

## **Management Discussion & Analysis**

The following Management Discussion and Analysis (“**MDA**”) provides additional analysis of the operations and financial position for the fiscal period ended March 31, 2010 for Pethealth Inc. (“**Pethealth**” or the “**Company**”) and includes information available to May 12, 2010. It is supplementary information and should be read in conjunction with the consolidated financial statements, including the accompanying notes, management’s report and the auditor’s report available through [www.sedar.com](http://www.sedar.com) and on the Company’s website at [www.pethealthinc.com](http://www.pethealthinc.com).

Certain statements contained in this MDA may constitute forward-looking information as defined under securities laws. Forward-looking information may relate to the Company’s future outlook and anticipated events or results and may include statements regarding the Company’s future financial position, business strategy, budgets, litigation, projected costs, capital expenditures, financial results, taxes, plans and objectives. In some cases, forward-looking information can be identified by terms such as “may”, “will”, “should”, “expect”, “plan”, “anticipate”, “believe”, “intend”, “estimate”, “predict”, “potential”, “continue”, or other similar expressions concerning matters that are not historical facts.

To the extent any forward-looking information constitutes future-oriented financial information or financial outlooks, as those terms are defined under securities laws, such information is being provided to enable a reader to assess the Company’s financial condition, material changes in the Company’s financial condition and its results of operations including liquidity and capital resources for the quarter ended March 31, 2010, compared with the quarter ended March 31, 2009. Readers are cautioned that this information may not be appropriate for any other purpose, including investment decisions.

Forward-looking information contained in this MDA is based on certain factors and assumptions regarding expected growth, results of operations, performance, and business prospects and opportunities. While the Company considers these assumptions to be reasonable, based on information currently available, they may prove to be incorrect.

Forward-looking information is also subject to certain factors, including risks and uncertainties that could cause actual results to differ materially from what the Company currently expects. These factors, some of which are more fully described in the “Risks and Uncertainties” section of this MDA, include: the timing and market acceptance of future products, competition in the Company’s markets, the Company’s reliance on customers, fluctuations in currency and exchange rates, commodity prices or interest rates, the broad economy, access to or the provision of credit, the Company’s ability to maintain good relations with its employees, changes in the law or regulations regarding the environment or other environmental liabilities, the Company’s ability to integrate acquisitions and the Company’s ability to protect its intellectual property. For more exhaustive information on these risks and uncertainties you should refer to our Company’s filings with the securities regulatory authorities, including the Company’s most recently filed Annual Information Form, which is available on SEDAR at [www.sedar.com](http://www.sedar.com) or at the Company’s website [www.pethealthinc.com](http://www.pethealthinc.com).

Forward-looking information contained in this commentary is based on our current estimates, expectations and projections, which we believe are reasonable as of the current date. You should not place undue importance on forward-looking information and should not rely upon this information as of any other date.

*Other than as required under securities laws, we do not undertake to update any forward-looking information at any particular time.*

*All financial information is presented in Canadian dollars unless otherwise specified. All references to a quarter refer to the fiscal quarter of the Company ended March 31, 2010 unless otherwise specified. This MDA is dated May 12, 2010. **All forward-looking information contained in this MDA is expressly qualified in its entirety by this cautionary statement.***

## FIRST QUARTER 2010 FINANCIAL HIGHLIGHTS

*Quarter ended March 31, 2010*

- Total revenue for the quarter ended March 31, 2010 was \$8.37 million, down 4.1% over Q1 2009.
- Net income, before taxes, was \$616,000 for the quarter (\$0.00 per share after giving effect to the \$585,000 annual dividend paid to holders of the Company's convertible preference shares in Q1 2010) vs. \$902,000 for the same period in the prior year (\$0.01 per share after giving effect to the \$600,000 annual dividend paid to holders of the Company's convertible preference shares in Q1 2009)
- Net income, after taxes, for Q1 2010 was \$528,000 (\$0.00 per share after giving effect to the \$585,000 dividend) compared to the same period in the prior year's net income of \$902,000 (0.01 per share after giving effect to the \$600,000 dividend payment made in the first quarter of 2009).
- EBITDA (see non GAAP accounting measures) for Q1 2010 was \$1.07 million compared to EBITDA of \$1.34 million for the same period in the prior year.
- Adjusted EBITDA (see non GAAP accounting measures) was \$1.0 million for the quarter, a 37% decrease from the same period in the prior year.
- The 20% and 10% appreciation of the Canadian dollar against the U.S. dollar and the British pound respectively had a significant impact on comparative year over year quarterly results as described below.

## COMPANY OVERVIEW

The Company is North America's second largest provider of medical insurance for dogs and cats to pet owners, operating in Canada, the United States and the United Kingdom. We sell our policies under several different brand names using a model which includes co-branding, white labelling and private labelling programs with distribution partners. In addition, the Company is a leading provider of pet recovery database services in North America, a market we entered in February 2003 under the brand 24PetWatch.TM. Most recently, the Company introduced its pet recovery database services in the U.K. market under its PetProtect brand. Furthermore, the Company, through its web-based product, PetPointTM, has become the leading provider of management software to animal welfare organisations in North America, a market we entered in 2005.

In May 2009, we announced the launch of Petango.com ("**Petango**"), our new and technologically advanced adoptable search site for pet owners looking to adopt a new cat or dog. Since the launch of Petango, the Company, by December 2009, had become the number two destination for adoptable pet search in terms of unique visitors. In November 2009, we launched thePetangoStore.com ("**the Petango Store**"), our on-line pet supply and pet pharmacy e-commerce platform. In March 2010, we integrated

Petango on-line adoptable search site, our on-line social networking site, PawsConnect.com and the Petango Store to create our pet portal under the brand Petango.

Pethealth's common shares trade on the TSX under the symbol "PTZ".

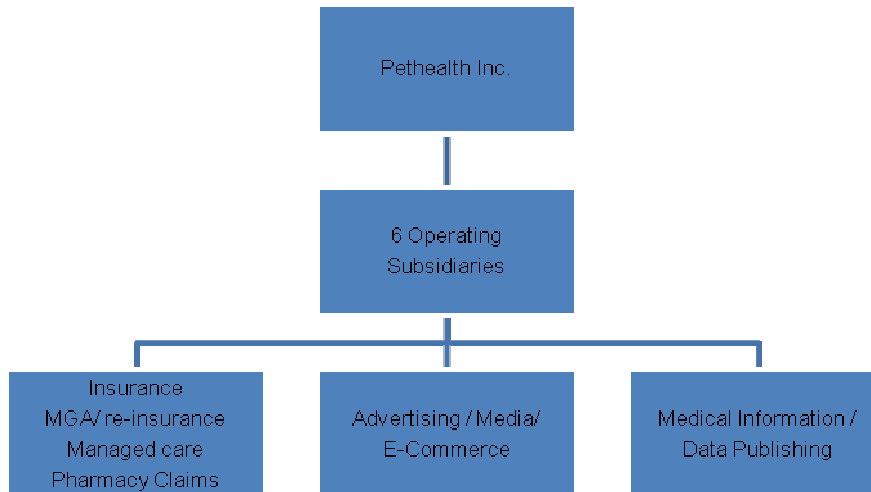
## Business Model

Our business model combines the financial benefits of a recurring revenue base from the sale and retention of pet health insurance policies with the potentially more significant "blue sky" opportunities generated from the platforms created by our industry-leading web-based applications. Together, these two complementary aspects of the model well position us to take advantage of the confluence of the changing demographics in pet ownership and the ever increasing reliance of pet owners on the Internet to purchase products and services and to obtain information.

## Strategy, Trends and Outlook<sup>1</sup>

Our strategy is to establish ourselves as: (a) the number one provider of financial related health services to owners of companion animals throughout North America and a leading provider in the United Kingdom; (b) the leading seller of online media advertising to retailers and national brands targeting companion animal owners in North America; and (c) the leading provider of epidemiological information, including for the purposes of continuing education, to animal clinics, animal welfare organisations, third party corporate entities operating within the companion animal market, and the pet owning public in North America.

We currently have six operating subsidiaries which are broken down into these three categories:



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<sup>1</sup> The "Strategy, trends and outlook" section contains certain forward-looking information. Please refer to the first page of this Management Discussion & Analysis for a discussion of the risks and uncertainties related to such information.

## **The North American Companion Animal Market**

The North American dog and cat population is estimated to be over 150 million of which less than 2% are insured and we estimate that less than 10% to be microchipped and registered with a pet recovery service. We believe that changing population demographics and cultural mores where pet owners are viewing their pet more and more as a member for the family coupled with the increasing sophistication and cost of veterinary care will accelerate demand for our products and services.

Our target market is the estimated 62% of the 115 million households in the U.S. and Canada that own at least one pet. We tailor our marketing and promotional activities to the female in these households who continues to be the primary caregiver. In addition, we target the approximate 19,000 companion animal veterinary clinics and 9,400 animal welfare organisations in North America for distribution of our RFID microchip technology and our PetPoint and EVE electronic platforms.

## **The United Kingdom Companion Animal Market**

According to Datamonitor, a market research firm, the U.K. companion animal market is estimated to be made up of over 14.2-million domestic dogs and cats of which it is estimated by market participants that 20%-22% are insured. In addition, and according to Datamonitor, the pet insurance market has experienced an average premium growth of 14.5% per annum since 2005, reaching £497-million in premiums for fiscal 2008. Datamonitor forecasts industry premiums to reach £726-million in 2013. Pet Protect currently accounts for approximately 3% of the pet insurance market share in the United Kingdom.

## **Business Segments**

We report our financial results in two reportable segments; our insurance operations (first box on the left above) and our non-insurance operations (second and third box above). Our insurance operations currently consist of the distribution and administration of the PetCare, Pet Protect, petPals, ShelterCare, QuickCare, CherryBlue and other co-branded, white labelled or private labelled pet insurance programs, while our non-insurance operations are made up of our 24PetWatch and Pet Protect manufacturer-neutral pet registry and recovery service, the distribution of RFID microchip technology, the development and distribution of PetPoint, our animal shelter management software program, and Petango, our on-line pet portal which includes our on-line adoptable search engine, thePetangoStore.com and social networking.

