

# LMS Medical Systems Inc.

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*For Immediate Release*

## **LMS ANNOUNCES THIRD QUARTER 2006 FINANCIAL RESULTS YEAR TO DATE REVENUES INCREASE BY \$335,000 OR 34% TO \$1.32 MILLION**

**Montreal, Quebec, February 14, 2006** - LMS Medical Systems Inc. (TSX: LMZ, AMEX: LMZ), a healthcare technology company and developer of the CALM™ system today reported results of operations for the third quarter ended December 31, 2005. All amounts are in Canadian dollars.

Revenues for the nine-month period ended December 31, 2005 increased 34% to \$1.32 million from \$985,000 for the same period in the prior year. The increase in revenue is the result of new hospital installations occurring subsequent to the release of CALM™3.0 and higher support revenues resulting from an increased installed hospital base. During the third quarter, LMS received sales orders for six new hospital installations, and completed four hospital installations. As a result of the deferral of two customer orders until the fourth quarter, revenue for the third quarter totaled \$501,000 versus \$678,000 for the same period last year. The two additional customer orders on hand were not completed in the third quarter, due to time constraints and customer availability for installation. Revenues related to these two orders should be recognized, upon installation, in the fourth quarter. The loss for the third quarter decreased to \$2.02 million (\$0.12 per share) compared to a loss of \$2.28 million (\$0.15 per share) for the same period in fiscal 2005. For the quarter, the overall decreases in all spending categories were in line with quarterly revenues and lower refundable investment tax credits.

Cash, cash equivalents and short-term investments held to maturity, as at December 31, 2005 totaled \$6.87 million versus \$11.86 million as at March 31, 2005. For the nine-month period, the decrease of \$4.99 million was predominantly due to our net loss of \$6.61 million offset by non-cash items and net changes in non-cash working capital of \$1.85 million. For the third quarter, the cash used in operations decreased by 52% or \$1.56 million from \$2.98 million in 2004 to \$1.42 million in 2005.

An expanded Management's Discussion and Analysis for the quarter, and previous periods, is accessible on the LMS website at [www.lmsmedical.com](http://www.lmsmedical.com) and with Company's regulatory filings in Canada at [www.sedar.com](http://www.sedar.com) and in the United States at [www.sec.gov](http://www.sec.gov).

### **OUTLOOK**

Regarding the fourth quarter, LMS' potential revenue pipeline continues to be strengthened, as we pursue multiple customer orders. Should these orders be confirmed and installed in the fourth quarter, the anticipated revenues would be in line with expectations for the fourth quarter and for the year ended March 31, 2006. In light of the inherent uncertainties, the actual timing of revenue recognition is partly dependant on the customer's availability and could be delayed.

### **Highlights**

- LMS realized record revenues of \$1.32 million, an increase of 34% over prior year;
- LMS received six sales orders for installation of its systems in new hospital sites, of which four were installed during the third quarter and two are expected to be installed in the fourth quarter;
- LMS completed the development of its new product CALM Shoulder Screen which is now commercially available;
- Dr. Arthur Porter, Director General and CEO of the McGill University Health Center and former CEO of Detroit Medical Center, joined the Board of Directors effective January 16, 2006;
- Dr. Emily Hamilton, founder of LMS and VP Medical Research, presented on February 2nd, 2006 in Miami at a conference of OB/GYN, the results of a study addressing the prediction of injury due to shoulder dystocia;
- Dr. Henry Lerner, OB/GYN, FACOG, a Clinical Instructor at Harvard Medical School having medical, legal and risk management experience, joined LMS as a Clinical Market Development Specialist.

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**ABOUT LMS**

LMS is a leader in the application of advanced mathematical modeling and neural networks for medical use. The LMS CALM™ Decision Support Suite provides physicians, nursing staff, risk managers and hospital administrators with clinical information systems and decision support tools designed to improve outcomes and patient care for mothers and their infants during labor and delivery.

