LMS Medical Systems Inc.

LMS' Management Discussion and Analysis of Financial Condition and results of Operations

The management's discussion and analysis ("MD&A") which follows, is provided to assist readers in their assessment and understanding of the consolidated results of operations, the financial position and changes in cash flows of LMS Medical Systems Inc. ("LMS" or "the Company") for the first quarter ended June 30, 2005. This MD&A should be read in conjunction with the unaudited interim first quarter financial statements as at and for the three month period ended June 30, 2005 and the annual audited consolidated financial statements and notes of LMS as at March 31, 2005 and 2004 and for the year ended March 31, 2005, the five-month period ended March 31, 2004 and the years ended October 31, 2003 and 2002, which are prepared in accordance with Canadian generally accepted accounting principles. Material differences between Canadian and United States generally accepted accounting principles, as applicable to our Company, are set forth in Note 17 to the annual audited consolidated financial statements of LMS.

Note Regarding Forward-Looking Statements

Our MD&A contains forward-looking statements which reflect our Company's current expectations regarding future events. The forward-looking statements in this quarterly filing, which includes this MD&A describe our expectations on August 11, 2005. The forward-looking statements are often, but not always, identified by the use of words such as "seek", "anticipate", "plan", "estimate", "expect" and "intend" and statements that an event or result "may", "will", "should", "could" or "might" occur or be achieved and other similar expressions. These forward-looking statements involve risk and uncertainties, including the difficulty in predicting product approvals, acceptance of and demands for new products, the impact of the products and pricing strategies of competitors, delays in developing and launching new products, the regulatory environment, fluctuations in operating results and other risks, any of which could cause actual results, performance, or achievements to differ materially from the results discussed or implied in the forward-looking statements. Many risks are inherent in the industry; others are more specific to our Company. Investors should consult the "Risk Factors" section of the Company's form 20-F as well as our Company's ongoing quarterly filings and annual reports for additional information on risks and uncertainties relating to these forward-looking statements. Investors should not place undue reliance on any forward-looking statements. We assume no obligation to update or alter any forward-looking statements whether as a result of new information, further events or otherwise.

As at August 11, 2005, there were 16,503,177 common shares outstanding, and 1,311,027 options as well as 688,092 warrants outstanding to purchase common shares. Not included in the above are 79,875 common shares to be issued under stock based compensation plans which are subject to Shareholders approval.

All dollar figures in this MD&A are in Canadian dollars unless otherwise indicated. "We", "us", "our" or "our Company" means LMS Medical Systems Inc. and its subsidiaries unless otherwise indicated.

Overall performance

We are an obstetrics-focused healthcare technology company. Based on advanced medical research focusing on the Labor & Delivery cycle, our unique technology provides obstetrics and gynecology teams and hospitals with state-of-the-art clinical decision support tools to assist them in achieving clinical and cost effective interventions.

Our core technology, Computer Assisted Labor Management (CALM™) was developed at the Faculty of Medicine, McGill University in Montréal, with Dr. Emily Hamilton as the principal investigator.

Overview

For the past nine years, we have been actively developing a series of software-based products that are focused in the area of obstetrics. Our products specifically deal with the labor and delivery process. In particular, our products focus on how labor develops in the mother and impacts the fetus. It is well known that distress created by the labor and delivery process often results in birth related brain damage.

The most significant developments affecting our Company in the first quarter ended June 30, 2005 were:

- We have substantially completed CALM™3.0, our labor and delivery product suite for large scale health facilities and expect to release the final product in the coming weeks. CALM™3.0 is the newest release of our CALM™ suite of products, and is currently scheduled for installation at a number of leading U.S. based hospitals.

- We unveiled CALM™ Shoulder Screen, a new addition to our Decision Support Suite. CALM™ Shoulder Screen focuses on the prediction of shoulder dystocia, a key obstetrical challenge.

- In April of 2005, we entered into an agreement with AON Risk Services, a subsidiary of AON Corporation, to assist hospitals in improving their risk management profile in obstetrics. LMS and AON will work together to expand our customer base. AON will propose to its clients that they consider the implementation of LMS decision support tools to address key clinical indicators with their obstetrics practice.

