities.

On November 8, 2011, the Company closed a private placement offering of units (the "Units"). The Company sold 8,333,333 Units at a price of \$0.24 per Unit for aggregate gross proceeds of U.S. \$2,000,000 (the "Units Offering"). Net proceeds from the Units Offering were \$1,808,646. Each Unit consists of two Ordinary Shares in the capital of the Company and two ordinary share purchase warrants (each, a "Warrant"). The first Warrant entitles the holder to purchase one additional Ordinary Share at a price of U.S. \$0.15 at any time prior to 5:00 p.m. on November 8, 2016. The second Warrant entitles the holder to purchase one additional Ordinary Share at a price of U.S. \$0.25 at any time prior to 5:00 p.m. on November 8, 2016.

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The net proceeds from the Units Offering will be used to fund operating deficits, to hire and compensate additional personnel and for general working capital purposes. Below is a summary of the net proceeds and the actual use of net proceeds from the Units Offering.

**Proceeds from Offering**

Gross Proceeds from Units Offering	\$2,000,000
Less: Offering Costs	<u>(191,354)</u>
Net Proceeds from Units Offering	<u>\$1,808,646</u>

**Use of Proceeds from Offering**

Operating Deficit for the period November 8, 2011 to June 30, 2013 (1)	\$1,437,170
Expense for additional personnel for the period November 8, 2011 to June 30, 2013	<u>252,667</u>
Total Actual Use of Proceeds	<u>\$1,689,837</u>
Net Proceeds of Units Offering available to fund future operating deficits, compensation for additional personnel and for general working capital purposes	<u>\$ 118,809</u>

'(1) Operating deficit is the operating loss plus depreciation and amortization and stock based compensation and expense for additional personnel.

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**Liquidity**

	<u>As of June 30,</u> <u>2013</u>	<u>As of December 31,</u> <u>2012</u>
<b>Current Assets</b>		
Cash	\$ 529,496	\$ 319,073
Accounts Receivable	204,797	144,561
Prepaid Expenses	94,934	73,466
	<u>829,227</u>	<u>537,100</u>
<b>Current Liabilities</b>		
Accounts payable and accrued liabilities	\$ 582,562	\$ 521,134
Deferred Revenue	543,580	267,056
Current portion of long-term debt	13,219	13,574
	<u>1,139,361</u>	<u>801,764</u>
<b>Net Working Capital</b>	<b><u>\$ (310,134)</u></b>	<b><u>\$ (264,664)</u></b>

As of June 30, 2013, cash and cash equivalents totalled \$529,496 compared to \$319,073 as of December 31, 2012. Net working capital at June 30, 2013 was \$(310,134) compared to \$(264,664) at December 31, 2012, a decrease of \$45,470 of net working capital. The working capital used during the six months ended June 30, 2012, was used primarily to fund operating cash flow deficits.

During the six month periods ended June 30, 2013 and 2012, we had cash outflows from operations of \$(12,656) and \$(578,259), respectively. The decrease in cash used in operating activities, when comparing the two periods, was primarily the result of a decrease in operating losses and a net increase in deferred revenues of \$208,785.

During the six month periods ended June 30, 2013 and 2012, cash flows provided by investing activities totalled \$0 and \$484,274, respectively. Cash flows provided by investing activities in 2012, were primarily the result of the sale of \$490,000 of available-for-sale securities.

Cash flows provided by (used in) financing activities totalled \$223,079 and \$(9,110) for the six month periods ended June 30, 2013 and 2012, respectively, and are as follows:

	<u>Year Ended December 31,</u>	
	<u>2012</u>	<u>2011</u>
Borrowing on Credit Facility.....	\$ 250,000	\$ —
Credit Facility Fees.....	(19,751)	—
Issuance costs related to conversion of trade payables into ordinary shares.....	—	(771)
Repayment of finance lease obligations .....	(7,170)	(8,339)
Net cash provided by (used in) financing activities .....	<u>\$ 223,079</u>	<u>\$ (9,110)</u>

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## **Commitments**

On November 19, 2012, the Company entered into a new two year agreement with a data provider, which became effective on January 1, 2013, requires the Company to pay a monthly fee equal to the greater of actual data usage priced at the contractual rates or \$10,000 and terminate all other data agreements the company had with this data provider effective December 31, 2012.