*Except for historical information contained herein, the matters discussed in this news release are forward-looking statements. Because these forward-looking statements involve risks and uncertainties, there are important factors that could cause actual results to differ materially from those expressed implied by the forward-looking statements including, but without limitation, economic conditions in general and in the healthcare market, the demand for and market for our products in domestic and international markets, our current dependence on the CALM product suite, the challenges associated with developing new products and obtaining regulatory approvals if necessary, research and development activities, the uncertainty of acceptance of our products by the medical community, the lengthy sales cycle for our products, third party reimbursement, competition in our markets, including the potential introduction of competitive products by others, our dependence on our distributors, physician training, enforceability and the costs of enforcement of our patents, potential infringements of our patents and the other factors set forth from time to time in the Company's filings with the United States Securities and Exchange Commission and with the Canadian Securities Commissions. The Company has no intention of or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.*

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**LMS Medical Systems Inc.**

*As at December 31, and March 31, 2005 and for the three and nine-month  
periods ended December 31, 2005 and 2004*



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**NOTICE OF DISCLOSURE OF NON-AUDITOR REVIEW  
OF INTERIM FINANCIAL STATEMENTS FOR THE PERIODS ENDED  
DECEMBER 31, 2005 AND 2004.**

Pursuant to National Instrument 51-102, Part 4, subsection 4.3(3)(a) issued by the Canadian Securities Administrators, if the external auditors have not performed a review of the interim financial statements, the interim financial statements must be accompanied by a notice indicating that they have not been reviewed by the external auditors.

The accompanying unaudited interim consolidated financial statements of the Company for the periods ended December 31, 2005 and 2004, have been prepared in accordance with Canadian generally accepted accounting principles and are the responsibility of the Company's management.

The Company's external auditors, Ernst & Young LLP, have not performed a review of these interim financial statements in accordance with the standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by the external auditors of an entity.

Dated this 14th day of February 2006.

## LMS Medical Systems Inc.

As at December 31, and March 31, 2005 and for the three and nine-month periods ended December 31, 2005 and 2004



### INTERIM CONSOLIDATED BALANCE SHEETS

As at [Unaudited]

	December 31, 2005 \$	March 31, 2005 \$
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	6,819,413	2,843,989
Short-term investments	50,000	9,013,583
Accounts receivable	951,433	739,588
Investment tax credits receivable	594,336	1,182,888
Prepaid expenses	165,559	375,837
<b>Total current assets</b>	<b>8,580,741</b>	<b>14,155,885</b>
Property, plant and equipment	436,968	502,196
Patents	196,286	110,287
	<b>9,213,995</b>	<b>14,768,368</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	1,084,503	1,200,448
Deferred revenues and deposits from distributors	899,164	780,357
Current portion of obligations under capital leases	30,479	44,558
<b>Total current liabilities</b>	<b>2,014,146</b>	<b>2,025,363</b>
Long-term portion of obligations under capital leases	19,865	39,105
	<b>2,034,011</b>	<b>2,064,468</b>
<b>Shareholders' equity</b>		
Capital stock [note 2]	47,665,694	47,616,028
Deferred share units [note 2]	190,000	—
Accruals for expected bonus to be paid in Common Shares [note 2]	300,000	—
Contributed surplus [note 2]	1,945,863	1,255,108
Warrants [note 2]	255,086	397,592
Deficit	(43,176,659)	(36,564,828)
<b>Total shareholders' equity</b>	<b>7,179,984</b>	<b>12,703,900</b>
	<b>9,213,995</b>	<b>14,768,368</b>

See accompanying notes

## LMS Medical Systems Inc.

As at December 31, and March 31, 2005 and for the three and nine-month periods ended December 31, 2005 and 2004



### INTERIM CONSOLIDATED STATEMENTS OF OPERATIONS

For the three-month and nine-month periods ended

[Unaudited]

	3 months		9 months	
	December 31, 2005	December 31, 2004	December 31, 2005	December 31, 2004
	\$	\$	\$	\$
<b>Revenues</b>				
Software licenses	300,387	607,234	916,857	702,404
Hardware	–	5,720	7,891	115,775
Technical support and other	201,433	64,862	395,691	167,433
<b>Total Revenues</b>	<b>501,820</b>	<b>677,816</b>	<b>1,320,439</b>	<b>985,612</b>
<b>Operating expenses</b>				
Research and development	909,233	1,128,279	2,789,672	2,734,494
Investment Tax Credits	(57,387)	(174,999)	(169,954)	(436,435)
Net research and development	851,846	953,280	2,619,718	2,298,059
Direct costs	77,164	81,679	191,788	184,527
Selling and market development	513,439	636,543	1,754,985	1,697,025
Administrative	660,586	756,294	2,062,663	1,623,622
Customer support	245,881	215,314	717,437	568,569
Quality assurance	50,275	40,416	150,077	114,488
Stock option expense	114,503	210,000	548,249	280,000
Special charges	–	42,971	–	613,855
Amortization of property, plant and equipment	56,099	43,757	164,328	97,791
Amortization of patents	5,079	868	10,528	2,601
Foreign exchange loss	6,527	30,968	214	23,489
	2,581,399	3,012,090	8,219,987	7,504,026
<b>Operating loss</b>	<b>(2,079,579)</b>	<b>(2,334,274)</b>	<b>(6,899,548)</b>	<b>(6,518,414)</b>
Interest and other income, net	(63,018)	(59,593)	(287,717)	(167,201)
<b>Net loss</b>	<b>(2,016,561)</b>	<b>(2,274,681)</b>	<b>(6,611,831)</b>	<b>(6,351,213)</b>
<b>Basic and diluted loss per share [note 3]</b>	<b>(0.12)</b>	<b>(0.15)</b>	<b>(0.40)</b>	<b>(0.42)</b>