- We have established a Risk and Patient Safety Advisory Board that will provide guidance on how to achieve widespread adoption of our risk management tools. This will include strategies to mobilize hospital teams to implement proactive risk reduction programs and to develop value propositions that address the concerns of hospital administrators, clinicians, risk managers and insurers. To date, Dr. Thomas J. Garite, Professor Emeritus in the Department of Obstetrics and Gynecology at the University of California, Irvine, Editor in Chief of the American Journal of Obstetrics and Gynecology; Dr. Eric Knox, professor of OB/GYN at the University of Minnesota and Dr. Marilyn Sue Bogner, President and Chief Scientist with the Institute for the Study of Human Error have been appointed to the Advisory Board which will be chaired by Mr. Harry G. Hohn of New York. Mr. Hohn, the former Chairman and Chief Executive Officer of New York Life is also a member of our Board of Directors.

Critical accounting policies and estimates

Our financial statements are prepared in accordance with Canadian GAAP. Our critical accounting policies and estimates include revenue recognition, the recording of research and development expenses and related investment tax credits, stock-based compensation expenses, financial instruments and income taxes. For a more detailed discussion of our critical accounting policies and estimates, please refer to the MD&A included in our 20-F filings with the United States Securities and Exchange Commission and our March 31, 2005, Annual Report. There have been no material changes to such estimates since that time.

Selected Financial Information
Three-month period ended June 30, 2005 and 2004

	Three-Months Ended June 30, 2005 $	Three-Months Ended June 30, 2004 $
Revenue		
Software licences	179,869	95,170
Hardware	–	110,055
Technical support and other	88,046	26,232
	267,915	231,457
Operating Expenses		
Research and development costs	975,747	691,346
Less: Tax credits	(56,350)	(127,235)
	919,397	564,111
Direct costs of revenue	33,938	72,989
Selling and market development	583,067	509,939
Administrative	669,739	476,435
Customer support	253,830	167,293
Quality assurance	55,188	42,517
Stock Option Expense	225,000	–
Special charges	–	223,441
Amortization of property, plant and equipment and patents	49,409	28,493
Foreign exchange loss (gain)	6,852	(4,268)
	2,796,420	2,080,950
Operating loss	(2,528,505)	(1,849,493)
Financial income, net	(66,479)	(48,233)
Net loss	(2,462,026)	(1,801,260)
Basic and diluted loss per share	(0.15)	(0.13)
Cash flow related to:		
Operating activities	(1,222,406)	(1,990,652)
Investing activities	8,844,686	(59,574)
Financing activities	(10,694)	12,172,239

	June 30, 2005 $	March 31, 2005 $
Balance sheet data		
Total assets	12,414,368	14,768,368
Total long term debt (includes current portion)	72,969	83,663
Total shareholders' equity	10,466,874	12,703,900

Selected Quarterly Financial Information

	2006	2005				2004		
	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2
Revenue	267,915	74,685	677,816	76,339	231,457	23,531	31,611	28,686
Operating Loss	2,528,505	2,945,464	2,334,274	2,334,647	1,849,493	1,497,941	1,264,647	1,345,644
Net Loss	2,462,026	2,885,320	2,274,681	2,275,272	1,801,260	1,556,095	1,260,384	1,371,856
Basic and Diluted Net Loss per Share	(0.15)	(0.18)	(0.15)	(0.16)	(0.13)	(0.17)	(0.35)	(0.44)

Results of operations

For the three-month period ended June 30, 2005 compared to the three-month period ended June 30, 2004.

Revenue

Our revenue for the three-month period ended June 30, 2005, increased to $268,000 compared to $231,000 for the same period in 2004. Sales of software licenses increased to $180,000 in 2005 compared to $95,000 in 2004, and technical support revenue increased to $88,000 compared to $26,000 in 2004. The increase in technical support revenue is a function of an increase in our install base. Hardware revenue declined to nil over the period from $110,000 for the same period in 2004. Hardware sales are only completed at the request of the customer and typically have a commensurate amount of associated costs.

Research and Development expenses and Investment Tax Credits

For the three-month period ended June 30, 2005 expenditures before investment tax credits were $976,000 as compared to $691,000 for the same period in 2004. The majority of these expenditures were incurred in the development of CALM™3.0. We will release the final version of CALM™3.0 in the coming weeks. The higher research and development costs are a reflection of an increase in the number of contract employees we have on staff. In the first quarter of fiscal 2006 we employed several additional contract employees compared to nil for the same period in fiscal 2005. Based on our current operating plan, we expect our research and development costs to remain relatively stable as we focus on continuing the development of our CALM™ suite of products, integrating our systems with a distributor and releasing CALM™ Patterns.

Investment tax credits decreased to $56,000 for the three-months ended June 30, 2005 from $127,000 for the three months ended June 30, 2004. This decrease is a function of our assessment of the refundable nature of these credits. No amounts related to carry forward investment tax credits have been recorded in the financial statements. Eligible expenditures incurred in Québec remain qualified for the refundable provincial research and development investment tax credits and have been recorded accordingly.