In July 2011, the Company entered into an agreement to lease office space in Denver, Colorado. The lease commenced on September 1, 2011, has a 38 month term with an option to extend the lease for an additional two years. The Company's minimum lease payments for the second half of 2013 and calendar 2014 are \$39,028 and \$66,666, respectively. The minimum lease payments are subject to changes based contractual payment adjustments to accommodate additional employees in the office space and annual lease payment adjustments. In addition, the Company agreed to pay the lessor monthly payments of \$2,468 for leasehold improvements paid for by the lessor. The scheduled finance lease payments for the second half of 2013 and calendar 2014 are \$14,808 and \$24,685 respectively.

## **Capital Resources**

The Company will seek to grow its customer base primarily through the Employee Benefits Channel and through the Tech Support Channel. The Company continues to make progress in building its Employee Benefit Channel by expanding its network of employee benefit brokers who market our services to their employer clients for inclusion in the clients' employee benefit plans as a voluntary employee benefit.

The Company began to develop the Anti-Virus Channel in early 2011 and, to date; this channel has not generated a meaningful number of customers or revenues. We are not anticipating any meaningful revenue growth in the short-term and there can be no assurance that the Company will be successful over the long-term in generating any significant revenue from the Anti-Virus channel.

Our cash balances and as of June 30, 2013 totaled \$ 529,496, and on July 31, 2013 we borrowed an additional \$250,000 on our Credit Facility (as defined below). Subsequent to this borrowing there is no available borrowing capacity on this Credit Facility. We are dependent upon our existing cash balances, along with our cash flow generated from gross profits, and additional debt or equity financing, if available, to fund our operating activities, expansion plans and other working capital needs.

We anticipate modest sequential revenue growth through the balance of 2013, driven by growth from our Employee Benefits Channel and our Tech Support Channel. We have reduced our projected revenue growth for the fourth of 2013 from our earlier estimate and, based on our current forecast of revenue growth, the Company has deferred the time frame during which it believes that it will likely generate positive operating income, before depreciation, amortization and stock-based compensation, from the fourth quarter of 2013 to early 2014. Given the Company's existing cash balances and decreasing operating losses, the Company believes it will have sufficient liquidity to fund its operating activities and working capital needs for at least twelve months from June 30, 2013.

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However, should the Company fall short of its projected revenue forecast, we will likely need to take further measures to reduce our operating costs and improve our working capital position. While we believe we can reduce costs to achieve positive operating cash flow in the short-term, given our current level of revenue, further cost reductions may limit our ability to grow our revenue, both in the short and long-term.

On November 19, 2012, the Company entered into a new two year agreement with one of its data providers, which became effective on January 1, 2013, requires the Company to pay a monthly fee equal to the greater of actual data usage priced at the contractual rates or \$10,000 and terminated the previous data agreements with this provider effective December 31, 2012. This new data agreement reduces our minimum payment for these data services by \$40,000 per month beginning January 1, 2013.

To further improve our financial flexibility, on February 8, 2013, ID Rehab entered into a \$500,000 secured credit facility (the "Credit Facility") with Costella Kirsch, a California based lender (the "Lender"). ID Rehab borrowed \$250,000 on the Credit Facility at closing and borrowed an additional \$250,000 (the "Second Draw") on July 31, 2013.

The Company issued to the Lender, as a Credit Facility fee, 1,000,000 of its Ordinary Shares at closing and an additional 1,000,000 of its Ordinary Shares on July 31, 2013, when it borrowed the Second Draw. The Credit Facility matures on June 30, 2016, is secured by all of the assets of ID Rehab and bears interest at 13% per annum. Payments on the Credit Facility are interest only through 2013 with the principal and interest due in equal installments over the remaining 30 month term. The mandatory principal payments on the Credit Facility are \$0, \$90,427, \$102,909 and \$56,664 for the years ended December 31, 2013, 2014, 2015 and 2016, respectively. The borrowings from the Credit Facility will be used for general corporate purposes.