## **INSURANCE SEGMENT**

We started selling our pet insurance programs in Canada and the United States in 1999 and 2001 respectively and entered the United Kingdom in July 2008 through our acquisition of Pet Protect. Our insurance policies offer major medical coverage to dogs and cats and are designed to cover unexpected accidents and illnesses. Our insurance programs are currently available to pet owners in 49 U.S. states, all 10 Canadian provinces and throughout the United Kingdom. We market our insurance programs mainly through five distribution channels: animal welfare organisations (currently North America only); corporate/retail partners; veterinary clinics; our own broker/affiliate network; and our own direct to consumer advertising. As part of our insurance strategy, we look to private label, white label or co-brand programs for our corporate/retail partners. We currently market our pet insurance programs under several brand names including PetCare, Pet Protect, petPals, ShelterCare, QuickCare, and CherryBlue and our co-branding and/or private label partners include Metropolitan Life Insurance Company (“**MetLife**”), Union Privilege (the benefits provider to AFL-CIO union members across the United States), and Stop & Shop Supermarket Company L.L.C. and Giant Food stores. Most recently we announced a broad agreement with the Ontario S.P.C.A. which includes offering a private label pet insurance program to residents of Ontario.

We offer our pet insurance programs in North America through our wholly owned subsidiaries PTZ Insurance Brokers Ltd. and PTZ Insurance Agency, Ltd. (collectively “**PTZ**”) and in the United Kingdom through Pet Protect Limited.

### **North America**

In the United States, PTZ currently operates our United States pet insurance business under a Managing General Agency Agreement (“**MGA Agreement**”) with the Praetorian Financial Group Inc. (“**Praetorian**”), a subsidiary of QBE Insurance Group Limited (“**QBE**”). Under the MGA Agreement, we are responsible for all product development, marketing and sales, claims adjudication, medical underwriting and premium collection including the management of the Praetorian’s premium trust account. In addition, we participate in a portion of the underwriting results for those core policies placed in the United States as is more fully described on page 14 of this MDA.

In Canada, PTZ operates our pet insurance business under an MGA Agreement with Lombard General Insurance Company (“**Lombard**”), a subsidiary of Fairfax Financial Holdings Limited. The Canadian MGA Agreement is similar in nature to the U.S. MGA agreement described above. PTZ does not, however, participate in the underwriting results for policies placed in Canada.

### **United Kingdom**

On July 28, 2008, we completed our acquisition of Pet Protect, a pet insurance intermediary operating in the United Kingdom, from Domestic & General Insurance PLC (“**D&G**”). Commencing October 31, 2008, we began renewing UK policies with QBE Insurance (Europe) Limited (“**QBE (Europe)**”), a subsidiary of QBE, who, as of September 30, 2009, underwrites 100% of our UK policies. Pet Protect earned a blended commission and fee revenue of approximately 17% of earned premium on pet insurance policies underwritten by D&G and a base commission of 33% on those policies underwritten by QBE (Europe). The MGA Agreement in place with QBE (Europe) is similar in nature to those in place in North America. We sell our policies in the U.K. under the Pet Protect and the petPals brands.

## **NON-INSURANCE SEGMENT**

Our non-insurance segment focuses on generating revenues from North American pet owners who have acquired their pet through adoption and from corporate entities and charitable foundations wishing to participate directly or indirectly with the adopter or in the pet adoption process. Our non-insurance segment is centered around the provision of PetPoint, our web based, software as a service (“**SAAS**”) system which, by March 31, 2010 had been licensed by 1,370 animal welfare organizations representing approximately 50% of North American adoptions completed through animal welfare organisations. Revenue opportunities resulting from the promotion of the PetPoint annual management application to this network of animal welfare organisations fall, on an aggregated basis, into five categories:

1. Advertising;
2. Sponsorship;
3. E-commerce;
4. Content syndication;
5. Medical/Data Publishing.

The first four comprise the elements of the operating subsidiaries in the middle box of the chart on page 3; the last comprises the business content in the box on the far right of the chart on page 3.

## 1. Advertising

We intend to take advantage of two trends in advertising: (i) the growing shift towards Internet advertising generally and highly targeted digital advertising specifically; (ii) the growing trend amongst retailers and national brands to advertise non-pet products on high traffic pet related sites.

While advertising revenues throughout the industry have recently shown signs of recovery from a soft 2009, we have continued to build out our platform so as to position it to take advantage of a sustained return in Internet based advertising spend which we anticipate will occur during 2010 and 2011. Our competitive advantage is that we have the only platform that can present advertisers' brands to specific new adopters post the completion of the adoption of a new pet via our PetPoint application and 24PetWatch microchip program. Advertising can be segmented according to species, breed and age of a pet and also the demographics of the individual pet owner. We regularly conduct data analysis, overlaying our consumer information with third party census data, to identify trends in the adopter demographic with respect to income, wealth, purchasing power and product purchasing habits.

Additionally, we are able to offer advertisers the ability to have their brands promoted via our network of animal welfare organisations' own web sites on which their adoptable search content is powered by Petango. Currently, nearly 500 of the 1,370 PetPoint licensees also use PetPoint to power their own sites' adoptable search.

While participating animal welfare organisations will always be given the opportunity of opting out from having non Pethealth related brands appear on their own site, opt out rates are generally very low and thus additional revenues, some of which will be shared back with the participating shelters, will be generated.

## 2. Sponsorship

We believe that, given our multi faceted program of products and services to the animal welfare community, we can generate significant sponsorship related revenues outside of those advertising revenues generated through our Petango/PetPoint platform.

Pethealth now commands a leading, if not the leading, relationship position with animal welfare organisations by virtue of the fact that over 1,370 animal welfare organisations at March 31, 2010 run our PetPoint application and, as a result, entrust us with the housing of their animal management data. Moreover, our ShelterCare insurance and 24PetWatch microchip programs are now the dominant insurance and lost pet recovery programs within animal welfare. Combined, these programs are saving animal welfare organisations millions of dollars annually and providing efficiencies in shelter operations not before possible.

With more and more national brands and retailers interested in accessing this demographic, we believe we can generate significant revenues by offering these other brands opportunities to tie their programs to Pethealth's various shelter targeted programs and services.

## 3. E-commerce

In December 2009, the Company launched ThePetangoStore.com web site promoting the sale of pet pharmacy and pet specialty retailer products to pet owners in the United States. While there are now several ecommerce related web sites focusing on the sale of pet pharmacy products, ThePetangoStore.com benefits from having lower new customer acquisition costs than most as sales are driven principally via the Company's shelter platform and to the approximately 70,000 new adopters coming to the Company each month. By year-end, ThePetangoStore.com was offering pet owners approximately 1,300 SKUs with plans to have as many as 3,500 by the end of 2010.

Sales will also be driven by offering commissions to animal welfare organisations as we are able to track sales from new pet owners back to the shelters from which they adopted their new dog or cat. This will

create an additional recurring revenue stream for animal welfare organisations which in turn will lead to more aggressive promotion by the same shelters, humane societies and SPCAs.

#### 4. Content Syndication

The syndication of adoptable search content (the pictures of adoptable dogs and cats with page descriptions) is not a new concept. Many of Pethealth's competitors in adoptable search are currently syndicating their own content to other third parties. Pethealth's advantage is that any adoptable search content syndicated by us will be live to those third parties whereas of the content of other sites is, at least in part, stale, meaning that the animals posted as available for adoption have in many cases already been adopted or, in some cases, euthanized. We believe that as this becomes more and more recognised, companies wishing to have adoptable search content on their own sites will want to avoid the very significant potential brand damage associated with the promotion of stale content.

#### 5. Medical/Data Publishing

Pethealth, via its PetPoint animal management application, is now the largest aggregator of animal welfare organisations' data in North America. In Q1 2010 alone, 403,888 animal "intakes" were completed by shelters running PetPoint and 180,446 adoptions were completed by these same organisations. These numbers represent increases of 10% and 14%, respectively, over Q1 2009. Furthermore, Pethealth expects its intake and adoption data to increase over the year as more organisations move to PetPoint. The value of aggregated shelter data continues to grow as the linkage between shelter data analysis and more efficient shelter operations also grows. Evidence of this can be seen by the number of shelter veterinary programs and by the growing number of Foundations devoted to animal welfare that have been initiated.

In 2009, the Company completed a 30 month agreement with PetSmart Charities whereby PetSmart will pay the company a minimum of \$400,000 over the life of the contract to have access to aggregated data to help further its own initiatives within the animal welfare community. The Company expects to execute other similar deals during 2010 and beyond.

While our commitment to the animal welfare community is that we will not sell the shelters' data to third parties, we nevertheless are in a position, by virtue of our integrated Internet platform, to communicate directly and regularly with pet owners on the merits of not only our own products and services but also those products and services offered by third parties.

#### **PetPoint**<sup>TM</sup>

PetPoint, the first ASP.NET management software application for animal welfare organisations was introduced in 2005. The PetPoint program is promoted to animal control agencies, shelter organisations (SPCAs and Humane Societies) and rescue groups in both Canada and the United States. We estimate that on an annualized basis, PetPoint licensed animal welfare organisations represent better than 50% of the total adoptions completed by all North American animal welfare organisations.

PetPoint is provided free to those animal welfare organisations that are using our 24PetWatch microchip program and agree to also promote our ShelterCare insurance program to their adopters. As a hosted solution, PetPoint provides us with the ability to deliver messaging to the pet adopter at the point of adoption. Through this network of animal welfare organisations we have developed a "virtual pipeline" through which we believe we are able to not only inform adopters about the products and services that are available, but also to influence where they will purchase these products and services. Thus, we believe we will be able to develop several revenue streams from PetPoint through the offering of retail products and services to adopters.

Additionally, we believe that other revenue opportunities exist through the network on the "wholesale" side of the animal welfare industry. As PetPoint is an ASP solution, we have the ability to aggregate shelter

demand and thus create and effect a “buying co-operative”, allowing animal welfare organisations to reduce their operating costs by leveraging their collective demand. We believe that this will not only have appeal to those companies currently or wishing to provide products and services to animal welfare organisations but that it will also provide opportunities for the expansion of our own products and services including a business to business expansion of the Petango Store and a tailored commercial insurance program, an initiative we have recently undertaken.

### **24PetWatch™ PetProtect RFID Microchip and Database Management**

Since selling our first microchip in January 2003, we have become one of the largest providers of RFID microchip technology for companion animal purposes in the world. Sales of microchips exceeded 300,00 in Q1 2010, an increase of 19% over those sold in Q1 2009. We now sell microchips in Canada, the United States and the United Kingdom. In Canada and the U.S., microchips are sold under the 24PetWatch brand and in the U.K. under the Pet Protect brand.