See accompanying notes

### INTERIM CONSOLIDATED STATEMENTS OF DEFICITS

For the three-month and nine-month periods ended

[Unaudited]

	3 months		9 months	
	December 31, 2005	December 31, 2004	December 31, 2005	December 31, 2004
	\$	\$	\$	\$
<b>Deficit, beginning of period</b>	<b>(41,160,098)</b>	<b>(31,255,952)</b>	<b>(36,564,828)</b>	<b>(26,224,654)</b>
Net loss	(2,016,561)	(2,274,681)	(6,611,831)	(6,351,213)
Shares, options, warrants and unsecured convertible debentures issuance costs	–	(56,183)	–	(806,133)
Costs related to reverse takeover transaction	–	–	–	(204,816)
<b>Deficit, end of period</b>	<b>(43,176,659)</b>	<b>(33,586,816)</b>	<b>(43,176,659)</b>	<b>(33,586,816)</b>

See accompanying notes

## LMS Medical Systems Inc.

As at December 31, and March 31, 2005 and for the three and nine-month periods ended December 31, 2005 and 2004



### INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS

For the three-month and nine-month periods ended

[Unaudited]

	3 months		9 months	
	December 31, 2005 \$	December 31, 2004 \$	December 31, 2005 \$	December 31, 2004 \$
<b>OPERATING ACTIVITIES</b>				
Net loss	(2,016,561)	(2,274,681)	(6,611,831)	(6,351,213)
Adjustments for non-cash items:				
Amortization of assets	61,178	44,625	174,856	100,392
Compensation expense accrued under the Bonus Plan [note 2]	100,000	–	300,000	–
Directors' compensation accrued under the DSU Plan [note 2]	46,000	–	154,625	–
Stock option expense	114,503	210,000	548,249	280,000
Net changes in non-cash operating working capital items	276,928	(960,140)	674,888	(141,810)
<b>Cash flows related to operating activities</b>	<b>(1,417,952)</b>	<b>(2,980,196)</b>	<b>(4,759,213)</b>	<b>(6,112,631)</b>
<b>INVESTING ACTIVITIES</b>				
Maturity of short-term investments	–	–	8,963,583	–
Additions to property, plant and equipment	(15,983)	(98,249)	(99,100)	(239,299)
Additions to patents	(29,844)	–	(96,527)	–
<b>Cash flows related to investing activities</b>	<b>(45,827)</b>	<b>(98,249)</b>	<b>8,767,956</b>	<b>(239,299)</b>
<b>FINANCING ACTIVITIES</b>				
Issuance of obligations under capital leases	–	36,306	–	36,306
Repayment of obligations under capital leases	(11,524)	(11,446)	(33,319)	(27,197)
Capital stock and other equity instruments issuance costs	–	(56,183)	–	(806,133)
Increase of capital stock resulting from the reverse takeover transaction	–	–	–	958,432
Issuance of capital stock	–	4,174,998	–	16,798,129
Costs related to reverse takeover transaction	–	–	–	(148,816)
<b>Cash flows related to financing activities</b>	<b>(11,524)</b>	<b>4,143,675</b>	<b>(33,319)</b>	<b>16,810,721</b>
<b>Net change in cash and cash equivalents</b>	<b>(1,475,303)</b>	<b>1,065,230</b>	<b>3,975,424</b>	<b>10,458,791</b>
Cash and cash equivalents, beginning of period	8,294,716	10,824,684	2,843,989	1,431,123
<b>Cash and cash equivalents, end of period</b>	<b>6,819,413</b>	<b>11,889,914</b>	<b>6,819,413</b>	<b>11,889,914</b>

See accompanying notes

# LMS Medical Systems Inc.

As at December 31, and March 31, 2005 and for the three and nine-month periods ended December 31, 2005 and 2004



## 1. DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION

### Description of business

LMS Medical Systems Inc. [the “Company” or “LMS”] is incorporated under the *Canada Business Corporations Act*. The Company is an early stage company operating in a single business segment and its principal activities have been devoted to the development of leading-edge technology in care management tools in the labor and delivery setting. The Company is currently pursuing its research and development activities as well as the implementation of its distribution network.