Direct costs of revenue

Direct costs of revenue for the three-month period ended June 30, 2005 decreased to $34,000 from $73,000 in 2004. This decrease is primarily due to costs related to the sale of hardware in 2004 that was not repeated in 2005. Current costs are predominantly royalty payments for third party software in connection with databases used within our monitoring system.

Selling and Market Development

Selling and Market Development expenses for the three-month period ended June 30, 2005 were $583,000 as compared to $510,000 for the same period in 2004. The increase is mainly the result of the addition of product management employees and clinical specialists as we expanded our ability to serve our growing customer base. Due to increases in staffing, related travel and tradeshow expenses also increased.

Administrative

Administrative expenses for the three-month period ended June 30, 2005 increased to $670,000 compared to $476,000 for the same period in 2004. The increase relates to the recording of $57,000 for director's fees for the quarter where nil was recorded in 2004, an increase of $193,000 for functions related to being a public company in the U.S. and Canada.

Customer Support

Our Customer Support department is a dedicated 24/7-service center for our customers. For the three-month period ended June 30, 2005 our Customer Support department expenses increased to $254,000 in 2005 from $167,000 for the same period in 2004. The change in 2005 results mainly from the addition of new employees to support the expansion of our customer support activities relating to an increased number of installations of our software as well as an increase in the maintenance of the overall install base.

Quality Assurance

In 2002, we created the department of Quality Assurance and Regulatory Affairs with the responsibility of ensuring compliance with all applicable requirements and regulations of each country where our products are expected to be marketed. For the three-month period ended June 30, 2005, these expenses increased slightly to $55,000 compared to $43,000 for the same period in 2004 as a result of increased travel and other costs.

Stock Option Expense

The Company incurred $225,000 in stock option expense during the period, compared to an amount of nil for the same period in the prior year. The Company records stock option expense for all stock option awards subsequent to November 1, 2003, when the Company adopted the transitional provisions of section 3870 *Stock Based Compensation.*

Special charges

We have incurred charges related to professional fees, listing fees and other expenses incurred in connection with the listing of our common shares on the Toronto Stock Exchange which occurred on April 22, 2004 and on the American Stock Exchange which occurred on February 15, 2005. The ticker symbol for both Stock Exchanges is LMZ. These charges have been recorded on a separate line item on the consolidated statement of operations under Special Charges. The Company incurred no special charges for the quarter ended June 30, 2005.

Foreign Exchange

For the three months ended June 30, 2005, the Company incurred a foreign exchange loss of $7,000, compared to a gain of $4,000 for the same period in 2004. This was the result of variations in the US currency rate against the Canadian dollar and the expansion of our activities in the U.S.

Operating Loss and Net Loss

After considering the above expenses, our operating loss for the three-month period ended June 30, 2005 was $2,529,000 compared to $1,849,000 for the same period in 2004.

We generated net interest income of $66,000 for the three months ended June 30, 2005, compared to $48,000 in the three months ended June 30, 2004. This interest income was generated from the additional cash and short term investments purchased from the proceeds of the equity acquisitions during the prior fiscal year.

As a result, the net loss for the three-month period ended June 30, 2005 totaled $2,462,000 ($0.15 per share) compared with $1,801,000 ($0.13 per share) for the three-month period ended June 30, 2004.

Liquidity and Capital Resources

Operating activities

Cash flow used for operations totaled $1,222,000 for the three month period ended June 30, 2005 compared to $1,991,000 for the same period in 2004.

In 2005, cash used in our operating activities is mainly explained by our net loss of $2,462,000 ($1,801,000 for the same period in 2004) offset by stock option expense of $225,000 and a net change in non-cash operating working capital of $965,000. The change in operating working capital resulted mainly from the collection of receivables that were outstanding at year end along with the receipt of $560,000 of investment tax credits receivable during the period.

Investing activities

Our investing activities consisted of an inflow of $8,964,000 representing the maturity of our short-term investments during the period along with expenditures of $119,000 for the acquisition of equipment and patents required for our activities. For the three-month period ended June 30, 2004 we spent $60,000 for the purchase of property plant and equipment.

Financing activities

During the three-month period ended June 30, 2005, financing activities used $11,000 of cash, representing the repayment of obligations under capital leases compared to an inflow of $12,172,000 for the same period in 2004. The increase in 2004 was a function of the issuance of capital stock of $12,120,000 from an equity financing and $958,000 from the issuance of capital stock resulting from the reverse takeover transaction, net of share issue costs of $899,000, along with the repayment of obligations under capital leases of $7,000.