We see RFID technology itself as highly commoditised, with microchips providing the same basic service that they did 15 years ago. As such, we are more focused on prioritising the broader use of RFID technology so as to allow the Company to collect and maintain large volumes of both pet and pet owner information which we can use to sell its various products and services from. Additionally, as described above, we are able to present partner brands to those 24PetWatch subscribers in ways in which no other competitor can.

By the end of Q1 2010, pets registered in the 24PetWatch database exceeded 3.27 million, with the database having doubled in approximately twenty-two months. In July of 2009, an independent third party study conducted by Dr Linda Lord of The Ohio State University and published in the Journal of the American Veterinary Medical Association (“JAVMA”) indicated that by August 2008, approximately one in five dogs and cats microchipped in the United States has been implanted with a 24PetWatch microchip. As the Company only began selling RFID technology nationally in the United States in 2004, this percentage points to the Company having a considerably greater percentage of annual market sales. Indeed, based on the Company’s performance over the past two years and based on the disclosure of some competitors, we estimate that better than one in three microchipped companion animals now carries the 24PetWatch microchip.

The study also reported that we “had a significantly higher percentage of animals registered” than either of its two main competitors. Having accurate pet owner and pet information tied to the microchip is fundamental to generating revenue from those third parties and advertisers looking to have their brands presented to 24PetWatch subscribers as well as to the Company’s own success in selling its pet insurance programs to the subscription base. The Company intends to monetise this significant statistical competitive advantage during 2010 and beyond.

We began selling our microchip program in the U.K. in September 2009. Whereas in the United States and Canada the majority of microchips sold are sold to animal welfare organisations, sales in the U.K. are currently sold principally to veterinary clinics. The success of the Pet Protect microchip program is then expected to assist the Company’s Pet Protect pet insurance program during 2010 and beyond.

We distribute Allflex USA Inc.’s ISO and non-ISO microchips in the United States and Allflex Europe S.A.’s ISO microchips in the United Kingdom on an exclusive basis.

### **Petango**

On May 5, 2009, the Company launched Petango - [www.petango.com](http://www.petango.com) – which we expect to become a leading on-line pet portal for current and prospective pet owners to view content, including on-line adoptable pet search, participate in on-line social networking and to purchase pet supplies and pet

pharmacy products through our on-line store. Our focus for Petango has been initially on on-line adoptable pet search. On-line adoptable pet search is a key driver of both initial and repeat traffic in terms of unique visitors as evidenced by Petango's rapid growth reaching over 2,000,000 unique visitors in Q1 2010. On March 1, 2010, we launched the new look Petango site to integrate both PawsConnect.com, our on-line social network and thePetangoStore.com, our on-line pet supply and pet pharmacy e-commerce platform. The launch of Petango marks the completion of what is now the pet industry's only fully integrated advertising platform for those national brands, national retailers and local retailers looking to advertise their brand to adopters.

#### On-Line Adoptable Pet Search

Petango displays content in real time, a competitive advantage made possible through its full integration with PetPoint. In addition to real time searches, the site also offers potential adopters many additional features including watch lists, e-mail alerts, on-line pet adoption applications , ask the expert, a pet community and the Petango Store.

#### On-Line Social Network

In November, 2007 we launched, in beta format, PawsConnect.com, a social network aimed at empowering the lives of pet owners by providing them with new and innovative ways to interact and learn more about the best way to care for their dogs and cats. Membership in PawsConnect.com was initially driven by leveraging the 24PetWatch subscription base of pet owners which currently exceeds 3.27 million pet owner/pet subscriptions and which is currently growing by approximately 90,000 pet owner/pet subscriptions per month. On March 1, 2010, the PawsConnect.com site was integrated into the Petango portal as part of the evolution of our desire to create a life time relationship with pet owners who have adopted their pet.

#### On-line retail pet supply and pharmacy store

In November 2009, we launched our e-commerce web site [www.thepetangostore.com](http://www.thepetangostore.com) as part of our move to become a dominant goods and services provider to pet owners. The store offers U.S. pet owners both pet medications and pet specialty retail. Through its integration with PetPoint and 24PetWatch, the store's primary audience is both pet owners who are in the process of adopting their new dog or cat who are targeted through PetPoint and those pet owners who have adopted their pet historically by virtue of their subscription to 24PetWatch. We believe that this integration provides us a significant competitive advantage over our competitors as 180,446 adoptions occurred through PetPoint during Q1 2010 and by March 31, 2010 the 24PetWatch subscription base had exceeded 3.27 million.

The Company believes that the Petango portal, integrated with PetPoint and 24PetWatch represents the most comprehensive advertising platform to the shelter demographic in the industry.

## OVERALL PERFORMANCE AND SELECTED QUARTERLY INFORMATION

Unless otherwise indicated, all comparisons of the results for Q1 2010 are against the results of Q1 2009.

| ('000s except per share amounts)   | Q1 2010 | Q1 2009 |
|--|---------|---------|
| Insurance commissions and fees   | 6,321   | 6,865   |
| Microchip technology and non-insurance revenue                                     | 2,045   | 1,851   |
| Interest and other revenue   | 9       | 15      |
| Total Revenue  | 8,375   | 8,731   |
| Net income before taxes  | 616     | 902     |
| Income taxes   | 88      | -       |
| Net income after taxes   | 528     | 902     |
| Net Income (loss) per share <sup>(1)</sup>   | (.003)  | .010    |
| Net Income (loss) per share on a fully diluted basis                               | (.003)  | .010    |
| Total assets   | 21,750  | 17,278  |
| Total cash and cash equivalents  | 6,764   | 2,207   |
| Long term debt (including current portion)   | 3,524   | 7,387   |
| Long term debt (excluding current portion)   | 945     | 4,341   |
| Cash dividends declared per series 1 convertible preferred share (annual dividend) | 0.12    | 0.12    |

Total revenue has been significantly impacted by year over year changes in foreign exchange rates. The 20% appreciation in the Canadian dollar against its U.S. counterpart coupled with the Canadian dollars 10% appreciation against its U.K. counterpart impacted revenue by \$1.23 million when compared to Q1 2009 as illustrated in the following table:

| ('000s)   | Q1 2010 | Q1 2009 |
|---|---------|---------|
| Revenue as reported   | 8,375   | 8,731   |
| Year over year foreign exchange impact on revenue                               | 1,230   | -       |
| Revenue adjusted for changes in foreign exchange rates for comparative purposes | 9,605   | 8,731   |

Net income has been impacted by both non-cash foreign exchange gains and losses related to the translation of our long term debt denominated in US dollars and by year over year changes in foreign exchange rates. For comparative purposes, the following table adjusts net Income before taxes for non-cash foreign exchange translation gains and losses:

| ('000s)  | Q1 2010 | Q1 2009 |
|--|---------|---------|
| Net income as reported   | 528     | 902     |
| Non-cash foreign exchange (gain) loss  | (99)    | 209     |
| Year over year foreign exchange impact on operating income                                       | 441     | -       |
| Net income adjusted for the impact of changes in foreign exchange rates for comparative purposes | 870     | 1,111   |

The first quarter results, in addition to the impact of foreign exchange rates, were also influenced by the following:

- The completion of the transition of the PetProtect policies from D&G insurance company to QBE (Europe) in September 2009. Our average commission on U.K. policies was 33% during Q1 2010 as compared to 23% during Q1 2009. We earned 17% commission for those policies underwritten by D&G and 33% commission for those policies underwritten by QBE.
- An increase in marketing expenses related to the promotion of Petango.com, our online pet portal.
- The execution of an exclusive four year agreement with Allflex (USA) which reduces the wholesale cost and delivery of microchips by a minimum of 10.5%.

## PERFORMANCE OF BUSINESS SEGMENTS

### For the Three Months Ended

|                                      | March 31, 2010 |                   |             | March 31, 2009 |                   |             |
|--------------------------------------|----------------|-------------------|-------------|----------------|-------------------|-------------|
|                                      | Insurance      | Non-<br>Insurance | Total       | Insurance      | Non-<br>Insurance | Total       |
| Operating revenue                    | \$6,321,438    | \$2,044,821       | \$8,366,259 | \$6,865,618    | \$1,850,760       | \$8,716,378 |
| Interest and other income            | 8,574          | -                 | 8,574       | 15,059         | -                 | 15,059      |
| Total revenue                        | \$6,330,012    | \$2,044,821       | \$8,374,833 | \$6,880,677    | \$1,850,760       | \$8,731,437 |
| Employment                           | 1,659,306      | 871,854           | 2,531,160   | 1,515,478      | 706,273           | 2,221,751   |
| Marketing                            | 1,824,728      | 453,499           | 2,278,227   | 1,852,562      | 147,340           | 1,999,902   |
| General & administration             | 1,351,305      | 223,859           | 1,575,164   | 1,379,003      | 284,840           | 1,663,843   |
| Cost of sales                        | -              | 1,029,801         | 1,029,801   | -              | 1,211,556         | 1,211,556   |
| Interest Expense on L/T Debt         | 41,832         | -                 | 41,832      | 82,449         | -                 | 82,449      |
| Foreign exchange                     | (136,518)      | -                 | (136,518)   | 253,410        | -                 | 253,410     |
| Other                                | 239,834        | 199,829           | 439,663     | 248,075        | 148,879           | 396,954     |
| Total expenses                       | 4,980,487      | 2,778,842         | 7,759,329   | 5,330,977      | 2,498,888         | 7,829,865   |
| Operating income (loss) before taxes | \$1,349,525    | (\$734,021)       | \$615,504   | \$1,549,700    | (\$648,128)       | \$901,572   |
| Income Taxes                         | 87,803         | -                 | 87,803      | -              | -                 | -           |
| Operating income (loss) before taxes | \$1,261,722    | (\$734,021)       | \$527,701   | \$1,549,700    | (\$648,128)       | \$901,572   |
| Add:                                 |                |                   |             |                |                   |             |
| Capital asset amortization           | \$214,063      | \$199,829         | \$413,892   | \$205,949      | \$148,879         | \$354,828   |
| Income Taxes                         | \$87,803       | -                 | \$87,803    | -              | -                 | -           |
| Interest Expense on L/T Debt         | \$41,832       | -                 | \$41,832    | \$82,449       | -                 | \$82,449    |
| Operating EBITDA                     | \$1,605,420    | (\$534,192)       | \$1,071,228 | \$1,838,098    | (\$499,249)       | \$1,338,849 |
| Add:                                 |                |                   |             |                |                   |             |
| Stock option expense                 | \$25,771       | -                 | \$25,771    | \$42,126       | -                 | \$42,126    |
| Non operating f/x*                   | (\$98,615)     | -                 | (\$98,615)  | \$209,189      | -                 | \$209,189   |
| Adjusted EBITDA                      | \$1,532,576    | (\$534,192)       | \$998,384   | \$2,089,413    | (\$499,249)       | \$1,590,164 |

<sup>(1)</sup>EBITDA, a non-GAAP measure, is operating income plus amortization, interest and taxes.