To date the Company has financed its cash requirements primarily from share issuances, loans payable, convertible debentures, investment tax credits and contract revenues. The success of the Company is dependent on obtaining the necessary regulatory approvals, generating revenue from the licensing of its technology in care management tools or directly from its technology and achieving future profitable operations. It will be necessary for the Company to raise additional funds for the continuing development and marketing of its technology and products.

### Basis of presentation

These unaudited interim consolidated financial statements of the Company have been prepared by management in accordance with Canadian generally accepted accounting principles [Canadian GAAP] for interim financial information. Accordingly, they do not include all of the disclosures required by Canadian GAAP for annual financial statements. In the opinion of management all adjustments of a normally recurring nature considered necessary for a fair presentation have been included. Operating results for the interim period are not necessarily indicative of the results that may be expected for the full year. These unaudited interim consolidated financial statements should be read in conjunction with the audited annual consolidated financial statements 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. The accounting policies and methods followed in the preparation of these unaudited interim consolidated financial statements are the same as those in the audited annual consolidated financial statements of LMS. The consolidated balance sheet as at March 31, 2005 has been derived from the audited consolidated financial statements of LMS at this date but does not include all of the information and footnotes required by Canadian GAAP for complete financial statements.

## 2. CAPITAL STOCK

An unlimited number of common shares without par value are authorized.

Changes in common shares issued and outstanding during the period are summarized as follows:

	Number	\$
<b>Common shares</b>		
<b>Balance as at March 31, 2005</b>	<b>16,503,177</b>	<b>47,616,028</b>
Shares issued under the Bonus Plan	13,872	33,986
Shares issued under the DSU Plan	6,400	15,680
<b>Balance as at December 31, 2005</b>	<b>16,523,449</b>	<b>47,665,694</b>

### Bonus Plan

LMS has a bonus plan [the “Bonus Plan”] that provides for annual awards to eligible executives and employees based on achievement of corporate and individual performance objectives. The fair value of these awards is to be paid in common shares and is based upon the market price of the shares on the Toronto Stock Exchange (“TSX”) on the date the awards are granted. On September 14, 2005, at the annual and special meeting of shareholders, the Bonus Plan was approved. Prior to the approval of the Bonus Plan by the shareholders, the Company provided for the related

## LMS Medical Systems Inc.

As at December 31, and March 31, 2005 and for the three and nine-month periods ended December 31, 2005 and 2004



## 2. CAPITAL STOCK [CONT'D]

expenses and recorded the amounts under accounts payable and accrued liabilities. Following the approval of the Bonus Plan by the shareholders, the Company issued 13,872 common shares to its employees in the amount of \$33,986 in payment of the bonus for the year ended March 31, 2005. As at December 31, 2005, the Company has recorded compensation expense under the plan for the three-month and nine-month periods ended December 31, 2005 in the amount of \$100,000 and \$300,000, respectively. The compensation expense and the related number of common shares to be granted under the Bonus Plan is conditional on meeting performance objectives and will be finalized as at March 31, 2006.

### Deferred Share Unit Plan

LMS has a deferred share unit plan [the "DSU Plan"] that provides for the payment of director's quarterly fixed compensation with deferred share units. Each deferred share unit is a right granted by LMS to an eligible director to receive one common share upon termination of service. The number of deferred share units to be granted under the DSU Plan is determined by the closing market price of the common shares on the Toronto Stock Exchange for the five business days ending on the last business day of each fiscal quarter. On September 14, 2005, at the annual and special meeting of shareholders, the DSU Plan was approved.

Prior to the approval of the DSU Plan by the shareholders, the Company provided for the related director's fixed compensation expense within accounts payable and accrued liabilities.

Following the approval of the DSU Plan by the shareholders, the Company debited accrued liabilities and credited the deferred share units account by \$144,000 for the deferred share units conditionally granted prior to approval of the Plan.

Director's compensation expense for the three-month and nine-month period ended December 31, 2005 in the amount of \$46,000 and \$154,625, respectively and 25,189 and 67,945 deferred share units respectively were granted under the DSU plan, for a total of 82,569 units granted under the plan to date. In September 2005, the Company issued 6,400 shares in the amount of \$15,680 for the redemption of 6,400 deferred share units as a result of the termination of service of a director.