As a result of the above activities our cash and cash equivalents increased by $7,612,000 for the three-month period ended June 30, 2005 compared to an increase of $10,122,000 for the same period in 2004.

As of June 30, 2005, we have no debt other than capital leases, which totaled $73,000 and are repayable over the next 5 years. Our operating obligations are as follows:

Less than 1 year	$243,000
1 to 3 years	$407,000
More than 3 years	$ 7,000
Total	$657,000

Future Outlook

Our focus in the first quarter of 2006 has been to continue to develop our product offering, as evidenced by the soon to be released CALM™3.0, while at the same time broadening the reach of our sales team and increasing our customer base, and implementing cost initiatives in order to control our expenses. We will continue to progress in these areas in the remainder of 2006. We expect to release a product offering of CALM™ Shoulder Screen in the third quarter of this fiscal year. It is also our goal to release CALM™ Patterns during the last part of the year. In the upcoming year, we expect that the level of expense will be commensurate with the level experienced in the first quarter of fiscal 2006, but we expect that our revenue will increase over the same period and we will experience a lower net loss than in the prior year.

Our revenue is expected to increase in the remainder of 2006 compared to the current quarter and compared to the last fiscal year, predominantly due to the fact that we will release the final version of CALM™3.0. We expect to install CALM™3.0 in a number of hospitals in the United States in the coming weeks and expect that we will have additional sales of this product throughout the year. Another function of the expected increase in revenue stems from the fact that we have entered into agreements with partners and distributors which will be in effect for this entire fiscal year. As a result of increased system sales, fees from technical support service agreements are also expected to increase as we increase our install base.

The level of research and development expenses incurred in the first quarter of fiscal 2006 is expected to continue in each of the next three quarters as we focus on the integration of our system with those of our distributors, the release of CALM™ Shoulder Screen and the release of CALM™ Patterns.

Direct costs are expected to increase commensurate with the increase in sales, and also as a function of sales mix as costs of hardware are typically a higher percentage of revenue than other direct costs. However, we do not intend to sell hardware unless required by customers. Selling and market development expenses are expected to continue at the same rate as experienced in the current quarter or to increase slightly. We will focus our sales efforts on the release of CALM™ 3.0, CALM™ Shoulder Screen and CALM™ Patterns as well as continue to broaden our sales reach and customer focus. Administrative expenses are expected to remain relatively in line with the levels of expense experienced in the first quarter of this year. We don't expect that customer support costs will increase in the short term as we believe we have the appropriate resources to support the level of growth expected for this fiscal year.

In light of the inherent uncertainties associated with our ability to secure sales, to invest in new projects, to expand and accelerate our product sales in the U.S and in other markets and to enter into additional distribution agreements, further financing may be required to support our operations in the future. Based on current plans, it is anticipated that total expenses will remain relatively stable for the next twelve months. We believe we have sufficient resources to fund operations for the next twelve months.

To date, we have financed our operations, technology development, patent filings and capital expenditures primarily through issuance of shares and issuances of convertible notes by way of private placements, with the receipt of investment tax credits earned on eligible expenditures, by loans and promissory notes from financial institutions and by capital leases. Since our inception, we have raised gross proceeds in excess of $47.6 million from equity-based financings.

We may require additional financing to expand our operations and intend to raise funds from time to time. Funding requirements may vary depending on a number of factors, including the progress of our research and development program, the establishment of collaborations and the market acceptance of our products in North America and internationally.

When additional funds are required, potential sources of financing include strategic relationships and public or private sales of our Common Shares. We do not have any committed sources of financing at this time and it is uncertain whether additional funding will be available when the need arises on terms that will be acceptable to us. If funds are raised by issuing additional Common Shares, or other securities convertible into our Common Shares, the ownership interests of our existing shareholders will be diluted. If we are unable to obtain financing when required, we will not be able to carry out our business plan, including marketing and distribution initiatives. We would have to significantly limit our operations and business, and our financial condition and results of operations would be materially harmed.

Related party transaction

The Company incurred fees of $47,000 during the period ($45,000 for the same period in the prior year) under a management services agreement with a related company having one common director.

Risk factors

For a more detailed discussion of risk factors that could materially affect our results of operations and financial condition, please refer to the company's Form 20-F.

Other MD&A requirements

All relevant information related to our Company is filed, in Canada, electronically at www.sedar.com and in the United States of America at www.sec.gov.

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