<sup>(2)</sup>Non-operating f/x, a non-GAAP measure, is the accounting loss (gain) associated with the translation of the Company's long term debt denominated in United States dollars.

<sup>(3)</sup>Adjusted EBITDA, a non-GAAP measure, is EBITDA plus stock option and equity-based compensation expense adjusted for non-operating f/x as defined above.

## Insurance Segment - Overview

Pet insurance revenues are earned primarily through commissions and fees generated from the sale and renewal of pet insurance policies on behalf of our carriers.

The operating results of the insurance segment are primarily driven by the following key performance drivers: (1) commission and fee growth, (2) loss ratios administration costs, customer acquisition costs and (3) administration costs.

### First quarter results:

| Quarter ended March 31, 2010<br>(000's)           | Canadian<br>Operations | USA Operations | UK<br>Operations | Total    |
|---|------------------------|----------------|------------------|----------|
| Insurance commissions and fees                    | \$ 1,280               | \$ 3,452       | \$ 1,589         | \$ 6,321 |
| Gross premiums earned by carriers                 | 3,363                  | 7,653          | 4,824            | 15,840   |
| Blended commissions as a percentage<br>of premium | 34.6%                  | 39.3%          | 32.8%            | 35.5%    |

| Quarter ended March 31, 2009<br>(000's)           | Canadian<br>Operations | USA<br>Operations | UK<br>Operations | Total    |
|---|------------------------|-------------------|------------------|----------|
| Insurance commissions and fees                    | \$ 1,213               | \$ 4,116          | \$ 1,536         | \$ 6,865 |
| Gross premiums earned by carriers                 | 3,170                  | 8,757             | 5,974            | 17,901   |
| Blended commissions as a percentage<br>of premium | 34.7%                  | 40.5%             | 22.9%            | 33.6%    |

The insurance operations reported a decrease in operating revenue of 8% and pre-tax operating income of 13% for the quarter as compared to a year ago which can be directly attributable to the appreciation of the Canadian dollar. In the absence of the Canadian dollar's appreciation, operating revenue would have increased by 5% and pre-tax operating income would have increased by 13%.

## Commission and fee revenue

### North America

Over 50% of our new policy sales in North America were generated by the shelter channel in Q1 2010. We expect this channel to remain the primary organic growth engine for our North American commission and fee revenue supported by:

- (1) The current trend that adoption is growing as a source of new pet acquisition, which the Company believes is set to continue. This trend was supported in a recent study released by PetSmart Charities and based on IPSOS market research, which showed that pet adoption accounted for 25% of all new pet acquisitions in 2009, when compared to a previous 2005/2006 APPMA Survey, which showed adoptions at approximately 15% of new pet acquisitions. Based on the trending of these two studies, 2010 is expected to be the first year when more people acquire new dogs and cats via adoption than any other single channel;
- (2) The continued growth of our shelter network, centered around the licensing of PetPoint, which will result in more adoptions occurring through our applications and programs;

- (3) An integrated program focused on increasing the number of adopters who, subsequent to completing an adoption, purchase a pet insurance policy. This program focuses specifically on up grading adopters from our 30 day ShelterCare gift of insurance offered by animal welfare organisations running PetPoint to long term policy holders.

In addition to organic growth, we intend to complete pet insurance acquisitions as and when they become available.

## **United Kingdom**

During 2009, we focused on implementing our underwriting profit improvement plan which included the introduction of additional co-payment rates, increases in deductibles, premium increases and the introduction of named peril programs in the UK. While these measures resulted in a reduction in the net policies in-force, we were successful in reducing the loss ratios, claims paid to premiums earned, from 82% while underwritten with D&G to 52% for policies underwritten by QBE (Europe) in 2009. The implementation of our profit improvement plan allowed for the increase in our commission rate from 17% to 33%. During the first quarter of 2010, UK loss ratios increased to 65% due in part to seasonal trends as well as timing differences between the veterinary inflation cycle and the premium rate increase cycle. During Q2, 2010 UK premium rates for both renewals and new business were implemented and our expectation is that the loss ratio will fall over the balance of the year.

While we intend to grow the UK commissions and fee revenue organically, our primary goal is to grow our commission and fee revenue by acquisition. The UK marketing consists of approximately 31 pet insurance providers operating, in aggregate, approximately 77 brands. We believe that the current macro economic conditions in the UK, and in particular the current condition of the U.K. financial service industry, will lead to future acquisition opportunities.

## **Loss ratios**

Our insurance programs are underwritten by third party insurance carriers in the three jurisdictions in which we operate. While we participate in a limited amount of the US and UK underwriting results, the long term viability of our insurance programs requires that the programs produce an adequate return for our third party carriers. A large component of our carriers return on our program stems from the loss ratio, that is, claims incurred expressed as a percentage of premiums earned.

### **Participation in U.S./U.K. underwriting results**

The underwriting risk associated with our pet insurance policies was borne entirely by our carriers prior to February 9, 2006. We announced on February 9, 2006, that we had added Praetorian as an underwriter for our pet insurance policies in the United States. Under the terms of the agreement, we participate in a portion of the underwriting results for the policies placed with Praetorian.

The Pet Protect business transitioned from D&G, on a renewals basis, to QBE (Europe) over a period of twelve months which commenced on October 1, 2008 and concluded September 30, 2009. Under the terms of the agreement with Praetorian, the U.S. and the U.K. underwriting profitability is aggregated and we participate in the underwriting profitability for policies underwritten by Praetorian and QBE (Europe) on the same terms as were in place on our U.S. portfolio, on a consolidated basis.

We participate positively in the underwriting results when the actual annual loss ratio for those policies placed in aggregate with Praetorian and QBE (Europe), on a weighted average basis, is less than 50% and negatively when the weighted average annual accident year-to-date loss ratio exceeds 50%. Our participation is banded between 45% and 55% and, as such, is limited to +/- 2.5% of gross earned premium. The relative weighting is based on geographical earned premium generated by each entity.

As our participation is based on the actual calendar year end loss ratio we are required to use estimates for interim reporting purposes (See Critical Accounting Estimates. The U.S. and U.K. core underwriting results for policies underwritten by Praetorian and QBE (Europe) in aggregate are currently estimated to be between 48.5% and 49.75% for the year. The mid-point of the range, or 49.125%, was recorded in Q1 2010. This compared to a combined participation of 2.5% of earned premium in the prior year resulting in \$270,822 being recorded in Q1 2009. The increase in the year over year aggregate loss ratio reflects the increased weighting of the U.K. business which runs at higher loss ratios than the US business. For Q1 2010, the UK business represented 44% of the aggregate UK/US business eligible for profit participation, up from 26% in 2009.

We intend to employ all of the following strategies to enhance our programs underwriting:

1. Increase the weighting of our core in force policies in North America which are sourced through the shelter channel, a channel which drives loss ratios more favourable to us;
2. Implement premium increases in relation to or greater than veterinary inflation rates – veterinary fees have been growing at an average of 6% - 7% per annum in North America and 11% in the United Kingdom. Premium increases are subject to state regulatory approval in the United States. In Canada, 2010 premium increases will also account for the introduction of HST in both the province of Ontario and the province British Columbia. The tax will increase claims costs by 8% in these two jurisdictions;
3. Improve the marketing position of lower loss ratio programs including the introduction of named peril programs in the United Kingdom which have experienced lower loss ratios than comprehensive programs in North America;
4. Implement a program tied to the Petango Store which will incent insured's to purchase pet pharmacy from us at discounted prices;
5. Adjust coverage's as necessary including co-payment rates and deductibles;

### **Customer acquisition costs**

Of the \$2.28 million we spent in marketing costs in the insurance segment in Q1 2010, 54% was related to the promotion of our ShelterCare program in North America. ShelterCare policies provided to new pet owners adopting dogs and cats from shelters using our PetPoint software solution. All marketing costs are expensed when incurred.

### **Administration costs**

As an MGA, we are responsible for claims adjudication, medical underwriting, billing, and customer service but excluding corporate expenses. For the three months ended March 31, 2010, administration costs, inclusive of North American insurance business and the Pet Protect business, represented 11.1% of gross premiums earned by the Company's carriers, which is consistent with past periods when adjusted for f/x moves.

We intend to maintain or reduce our administrative costs as a percentage of premium through leveraging certain technologies such as our internally developed web based claims adjudication software, EVE. EVE allows for claims under our North American insurance programs to be adjusted online and for the electronic registration of North American pet owner/pet subscriptions with the 24PetWatch program. EVE allows us to reduce claims settlement times, eliminates the paperwork associated with both the claims process and microchip registration, and provides the Company with a distinct competitive advantage over other providers of pet insurance. As of the date of this MDA, 838 veterinary clinics in North America were using EVE.

In addition, we expect to implement a new internal enterprise wide management information system during the third quarter of 2010. The new system has been designed to streamline both our insurance and non-insurance operations which is expected to result in operational cost reductions thus having a positive impact on our administrative costs as a percentage of gross premiums.

We believe that our administrative costs as a percentage of premiums continue to be the best in the industry.

For the quarter ended March 31, 2010 our insurance segment reported total revenues of \$6,330,012, an 8% decrease from the same period in 2009, net income before taxes of \$1,349,525 as compared to net income of \$1,549,700 in the same period in 2009 and Adjusted EBITDA of \$1,532,576 compared to Adjusted EBITDA of \$2,089,413 last year.