The changes to the number of deferred share units outstanding and the weighted average price of grant or issue are as follows:

	Number	\$
Balance as at March 31, 2005	14,624	3.87
Units granted during the period	67,945	2.25
Shares issued during the period	(6,400)	2.45
<b>Balance as at December 31, 2005</b>	<b>76,169</b>	<b>2.54</b>

### Warrants

	Number	\$
Balance as at March 31, 2005	1,117,177	397,592
Expired	(429,085)	(142,506)
<b>Balance as at December 31, 2005</b>	<b>688,092</b>	<b>255,086</b>

During the nine-month period 429,085 warrants expired. These warrants were valued at \$142,506. This amount has been credited to contributed surplus. As at December 31, 2005, each outstanding warrant allows its holder to acquire one common share for cash consideration of: \$3.23 for 596,561 warrants, \$3.32 for 71,531 warrants and \$4.85 for 20,000 warrants. The warrants expire from March 2006 to September 2009 with an average remaining life of 2.36 years as at December 31, 2005. When warrants are exercised or expired, the carrying value of the warrants is credited to contributed surplus.

## LMS Medical Systems Inc.

As at December 31, and March 31, 2005 and for the three and nine-month periods ended December 31, 2005 and 2004



### 2. CAPITAL STOCK [CONT'D]

#### Stock Options

The changes to the number of stock options outstanding and their weighted average exercise prices for the nine-month period ending December 31, 2005, are as follows:

	Number	Weighted average exercise price \$
Balance as at March 31, 2005	1,386,499	4.30
Granted	235,593	2.45
Cancelled	(115,973)	(4.38)
<b>Balance as at December 31, 2005</b>	<b>1,506,119</b>	<b>4.11</b>

Additional information concerning stock options outstanding as at December 31, 2005 is as follows:

Exercise price	Options outstanding			Options exercisable	
	Weighted average months to expiry #	Weighted average exercise price #	\$	Weighted average exercise price #	\$
\$2.45	150,359	56	2.45	-	-
\$3.00	26,666	-	3.00	26,666	3.00
\$3.69	40,166	38	3.69	40,166	3.69
\$4.00 - \$4.62	1,288,928	35	4.34	633,795	4.44
\$2.45 - \$4.62	1,506,119	36	4.11	700,627	4.11

As at January 31, 2005, the Company had 1,479,453 share stock options outstanding.

During the nine-month period, the Company issued an additional 235,593 options to its employees and directors. The fair value of these options using the Black-Scholes option pricing model is estimated to be \$238,000 and the Company will record the related expenses over the remaining vesting period. The assumptions used included: expected life of 5 years, fair value of \$2.45 per common share, dividend yield of nil, volatility factor of 0.423 and risk free interest rate of 3%.

During the three-month period ended December 31, 2005 and 2004, the Company recorded stock option expense of \$114,503 and \$210,000 respectively. During the nine-month period ended December 31, 2005 and 2004, the Company recorded stock option expense of \$548,249 and \$280,000 respectively.

Prior to November 1, 2003, no compensation expense was recognized when options were issued to employees and directors. Pro forma disclosure regarding options granted under the LMS stock option plan prior to November 1, 2003 is as follows:

	3 months		9 months	
	December 31, 2005 \$	December 31, 2004 \$	December 31, 2005 \$	December 31, 2004 \$
<b>Net loss</b>	<b>(2,016,561)</b>	<b>(2,274,681)</b>	<b>(6,611,831)</b>	<b>(6,351,213)</b>
Stock-based compensation costs that would have been included in the determination of net loss if the fair value based method has been applied	(10,498)	(29,349)	(61,547)	(88,047)
<b>Pro forma net loss</b>	<b>(2,027,059)</b>	<b>(2,304,030)</b>	<b>(6,673,378)</b>	<b>(6,439,260)</b>
<b>Pro forma basic and diluted loss per share</b>	<b>(0.12)</b>	<b>(0.15)</b>	<b>(0.40)</b>	<b>(0.42)</b>

## LMS Medical Systems Inc.

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### 3. BASIC AND DILUTED LOSS PER SHARE

The numerator and denominator for the calculation of basic and diluted loss per share are as follows:

	3 months		9 months	
	December 31, 2005	December 31, 2004	December 31, 2005	December 31, 2004
	\$	\$	\$	\$
<b>Numerator</b>				
Net loss attributable to common shares - basic and diluted	<b>(2,016,561)</b>	(2,274,681)	<b>(6,611,831)</b>	(6,351,213)
<b>Denominator</b>				
Weighted-average number of common shares - basic and diluted	<b>16,523,449</b>	15,188,926	<b>16,508,245</b>	15,188,926

### 4. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform to the basis of presentation adopted in the current periods.