ID Rehab is required to pay the Lender certain additional fees if ID Rehab does not achieve certain financial targets in 2014 and 2015. Because ID Rehab believes that it is more likely than not that it will achieve these targets, no liability has been recorded for these fees in the accompanying financial statements.

### **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 August 27, 2013, we have the following equity securities outstanding:

#### Ordinary Shares

- 121,834,997 Ordinary Shares outstanding;
- 53,697,689 warrants, each of which is exercisable for one Ordinary Share at prices ranging from \$0.03 to \$0.48;
- 12,187,000 stock options, each of which is exercisable for one Ordinary Share at prices ranging from \$0.10 to \$0.60 per share; and
- 900,000 stock options, each of which is exercisable for one ordinary share at CDN\$0.60 per Ordinary Share.

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The warrants outstanding are denominated in U.S. dollars and 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 cash proceeds from the exercise of these warrants if they are exercised due to the aforementioned cashless exercise provisions.

Certain of the warrant agreements contain anti-dilution provisions that require a reduction in the exercise price of the warrant in the event the Company issues or sells its Ordinary Shares for an effective price that is less than the then existing exercise price of the warrant. These anti-dilution provisions in certain of our warrant agreements have been triggered at various times from the issuance of Ordinary Shares which has caused a reduction in the exercise price of certain of the warrants.

Also, it is unlikely that we will receive any of the cash proceeds from the exercise of the stock options, if they are exercised, since the stock options contain a cashless exercise provision, which, upon certain conditions, permit the holder to exercise their stock options on a net cash exercise basis and receive Ordinary Shares without payment of any cash consideration.

#### Series C Preferred Stock

On February 24, 2011 the Company issued 3,123,481 shares of its Series C Preferred. In June 2012, 50 shares of the Series C Preferred were converted to Ordinary Shares. As of March 31, 2013, the Company had outstanding 3,073,481 shares of its Series C Preferred. The holders of the Series C Preferred have the right to convert each share of their Series C Preferred into 10,000 Ordinary Shares of the Company, or 30,734,810 Ordinary Shares. The Company has reserved 30,734,810 of its Ordinary Shares to effect the conversion of Series C Preferred. The Series C Preferred is considered to be mandatory redeemable shares and is classified as a liability on the Company's consolidated statement of financial position as of June 30, 2013 and December 31, 2012.

The Series C Preferred has voting rights and powers equal to the voting rights of Ordinary Shares on an "as if" converted to ordinary shares basis.

In the event the Company issues or sells its Ordinary Shares for an effective price (the "New Issuance Price") that is less than the then existing conversion price of the Series C Preferred in effect immediately prior to such issue or sale, then immediately after such issuance the conversion price then in effect shall be reduced to the New Issuance Price, but not less than \$.15 per Ordinary Share.

#### **Off-balance Sheet Arrangements**

Other than the office lease commitment described in Note 12 of the Company's December 31, 2012 audited consolidated financial statements and under the "Commitments " section above, the Company did not have any off-balance sheet arrangements as of June 30, 2013 or December 31, 2012.

#### **Transactions with Related Parties**

None.

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## **Contingencies**

As of the date of this report the Company is not involved in any litigation, threatened litigation or other claims.

## **Recent Accounting Pronouncements**

The IASB has issued a number of new and revised Internal Accounting Standards, International Financial Reporting Standards, amendments and related interpretations which are effective for the Company's financial year beginning on or after January 1, 2013. For the purpose of preparing and presenting the financial information for the relevant periods, the Company has consistently adopted all these new standards for the relevant reporting periods.

At the date of authorization of these consolidated financial statements, the IASB and IFRIC have issued the following new and revised Standards and Interpretations:

### **IFRS 9 Financial Instruments**

IFRS 9 addresses the classification and measurement of financial assets. IFRS 9 is effective for annual periods beginning on or after January 1, 2015, however is available for early adoption. The Company has not early adopted this standard and has not fully assessed the impact of adopting IFRS 9.