### **Non Insurance Segment - Overview**

During Q1 2010 we continued to focus primarily on the continued build out our technology platforms, which, in and of themselves, were not designed to operate as stand-alone sources of revenue. Instead, these platforms are expected to be used to deliver services from which we expect to generate significant business at margins greater than those that can be expected to be earned from the insurance operations.

While it is our intention to bring the non-insurance side of the business into profitability as quickly as possible, we feel that, given its long term potential, funding rapid expansion in the short term is the best way to maximise future returns.

### **PetPoint**

PetPoint had been licensed by 1,370 animal welfare organisations by March 31, 2010, an increase of 22% from those licensed at March 31, 2009. For the quarter, 403,888 intakes (animals entering the animal welfare organisations) and 180,446 adoptions were completed through PetPoint, an increase of 10% and 14% from those completed last year. On an annualised basis, assuming the same growth rate, we expect that over 2 million intakes and 460,000 adoptions will be completed through PetPoint during 2010. During May 2010, we added Transfer Network and the revamped Case Module (used for Animal Control and Humane Law Enforcement), features that are driving the number of animal welfare organisations licensing the system.

### **24PetWatch**

The sale of RFID microchips to animal welfare organisations and veterinary clinics accounted for revenue of \$1,705,357 in Q1 2010 representing 83% of the total non-insurance revenues for the quarter. This

compared to \$1,671,175 in Q1 2009, a 2% increase. On May 11, we announced that we had entered into an exclusive supply and purchase agreement with Allflex (USA) effective January 1, 2010. Under the terms of the agreement, Allflex has agreed to handle all shipping logistics in the United States and Canada as well as fix the wholesale pricing of its microchip technology over 4 years. The agreement is expected to reduce our costs by approximately \$450,000 in the first year and by a minimum of \$500,000 annually thereafter.

In addition, the sale of ancillary products and services to the 24PetWatch database of pet owners, such as pet tags and change of address fees but excluding insurance products, accounted for an additional \$339,464 in revenue, 89% higher than the \$179,585 sold in the same quarter in the prior year. Our 24PetWatch call center received 51,214 inbound calls from subscribers of the 24PetWatch service during Q1 2010, representing a 24% increase over Q1 2009. Subscribers representing 28.5% of total inbound calls chose to purchase one or more of the Company's products and services during the quarter vs. 22.6% in Q1 2009. We expect that the growth of both Petango and the Petango Store will provide further opportunities to cross sell products and services to the 24PetWatch database of pet owners

### **Petango adoptable search**

On May 5, 2009, we launched Petango, our adoptable search engine. By year end it had become the second most popular destination for on-line adoptable search in terms of unique visitors reaching over 2,000,000 in Q1 2010. As a result of seasonality, unique visitors dipped to 719,000 during the month of March. We expect that as we move into spring and summer that unique visitors will grow and quickly surpass those unique visitors recorded in December. On March 1, 2010, the new Petango site was launched expanding the Petango brand and integrating it with our social networking site and the Petango Store. We expect that this integration will further drive all three properties.

### **The Petango Store**

On November 11, 2009, we launched our on-line pet supply and pharmacy at [www.thepetangostore.com](http://www.thepetangostore.com). For Q1 2010, results from the store were not material.

### **Medical information / data publishing**

On September 8, 2009, we announced that we had signed a licensing agreement with PetSmart Charities Inc. ("PetSmart Charities") which grants PetSmart Charities access to the aggregated animal shelter data we compile. The non-exclusive license runs through until December 31, 2011 and will see PetSmart Charities pay us a minimum of US\$400,000.

### **Non-Insurance segment consolidated**

For the quarter ended March 31, 2010 our non-insurance segment reported total revenues of \$2,044,821, a 10% increase from 2009, operating losses of (\$734,021) as compared to operating losses of (\$648,128) in 2009 and Adjusted EBITDA of (\$534,192) compared to Adjusted EBITDA of (\$499,249) last year. We believe that funding the rapid build out of our non-insurance platforms primarily from the stable and recurring cash flows generated in our insurance segment remains the best way to maximise long term shareholder value.

## SUMMARY OF QUARTERLY RESULTS

The following charts detail the Company's consolidated results for the past eight quarters:

| (\$ thousands)  | For the Quarter Ended |                 |                |                 |
|---|-----------------------|-----------------|----------------|-----------------|
|   | Q2<br>June '09        | Q3<br>Sept. '09 | Q4<br>Dec. '09 | Q1<br>March '10 |
| Insurance commission and fee revenue                      | \$ 6,794              | \$ 7,008        | \$ 7,197       | \$ 6,321        |
| Microchip technology and non-insurance revenue            | 1,858                 | 1,949           | 1,677          | 2,045           |
| Interest and other income                                 | 10                    | 9               | 10             | 9               |
| Total revenue   | 8,662                 | 8,966           | 8,884          | 8,375           |
| Net income(loss) before income taxes                      | 1,675                 | 1,057           | 1,002          | 616             |
| Income taxes  | -                     | -               | 487            | 88              |
| Net income after taxes                                    | 1,675                 | 1,057           | 515            | 528             |
| Net income(loss) per share (i)                            | 0.059                 | 0.037           | 0.12           | (.003)          |
| Net income(loss) per share (on a fully diluted basis) (i) | 0.059                 | 0.037           | 0.12           | (.003)          |
| Gross premiums earned by carriers (ii)                    | \$ 17,851             | \$ 16,970       | \$ 16,139      | \$15,840        |

| (\$ thousands)                                      | For the Quarter Ended |                |               |                 |
|---|-----------------------|----------------|---------------|-----------------|
|   | Q2<br>June '08        | Q3<br>Sept '08 | Q4<br>Dec '08 | Q1<br>March '09 |
| Insurance commission and fee revenue                | \$ 4,415              | \$ 5,446       | \$ 6,490      | \$ 6,866        |
| Microchip technology and non-insurance revenue      | 1,247                 | 1,425          | 1,682         | 1,850           |
| Interest and other income                           | 26                    | 26             | 40            | 15              |
| Total revenue                                       | 5,688                 | 6,897          | 8,212         | 8,731           |
| Net income after income taxes                       | 359                   | 106            | (479)         | 902             |
| Net income per share (i)                            | .013                  | 0.004          | 0.003         | 0.010           |
| Net income per share (on a fully diluted basis) (i) | .013                  | 0.004          | 0.003         | 0.010           |
| Gross premiums earned by carriers (ii)              | \$ 10,086             | \$ 15,023      | \$ 18,185     | \$ 17,901       |

As discussed previously, the two year quarterly trends in the business have been primarily influenced by:

- Growth in our insurance portfolio, including our acquisition of PetProtect on July 28, 2008. Commissions are fee revenue was impacted significantly by PetProtect since the acquisition as commission increased over the course of 12 months (October 2008 through September 2009) from 17% to 33% on UK business;
- Our continued build out of our technology platforms and shelter network;
- Foreign exchange fluctuations, both positive and negative. Q1 2010 vs. Q1 2009 was particularly impacted as, in aggregate, insurance and non-insurance segment revenues would have been \$1,230,030 higher and net income would have been \$441,022 higher had Q1 2009 rates remained in effect.

## LIQUIDITY AND CAPITAL RESOURCES

| <i>Consolidated Cash flows:</i>                              | <u>Three Months Ended</u> |                          |
|--|---------------------------|--------------------------|
|  | March 31, 2010            | March 31, 2009           |
| Net cash inflow - operations                                 | \$ 876,985                | \$ 1,497,330             |
| Change in non-cash operating working capital balances        | 529,708                   | 695,375                  |
| Net cash outflow - financing                                 | (1,163,597) <sup>1</sup>  | (1,475,371) <sup>3</sup> |
| Net cash outflow - investment                                | (715,349) <sup>2</sup>    | (378,900) <sup>4</sup>   |
| Effect of exchange rate changes on cash and cash equivalents | (73,705)                  | -                        |
| (Decrease)/increase in cash                                  | (545,958)                 | 338,434                  |
| Cash balance – beginning of period                           | 7,310,238                 | 1,868,071                |
| Cash balance – end of period                                 | \$ 6,764,280              | \$ 2,206,505             |

<sup>1</sup> Inclusive of (1) \$585,000 (\$0.12) dividend payment made to holders of the Company's convertible preference shares and tax on dividend payment of \$25,000. The Company is required to make this payment annually each January. (2) Repayment of long term debt \$540,020. (3) Repayment of obligations under capital leases \$52,327 and (4) Issuance of common shares on exercise of options.

<sup>2</sup> Inclusive of (1) purchase of capital and intangible assets \$715,349 (primarily software development); \$12,724 of these were financed through new capital leases.

<sup>3</sup> Inclusive of (1) \$600,000 (\$0.12) dividend payment made to holders of the Company's convertible preference shares and tax on dividend payment of \$25,000. The Company is required to make this payment annually each January and (2) Repayment of long term debt \$803,239 and (3) Repayment of obligations under capital leases \$47,132.

<sup>4</sup> Inclusive of (1) purchase of capital and intangible assets \$378,900 (primarily software development); \$156,544 of these were financed through new capital leases.

On February 9, 2006, the Company entered into an agreement with Praetorian Financial Group Inc. whereby Praetorian agreed to become one of the Company's underwriters for the Company's pet insurance programs in the United States. Under the terms of the agreement, the Company participates in a portion of the underwriting results for the policies placed with Praetorian and QBE (Europe). As part of its agreement, the Company is to post security in favour of Praetorian of an amount up to 2.5% of the core insurance premiums earned by Praetorian in the form of a letter of credit or other agreed upon form. As of the date of this MDA, this portion of the agreement had not yet been formalised between the parties.

On July 28, 2008, the Company entered into a U.S. \$7,098,000, fixed interest rate of 4.52%, 3-year loan agreement with a recognised financial institution to finance the £3.5 - million (\$7.1 - million) acquisition of Pet Protect. The loan is repayable in equal monthly instalments over the 36 month term. At March 31, 2010, the loan had an outstanding principal balance of U.S. \$3,336,044.

On December 19, 2007, the Company entered into an agreement with Microsoft Canada Inc. to finance the acquisition of system and applications software and related support services that were delivered beginning February 1, 2008. The principal amount financed was \$450,000 at an effective interest rate of 8.5% and is repayable in thirty-six monthly instalments of \$14,205 which commenced February 1, 2008. At March 31, 2010, the loan had an outstanding principal balance of \$136,673.

The Company's contractual commitments are as follows:

|   | Payments Due by Period |                     |                     |                     |                     |
|---|------------------------|---------------------|---------------------|---------------------|---------------------|
|   | Total                  | Less than 1 year    | 1-3 years           | 4-5 years           | After 5 years       |
| Accounts payable & accrued liabilities                  | \$ 4,020,697           | \$ 4,020,697        | \$ -                | \$ -                | \$ -                |
| Long term debt  | 3,646,764              | 2,690,643           | 956,121             | -                   | -                   |
| Capital lease obligations                               | 385,691                | 206,933             | 170,941             | 7,817               | -                   |
| Operating lease obligations (including premises leases) | \$ 6,174,211           | \$ 845,341          | \$ 2,382,651        | \$ 1,470,756        | \$ 1,475,463        |
| Other contractual obligations                           | -                      | -                   | -                   | -                   | -                   |
| <b>TOTAL</b>  | <b>\$ 14,227,363</b>   | <b>\$ 7,763,614</b> | <b>\$ 3,509,713</b> | <b>\$ 1,478,573</b> | <b>\$ 1,475,463</b> |

(1) Of the total operating leases, \$6,142,886 relates specifically to the Company's long term lease of office space.

In addition to the above contractual obligations, we pay an annual dividend to the holders of its Series 1 cumulative 6% convertible preferred shares of \$585,000 in aggregate each January. We made this annual dividend payment on January 25, 2010 to holders of record on January 20, 2010.

We anticipate that, based on the profitability of the Company and forecasted cash requirements, there are sufficient cash resources to fund the Company's current operations. However, opportunities to accelerate our growth objectives, including possible acquisitions, new products and/or services, maximising the current or future distribution channels, or the establishment of new distribution channels, may present themselves and may require us to raise additional debt and/or equity financing to take advantage of such opportunities.

## FOREIGN EXCHANGE

Our United States subsidiaries are "integrated subsidiaries" as defined under Canadian Generally Accepted Accounting Principles and, as such, foreign exchange translation gains or losses are recognised on the date on which the related transaction occurs. As a result, the net impact of the change in the exchange pairs the transaction to the balance sheet date, in the case of unsettled financial assets and liabilities, or the

settlement date, in the case of settled financial assets and liabilities, and is recorded on the statement of income, comprehensive income and deficit.

Our United Kingdom subsidiary is a “self sustaining subsidiary” as defined under Canadian Generally Accepted Accounting Principles and, as such, our exposure to currency fluctuations is limited to its net investment in the subsidiary. Foreign exchange translation gains and losses are calculated using the current method, that is, the rates in effect at each balance sheet date. The foreign accounting exchange translation gains or losses resulting from holding the net investment between balance sheet dates is recorded on the balance sheet as accumulated other comprehensive income and are not reflected in the statement of income, comprehensive income and deficit until such time that the net investment is removed from the balance sheet either through a sale or an impairment in value.

Under Canadian Generally Accepted Accounting Principles, our U.S. dollar denominated loan is a foreign currency transaction and does not form part of the foreign operation. As a result, the foreign exchange accounting translation gains and losses, which result from the relative value of the exchange rate between the Canadian and U.S. dollar in place on the balance sheet date as compared to the exchange rate in place at the commencement of the loan, are recorded on the statement of income and other comprehensive income. As we repay our U.S. denominated debt with cash generated from our U.S. business we do not experience a cash flow impact from holding U.S. dollar denominated debt.

We report our consolidated results in Canadian dollars and therefore the net translated value of its United States and United Kingdom denominated financial assets and liabilities is reflected on the Balance Sheet. Foreign currency translations can have a significant impact on reported consolidated results during periods of fluctuating exchange rates.

We do not employ a foreign currency derivative hedging program.

At March 31, 2010, the Company had the following financial assets and liabilities, denominated in U.S. dollars and U.K. Pound Sterling excluding inter-company balances, which are eliminated for consolidation:

|   | USD       |                    | £               |
|---|-----------|--------------------|-----------------|
| Cash and cash equivalents                 | \$        | 393,004            | £ 519,947       |
| Accounts & other receivables              |           | 1,297,416          | 198             |
| Loan                                      |           | (3,336,046)        | -               |
| Accounts payable                          |           | (727,672)          | (1,991)         |
| Accrued liabilities                       |           | (384,496)          | (498,181)       |
| Deferred revenue                          |           | (210,295)          | -               |
| <b>Net financial (liabilities)/assets</b> | <b>\$</b> | <b>(2,968,089)</b> | <b>£ 19,973</b> |

#### Sensitivity

As of March 31, 2010, a 10% appreciation or depreciation in the Canadian dollar against the U.S. dollar and the Pound Sterling at the balance sheet date would have resulted in a decrease or increase in consolidated net income of approximately \$268,011 as it relates to the above listed financial assets and liabilities.

In addition, as we report our consolidated results in Canadian dollars, changes in the relative value of the Canadian dollar against the U.S. dollar impact revenues and net income positively in periods when the Canadian dollar falls in value relative to the U.S. dollar, and negatively when the Canadian dollar strengthens.

For the quarter ended March 31, 2010, the 20% appreciation in the Canadian dollar against the US dollar and the 10% appreciation in the Canadian dollar against the pound sterling vs. Q1 2009 did have a

significant impact on year over year comparative revenue and earnings – on an f/x adjusted pro-forma basis, the appreciation in the Canadian dollar against the two currencies decreased the consolidated revenue by \$1,230,030 and earnings by \$441,022 as compared to the same period in the prior year.

## OUTSTANDING SHARE DATA

The table below contains a summary of the outstanding shares for each class of equity at March 31, 2010. The total number of outstanding and issuable shares is also presented assuming full conversion of outstanding options and shares reserved for future option grants.

| Outstanding shares  | Common Shares | Series 1 Convertible Preference shares (non-voting) <sup>(1)</sup> | Total Shares              |
|---|---------------|--|---------------------------|
| Common equity   |               |  |                           |
| Outstanding shares as at March 31, 2010                           | 32,503,568    | 4,875,000  | 37,378,568 <sup>(2)</sup> |
| Options outstanding <sup>(3)</sup> and issuable at March 31, 2010 | 3,698,443     | -  | 3,698,443                 |
|   | 36,202,011    | 4,875,000  | 41,077,011                |

<sup>(1)</sup> On January 21, 2004, we completed a private placement financing of 5,000,000 Series 1 6% convertible preferred shares of the Company ("preferred shares") at a price of \$2.00 per preferred share for aggregate gross proceeds to the Company of \$10,000,000 and the net proceeds were \$9,339,272 after deducting agent and issuance costs. Each preferred share is entitled to cumulative dividends at the fixed rate of 6% payable annually on the anniversary date. Each preferred share is convertible into 1 common share in the capital of the Company at any time at the option of the holder.

<sup>(2)</sup> For the purposes of calculating diluted earnings per share, the weighted average number of shares was 33,117,947 for the quarter ended March 31, 2010.

<sup>(3)</sup> Assuming full conversion and ignoring exercise prices.

## RELATED PARTY TRANSACTIONS

On August 1, 2002, the Board of Directors authorised the Company to lend to the President and Chief Executive Officer the amount of \$500,000 for the exclusive purpose of purchasing shares of the Company. The loan amount was advanced by the Company and evidenced by a promissory note and a securities pledge agreement in favour of the Company for 833,333 common shares in the capital of the Company. As of August 1, 2002, these pledged shares represented (and continue to represent as of the current year end) a market value in excess of the loan amount of \$500,000. The promissory note bears interest at the lesser of the prevailing prime rate and 7% per annum with a maturity date of August 1, 2012. Immediately following the advance of the loan, the President and Chief Executive Officer purchased 416,666 units of the Company at a purchase price of \$1.20 per unit, each such unit consisting of a common share and a common share purchase warrant, which warrant entitled the holder thereof to acquire one common share at an exercise price of \$1.00 per common share up to and including December 19, 2002.

On December 19, 2002, the Board of Directors further authorised the Company to loan to the President and Chief Executive Officer an additional amount of \$530,303 for the exclusive purpose of exercising the previously issued warrants to purchase 530,303 common shares in the capital of the Company. The loan amount was advanced by the Company and evidenced by a promissory note and a securities pledge agreement in favour of the Company for 530,303 common shares in the capital of the Company. As of

December 19, 2002, these additional pledged shares represented (and continue to represent as of the current year end) a market value in excess of the loan amount of \$530,303 and accrued interest. Pursuant to this securities pledge agreement, all of the common shares in the capital of the Company pledged by the borrower to the Company secure all of the obligations of the borrower of such loan amounts. The promissory note bears interest at the lesser of the prevailing prime rate and 7% per annum with a maturity date of December 19, 2012. Immediately following the advance of the loan by the Company, the President and Chief Executive Officer exercised the warrants and purchased an additional 530,303 common shares in the capital of the Company at an exercise price of \$1.00 per warrant.

As at March 31, 2010, accrued interest receivable was \$414,399 (2009 - \$382,023).

## CRITICAL ACCOUNTING ESTIMATES

The preparation of consolidated financial statements that conform with Canadian generally accepted accounting principles (GAAP) requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent liabilities at the date of the Consolidated Financial Statements and the reported amounts of revenue and expenses during the reporting period. The Company bases its estimates on historical experience, current trends and other assumptions that are believed to be reasonable under the circumstances. Actual results could differ from those estimates. In our judgment, the accounting policies and estimates detailed in Note 1 of the Notes to the Consolidated Financial Statements for the year ended December 31, 2009 do not require us to make assumptions about matters that are highly uncertain and accordingly none of the estimates is considered a "critical accounting estimate" as defined in Form 51-102F1 published by the Ontario Securities Commission, except as noted below:

### **Valuation of goodwill and other intangibles**

Goodwill is not subject to amortization. Instead, it is tested for impairment at the reporting unit level on an annual basis and if an event or change in circumstances occurs that indicates that the carrying value of the reporting unit might exceed its fair value. The first step of goodwill impairment testing involves determining whether the fair value of the reporting unit to which the goodwill is associated is less than its carrying value. Where fair value of the reporting unit exceeds its carrying value, goodwill of that reporting unit is considered not to be impaired. When the fair value of the reporting unit is less than its carrying value, a second step is required and the fair value of the goodwill in that reporting unit is compared to its carrying value. If the fair value of goodwill is less than its carrying value, goodwill is considered to be impaired and a charge for impairment representing the excess of carrying value over fair value of the goodwill is recognized immediately in the Consolidated Statement of Income.