### **IFRS 10 Consolidated Financial Statements**

IFRS 10 establishes principles for the presentation of consolidated financial statements when an entity controls one or more other entities. IFRS 10 is effective for annual periods beginning on or after January 1, 2013. The standard has been adopted and the standard did not have an impact on the financial statements.

### **IFRS 11 Joint Arrangements**

IFRS 11 provides for the accounting of joint ventures by focusing on the rights and obligations of the arrangement, rather than its legal form (as is currently the case). The standard also eliminated the option to account for jointly controlled entities using the proportionate consolidation method. The standard is effective for annual periods beginning on or after January 1, 2013. The Company has not adopted this standard as the standard is not applicable to the Company as this time.

### **IFRS 12 Disclosure of Interests in Other Entities**

IFRS 12 provides the disclosure requirements for interest held in other entities including joint arrangements, associates, special purpose entities and other off balance sheet vehicles. The standard requires an entity to disclose information regarding the nature and risks associated with its interests in other entities and the effects of those interests on its financial position, financial performance and cash flows. IFRS 12 is effective for annual period beginning on or after January 1, 2013. The Company has not adopted this standard as the standard is not applicable to the Company as this time.

### **IFRS 13 Fair Value Measurement**

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IFRS 13 provides a precise definition of fair value, establishes a single source for determining fair value and introduces consistent requirements for disclosure relating to fair value measurements. The standard will be effective for annual periods beginning on or after January 1, 2013. The standard has been adopted and its adoption has not had any impact on the disclosures in these financial statements.

#### **IAS 27 Separate Financial Statements**

IAS 27 prescribes the accounting and disclosure requirements for investments in subsidiaries, joint ventures, and associates when the entity prepares separate financial statements. IAS 27 requires an entity preparing separate financial statements to account for those investments at cost or in accordance with IFRS 9, Financial Instruments. IAS 27 is effective for annual periods beginning on or after January 1, 2013. The Company has not adopted this standard as the standard is not applicable to the Company as this time.

#### **IAS 28 Investments in Associates and Joint Ventures**

IAS 28, revised the existing standard and prescribes the accounting for investments in associates and joint ventures and sets out the requirements for the application of the equity method when accounting for investments in associates and joint ventures. IAS 28 is effective for annual periods beginning on or after January 1, 2013. The Company has not adopted this standard as the standard is not applicable to the Company as this time.

#### **IAS 32 and IFRS 7 Offsetting Financial Assets and Financial Liabilities**

In December 2011, the IASB published Offsetting financial Assets and Financial Liabilities and issued new disclosure requirements in IFRS 7 Financial Instruments: Disclosures. The amendments to IAS 32 provide specific guidance for when an entity can offset financial assets and liabilities by clarifying when a legally enforceable right to do so exists, and when an entity meets the criterion for the intent to settle on a net basis. The effective date for the amendments to IAS 32 is for annual period beginning on or after January 1, 2014. The effective date for the amendments to IFRS 7 is for annual periods beginning after January 1, 2013. These amendments are to be applied retrospectively. The Company has not adopted this standard as the standard is not applicable to the Company as this time.

#### **Financial Instruments and Other Instruments**

On February 24, 2011, the Company issued 3,123,481 shares of its Series C Preferred and five-year warrants to purchase 15,617,405 of its Ordinary Shares at an exercise price of \$0.12 per share and received gross proceeds of \$3,123,481. In addition, the Company issued to the underwriters of this offering five-year warrants to purchase 4,348,481 of its Ordinary Shares at an exercise price of \$0.12 per share. The Series C Preferred is considered to be mandatory redeemable shares and is classified as a liability on the Company's statement of financial position.