The fair value of the Company's reporting units are determined from internally developed valuation models that consider various factors and assumptions such as forecasted earnings, growth rates, discount rates, and, where applicable, terminal multiples. Management is required to use judgment in estimating the fair value of reporting units and the use of different assumptions and estimates in the fair value calculations could influence the determination of the existence of impairment and the valuation of goodwill. Management believes that the assumptions and estimates used are reasonable and supportable. Where possible, fair values generated internally are compared to relevant market information.

The Company's most current goodwill testing concludes that the goodwill in each reporting unit is considered not to be impaired. Additionally, the reporting units are not at risk of failing the first step of goodwill impairment testing.

Other intangible assets with an indefinite life are not subject to amortization; rather, they should be assessed annually for impairment. As at March 31, 2010, the Company does not have any indefinite life

intangibles. Finite life intangible assets that are subject to amortization, after initial recognition, are amortized over their estimated useful life. We make an annual assessment on whether any events or changes in circumstances have occurred to indicate that the carrying value of these finite life intangible assets may not be recoverable. Determining the estimated useful life and the identification of any events or changes in circumstances affecting the recoverability of carrying value of these finite life intangible assets requires an analysis of facts and management's judgment. When events or changes in circumstances indicate that the carrying value may not be recoverable and the carrying value is higher than the sum of undiscounted cash flows expected from the asset's use and eventual disposition, the asset is written down to its fair value. This accounting policy impacts both of our business segments. See Notes 2(b), 8 and 9 to the 2009 Consolidated Financial Statements for additional disclosures regarding goodwill and other intangibles.

### **Participation in Underwriting results – Interim periods only**

As previously discussed under the heading Insurance Segment – Overview, the Company participates in a portion of the aggregate underwriting results for those core policies underwritten by Praetorian and QBE (Europe). Under the terms of our underwriting agreements, we participate positively in the underwriting results when the actual annual loss ratio for those policies placed in aggregate with Praetorian and QBE (Europe), on a weighted average basis, is less than 50% and negatively when the weighted average annual accident loss ratio exceeds 50%. Our participation is banded between 45% and 55% and, as such, is limited to +/- 2.5% of gross earned premium. The relative weighting is based on geographical earned premium generated by each entity. The annual weighted average loss ratio is calculated at the conclusion of each calendar year and is influenced both by the actual ratio of losses to earned premium and the prevailing exchange rates in place on December 31 of any given year. As a result, interim periods are estimated based on a range of projected annual results.

The range of projected annual results is based on year to date actual results, seasonality of losses and premiums, projections based on expected changes in relative weightings of the US and UK programs (including foreign exchange rates) and projections based on known adjustments to underwriting guidelines and/or rates to occur to each program over the remainder of the year.

### **BUSINESS ACQUISITION REPORT ("BAR")**

On February 12, 2010, we received a letter from the Ontario Securities Commission ("**OSC**") stating that the OSC's Corporate Finance branch had selected the Company for a full review of its continuous disclosure record. On the basis of their review, the OSC had several questions that it outlined in the February 12, 2010 letter and in a subsequent letter to the Company dated March 31, 2010. We have had ongoing contact with the OSC to address these questions, including response letters dated March 15, 2010 and April 13, 2010. One such issue related to the Business Acquisition Report ("**BAR**") we filed in connection with our acquisition of Pet Protect Limited in July 2009. Although we filed the BAR, it had not been effected within the prescribed timeline and did not include certain disclosure relating to acquisition statements that were included in the BAR as prescribed in section 6.1(4) and 6.2(2)(a) of NI 52-107; sections which require that certain disclosure be included in the BAR if the acquisition statements were prepared using UK Accounting Standards (or any other accounting principles that are different from the Company's GAAP). We have since filed consolidated financial statements for the year ended December 31, 2009 which consolidate the financial position and results of the acquired entity.

## NON GAAP ACCOUNTING MEASURES

The Company believes the presentation of EBITDA and Adjusted EBITDA is a useful means of providing investors with additional information in reviewing and analysing the Company's operating results. EBITDA and Adjusted EBITDA are considered to be a non-GAAP earnings measures and do not have any standardised meaning prescribed by GAAP. It is, therefore, unlikely to be comparable to similar measures presented by other issuers.

The following table reconciles operating income, EBITDA and Adjusted EBITDA:

|  | Three Months Ended |                |
|--|--------------------|----------------|
|  | March 31, 2010     | March 31, 2009 |
| Operating income after taxes                       | 527,701            | 901,572        |
| Amortisation                                       | 413,892            | 354,828        |
| Interest on long term debt                         | 41,832             | 82,449         |
| Income taxes                                       | 87,803             | -              |
| EBITDA <sup>(1)</sup>                              | 1,071,228          | 1,338,849      |
| Stock option and equity-based compensation expense |                    |                |
|  | 25,771             | 42,126         |
| Non-operating f/x loss / (gain) <sup>(2)</sup>     | (98,615)           | 209,189        |
| Adjusted EBITDA <sup>(3)</sup>                     | 998,384            | 1,590,164      |

<sup>(1)</sup>EBITDA, a non-GAAP measure, is operating income plus amortization, interest and taxes.

<sup>(2)</sup>Non-operating f/x, a non-GAAP measure, is the accounting loss (gain) associated with the translation of the Company's long term debt denominated in United States dollars.

<sup>(3)</sup>Adjusted EBITDA, a non-GAAP measure, is EBITDA plus stock option and equity-based compensation expense adjusted for non-operating f/x as defined above.

## ACCOUNTING PRONOUNCEMENTS

### Financial Instruments

As of January 1, 2009, the Company has adopted the changes required under CICA Handbook Section 3862 Financial Instruments – Disclosures regarding fair value measurement and liquidity. Section 3862 requires additional disclosures: (i) levels in the fair value hierarchy into which the fair value measurements are categorized in their entirety; (ii) any significant transfers between Level 1 and Level 2 and the reasons for those transfers; and (iii) reconciliation of the beginning to the ending balances for those fair value measurements that result from the use of significant unobservable inputs in valuation techniques (Level 3), disclosing separately changes during the period. Three levels of fair value hierarchy are defined as: Level 1 – quoted prices (unadjusted) in active markets for identical assets or liabilities; Level 2 – inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly, and Exchange markets prices are readily available; and Level 3 – inputs for asset or liability that are not based on observable market data.

These new standards had no impact on the classification and measurement of the transactions in the Company's consolidated financial statements.

### Goodwill and Intangible assets

On January 1, 2009, the Company adopted the CICA's new accounting requirements for goodwill and intangible assets. The Company has restated prior periods' financial statements for this change. The new rules required the Company to reclassify certain computer software from capital assets to intangible assets.

On January 1, 2009, the impact of this change in accounting policy was an increase in the intangible assets of \$2,930,973 and a decrease in capital assets of \$2,930,973. Amortization of intangible assets increased by \$1,783,117 and decreased in capital assets by \$1,783,117.

## **International Financial Reporting Standards**

In February 2008, the CICA announced that Canadian GAAP for publicly accountable enterprises will be replaced by IFRS for fiscal years beginning on or after January 1, 2011. Companies will be required to provide IFRS comparative information for the previous fiscal year. Accordingly, the conversion from Canadian GAAP to IFRS will be applicable to our reporting for the first quarter of 2011, for which the current and comparative information will be prepared under IFRS.

We completed the scoping phase of the project, which consisted of project initiation and awareness, identification of high-level differences between Canadian GAAP and IFRS, project planning and resourcing. We have now commenced the evaluation and design phase which includes, amongst other things, the detailed review and quantification of the high-level differences identified in the scoping phase, the selection of accounting policies where choices exist and a detailed review and impact analysis of the adoption of IFRS 1 including impacts on information technology and data systems, internal controls over financial reporting and disclosure controls and procedures. The impact on such elements will depend on the particular circumstances prevailing at the adoption date and the IFRS accounting policy choices made.

The measurement differences between Canadian GAAP and IFRS will have an impact on the opening financial position of the Company at transition. As well, the results from operation under IFRS will differ from Canadian GAAP as will disclosures. Significant areas that have been identified to date include foreign currency, share-based compensation and leases.

### **Foreign currency**

The assessment of an entities functional currency differs under Canadian GAAP and IFRS. Under Canadian GAAP we are required to assess each subsidiary to determine if that subsidiary is to be accounted for as an integrated subsidiary (functional currency being the same as the parent) or a self sustaining subsidiary (functional currency of the country in which the subsidiary operates). This assessment is made utilizing guidance as provided for in CICA 1651 which includes but is not limited to impact of day to day activities on cash flows, sales price determination, sales market, cost base, and day to day interrelationship with reporting enterprise. Once a subsidiary is determined to be an integrated subsidiary or a self sustaining subsidiary it remains that way unless a significant change in economic facts and circumstances has occurred. Under IFRS, the determination of functional currency requires that we first determine if a conclusion can be drawn from the primary indicators being (1) the currency that dominates the determination of sales prices and (2) the currency that most influences operating costs. Secondary indicators such as level of autonomy, self financing, interrelationship with reporting enterprise, etc. are only reviewed as support if a conclusion can not be reached from reviewing the primary indicators.

Under Canadian GAAP, we have accounted for our U.S. subsidiaries as integrated subsidiaries (functional currency of Canadian dollars). As integrated subsidiaries, foreign exchange translation gains or losses are recognized on the date on which the related transaction occurs. As a result, the net impact of the change in the exchange pairs the transaction to the balance sheet date, in the case of unsettled financial assets and liabilities, or the settlement date, in the case of settled financial assets and liabilities, and is recorded on the statement of operations and deficit. Under IFRS, one or more of our U.S. subsidiaries could be determined to have a functional currency of U.S. dollars. If functional currency is determined to be U.S. dollars, our exposure to currency fluctuations is limited to the net investment in the subsidiary. Foreign exchange translation gains and losses would be calculated using the current method, that is, the rates in effect at each balance sheet date. The foreign accounting exchange translation gains or losses resulting from holding the net investment between balance sheet dates would be recorded on the balance sheet as

accumulated other comprehensive income and are not reflected in the statement of operations and deficit until such time that the net investment is removed from the balance sheet either through a sale or an impairment in value.

We have not yet determined the functional currency of our U.S. subsidiaries as that determination will be influenced by transactions and operating changes which may or may not occur prior to January 1, 2011.

#### Share based compensation

The factors affecting stock-based compensation include estimates of when stock options might be exercised and the expected future stock price volatility. The timing of when stock options will be exercised is out of our control and will depend upon a variety of factors including the market value of the our common shares and the financial objectives of the holders of the stock options. We have used historical data to determine volatility in accordance with Black-Scholes modeling, however the future volatility is inherently uncertain and the model has its limitations. While these estimates may have a material impact on stock-based compensation, and hence the results of operations, there is expected to be no impact on the Company's financial condition.

#### Leases

While Canadian GAAP and IFRS are similar in their categorization of leases, "Capital" and "Operating" under Canadian GAAP and "Finance" and "Operating" under IFRS the two differ with respect to the criteria used to determine proper classification. The fair value of the underlying assets associated with Capital and Finance leases are carried on the balance sheet as assets of the Company and are amortized into income over the useful life of the asset. The assets underlying operating leases are not assets of the Company and as such lease payments are charged against earnings as payments are made. While we do not expect that reclassification of certain of our leases from Capital/Finance to Operating or vice versa to have a material impact, we do expect that reclassifications could impact our presentation of assets.

#### Impact on Financial Statement Presentation

Our financial statements will have a different appearance under IFRS when compared to our current presentation under Canadian GAAP. The Company's Balance Sheet will be renamed to the Statement of Financial Position. Various asset, liability and equity line items will be reordered based on liquidity. Specific areas of the Company's financial statements will be called, the income statement and statement of changes in equity (currently combined as the statement of operations and deficit), statement of comprehensive income/(loss), statement of cash flows and notes to financial statements.

IFRS 1 is a financial reporting standard that stipulates the requirements for an entity that is preparing IFRS compliant statements for the first time, and applies at the time of changeover. IFRS 1 provides for the optional exemptions to the general rule of retroactive application of IFRS. While the Company has not finalized decisions, it currently expects to elect the following exemption to retrospective application:

- Foreign currency – the Company expects to reset the cumulative translation gains and losses to nil at transition (reverse it against retained earnings) instead of computing the translation gains and loss amounts retroactively under IFRS;
- Business combinations – the relevant standard under IFRS may be applied retroactively or prospectively on transition. The Company expects to elect not to restate acquisitions prior to the IFRS transitional date of January 1, 2010.

The Company continues to evaluate and quantify the impact of transitioning to IFRS.

## RISKS AND UNCERTAINTIES

Management of the Company has identified several risks associated with execution of the Company's business plan, including its stage of development. The Company intends to continue to modify and/or expand its business and business plan, which will continue to place heavy demands on the Company's management, operating systems, internal controls and financial and physical resources.

The Company faces challenging macro economic and market conditions in Canada, the U.S. and the United Kingdom. The deterioration of the U.S. residential mortgage market that began in 2007 precipitated a global credit crisis prompting unprecedented responses from governments and central banks. Such an environment could cause the Company to make unplanned modifications to its products and services and could potentially have a material adverse effect on the Company's business, operations, future prospects and financial results.

The Company currently transacts sales in Canadian and United States dollars as well as British Pounds Sterling. In North America, the majority of operating costs are incurred in Canadian dollars while revenues are generated in both United States and Canadian dollars. In the United Kingdom, operating costs are incurred in both British Pounds Sterling and Canadian dollars while revenues are generated in British Pounds Sterling. In North America and the United Kingdom, the Company is exposed to foreign exchange fluctuations. From time to time the cost effectiveness of any currency hedging strategy is examined relative to the identified risk.

The pet insurance market in North America and the United Kingdom is competitive. The Company may not be aware of other companies' plans or existing property and casualty insurance carriers' plans to enter the market. Changes in the competitive landscape in the markets in which the Company operates could have a material adverse effect on the Company's business, operations, future prospects and financial results.

The business of insurance is subject to substantial government regulation and supervision in North America and the United Kingdom, including, in the United States, a state-by-state approval requirement for all policy form and rate modifications. Changes in the current regulatory and supervisory framework could include increased governmental involvement and unanticipated expenses in the insurance industry, or could otherwise change the business and economic environment in which insurance industry participants operate. Such changes could cause the Company to make unplanned modifications to its products and services and could potentially have a material adverse effect on the Company's business, operations, future prospects and financial results.

The Company does not underwrite the risk associated with the pet insurance policies it places with pet owners in Canada and has limited participation in the United States and the United Kingdom. In Canada, the underlying risk is borne by Lombard, in the U.S. and the U.K. by QBE. There are no assurances that Lombard or QBE will continue to underwrite the risk associated with the Company's pet insurance policies or that a suitable replacement could be secured on a timely basis. The loss of Lombard or QBE could have a material adverse effect on the Company's business, operations, future prospects and financial results.

As a component of the Company's existing companion animal pet registry and recovery database service, the Company distributes microchip technology. Microchip technology is purchased from third party suppliers and resold to members of the veterinary and the animal welfare communities. As such, revenues are dependent on such suppliers' ability to supply sufficient quantities of products on a timely basis to meet expected customer demands. The Company relies on the veterinary and shelter communities to resell the products and services to their customers. The consumer demand required for the successful execution of this component of the Company's business plan may not necessarily develop as expected through these distribution channels. These microchip technologies are subject to certain patents not owned by the Company or the Company's provider, which may restrict the Company's ability to carry out its existing distribution strategies for such microchip technology and/or may result in unanticipated costs that could have a potentially material adverse effect on the Company's financial resources. There is no assurance that the Company's existing provider will be able to adapt to changing technologies or successfully develop

products and/or licence technology not otherwise subject to third party intellectual property rights.

Sales through thePetangoStore.com are fulfilled by third party distributors and, as such, we are dependent on their ability to supply sufficient quantities of products on a timely basis to meet expected customer demands. A significant portion of our store sales are medications which are supplied by a single distributor and, historically, substantially all of the major pharmaceutical manufacturers have declined to sell prescription and non-prescription pet medications directly to non-veterinary suppliers such as our supplier making it necessary for them to establish secondary sources of supply. If our supplier is unable to continue to purchase from their secondary suppliers, our ability to sell prescription and non-prescription medications could be interrupted. The sale and delivery of prescription medications is generally subject to certain pharmacy laws and licensing. There is no assurance that our pharmacy supplier will be able to adapt to changing laws and regulations nor is there assurance that we could source an alternate supplier in a timely manner should our current supplier suffer an interruption in their business. In addition, there is generally resistance from some veterinarians to authorize prescriptions to external suppliers and an increase in this resistance could adversely affect our prescription medication sales. The occurrence of one or more of these store-related risks could adversely affect the successful execution of this component of the Company's business strategy.

The market for computer software is highly competitive and rapid technological innovation and change may make the Company's software products obsolete. The Company has developed its PetPoint and PawsConnect.com products using third party operating systems. There can be no assurance that these suppliers will not make changes to these operating systems, requiring substantial changes to the Company's software products. There can also be no assurance that additional competitors will not enter the marketplace in North America and offer the same or similar software products as currently offered by the Company. There is no assurance that the Company will be able to continue to develop and market its software products or that it will be able to continue to offer such products in a cost effective manner.

The Company relies significantly on its database to run its day-to-day operations and to provide a base for future revenue streams. The database contains individuals' private information. The Company is subject to privacy legislation in both Canada and in the United States. This legislation restricts the use of personal information as prescribed by applicable laws, which could materially adversely affect the way the Company conducts its existing and future business.

From time to time in connection with its operations, the Company is named as a defendant in actions for damages and costs allegedly sustained by the plaintiffs. Management evaluates the risks associated with each claim on a claim by claim basis.

The Company extends credit to veterinary clinics and animal welfare organisations, which arise primarily from the sale of RFID microchips and individual consumers and to individuals insured in connection its individual insurance policy portfolio. No individual customer makes up more than 5% of the outstanding trade receivable balance. The Company reviews individual credit balances for veterinary clinics and animal welfare organisations and sets reserves where appropriate. The Company manages this portfolio of credits through a policy which restricts further shipments to any organisation more than 90 days past due. The Company manages its individual insured credit portfolio utilizing an extensive communications program and sets reserves based on a pooled basis.

## CONTROLS AND PROCEDURES

As required by Multilateral Instrument 52-109 issued by the Canadian Securities Administrators, the Company's Chief Executive Officer and Chief Financial Officer have made certain certifications related to the information in the Company's annual and interim filings (as defined in Multilateral Instrument 52-109) with the provincial securities legislation.

### *Evaluation of Disclosure Controls and Procedures*

Disclosure controls and procedures are designed to provide reasonable assurance that all relevant information is gathered and reported to senior management, including the Company's Chief Executive Officer and Chief Financial Officer, on a timely basis so that appropriate decisions can be made regarding public disclosure. As at the end of the period covered by this MDA, management of the Company, with the participation of the Chief Executive Officer and the Chief Financial Officer, evaluated the effectiveness of the Company's disclosure controls and procedures as required by Canadian securities laws. Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that, as of the end of the period covered by this MDA, the disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed in the Company's annual filings and interim filings (as such terms are defined under Multilateral Instrument 52-109 – Certification of Disclosure in Issuers' Annual and Interim Filings) and other reports filed or submitted under Canadian securities laws is recorded, processed, summarised and reported within the time periods specified by those laws and that material information is accumulated and communicated to management of the Company, including the Chief Executive Officer and the Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

### *Internal Control over Financial Reporting*

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Multilateral Instrument 52-109. Internal control over financial reporting means a process designed by or under the supervision of the Chief Executive Officer and Chief Financial Officer, and effected by the board of directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP, and includes those policies and procedures that: (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company; (2) are designed to provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and that receipts and expenditures of the Company are being made only in accordance with authorisations of management and directors of the Company; and (3) are designed to provide reasonable assurance regarding prevention or timely detection of unauthorised acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

All internal control systems have inherent limitations and therefore the Company's internal control over financial reporting can only provide reasonable assurance and may not prevent or detect misstatements due to error or fraud.

The Company's management, including the Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of our internal control over financial reporting as of March 31, 2010 using the Committee of Sponsoring Organisations of the Treadway Commission (COSO) framework. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that our internal control over financial reporting was operating effectively as of March 31, 2010.