In accordance with IAS 32, the Company estimated the fair value of the liability component of the Series C Preferred Stock to be \$2,978,009, including the related warrants, by discounting the redemption amount at a market rate for a similar liability that does not have an associated

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equity component. The warrants were issued with the Series C Preferred and their fair value, using the Black Scholes options pricing model, is estimated to be \$814,105, resulting in a fair value of \$2,165,904 for the liability portion of the Series C Preferred stock. Further, as the Series C Preferred is convertible, a portion of the proceeds were allocated to the conversion feature embedded in the Series C Preferred. The residual amount reflecting the conversion feature of \$145,472 was recorded as the equity component. The Series C Preferred and the related warrants are classified as a liability, and the discount will be amortized over the period from issuance to February 2016 (the redemption date) as a charge to interest expense.

### **Forward-looking Information and Statements**

Certain statements contained in this report constitute forward looking information within the meaning of securities laws. Implicit in this information, particularly in respect of the Company's future operating results and economic performance are assumptions regarding projected revenues and expenses. These assumptions, although considered reasonable by the Company at the time of preparation, may prove to be incorrect. Readers are cautioned that the Company's actual future operating results and economic performance are subject to a number of risks and uncertainties, including general economic, market and business conditions, and could differ materially from what is currently expected. Forward-looking information contained in this report is based on management's current estimates, expectations and projections, which management believes are reasonable as of the current date. The reader should not place undue reliance on forward-looking statements and should not rely upon this information as of any other date. In addition to presenting an analysis of results for the three and six month periods ended June 30, 2013 and 2012, this report also discusses certain important events that occurred between the end of the period and August 27, 2013.

Forward-looking information included or incorporated by reference in this document includes statements with respect to the Company's:

- Efforts to upgrade users from "free alerts" to a premium identity theft protection product--See Marketing of Services;
- Efforts to establish distribution relationships with companies that provide personal computer performance enhancement services in order to generate additional sales-- See Marketing of Services;
- Efforts and plans to expand its employee benefits distribution channel, the number of benefits brokers and our customer base-- See Marketing of Services;
- Position that it is unable to provide assurance that it will be successful in generating any significant revenue from its Anti-Virus Channel--See Capital Resources;
- Belief that it will achieve positive operating income, before depreciation, amortization and stock-based compensation, beginning in the first quarter of 2014 and meaningful sequential revenue growth through the balance of 2013--See Capital Resources;
- Ability to further reduce our cost structure in order to achieve positive operating income, before depreciation, amortization and stock-based compensation; and

### **Material Risk Factor and Assumptions**

The following table outlines material forward-looking information included in the MD&A:

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<b><u>Forward-looking Information</u></b>	<b><u>Key Assumptions</u></b>	<b><u>Most Relevant Risk Factors</u></b>
Certain beliefs surrounding the future revenue generating potential of the Anti-Virus Channel.	Significant uncertainty surrounding the number of paying customers the Company may be able to attract through the Anti-Virus Channel.	The Company may not be successful in generating a meaningful number of paying customers due to product pricing or other offering terms, ineffective or insufficient marketing support and a lack of customer education about our products. We may not have our product exposed to a sufficient number of potential customers through our existing desktop software partners to enable us to generate a meaningful number of paying customers. In addition, the Company may not be able to enter into agreements with any additional desktop software providers. Also, see the following two risk factors.
Our efforts to upgrade users from "free alerts" to a premium identity theft protection product	A meaningful percentage of registered users who receive free alerts over the long-term will likely upgrade to a premium identity theft protection product.	Registered user may not be compelled to purchase a premium identity theft protection product from receiving "free alerts".
Modest Sequential revenue growth through the balance of 2013.	Our relationships with tech support companies and Benefit Brokers are new and evolving, the Company has limited experience with these entities and a significant portion of the Benefit Brokers business is generated in early in each calendar year.	The Benefit Broker's the Company has engaged to promote its product offering to employers are not successful in convincing employers to include our product offering in their employee benefits offerings and an insufficient number of employees chose to purchase our products.
The belief that the Company will achieve positive operating income beginning in early 2014.	The Company will be successful in generating significant incremental revenue and/or further reducing costs in the near-term to achieve positive operating income beginning early in 2014.	Ability to generate sufficient incremental revenue (see above risk factor) and/or further reduce costs in the near-term.