# DIAGNOS Inc.

Management Discussion and Analysis

Three-month and Nine-month Periods ended December 31, 2016

Diagnos Inc.

# Management Discussion and Analysis

The following Management Discussion and Analysis (“MD&A”), dated February 3, 2017, analyses the consolidated financial position of DIAGNOS Inc. and its subsidiaries (“DIAGNOS”, “the Corporation” or “We”) as at December 31, 2016 and for the three-month and nine-month periods ended December 31, 2016 and should be read in conjunction with the December 31, 2016 interim unaudited condensed consolidated financial statements and accompanying notes. The currency used is the Canadian dollar unless otherwise stated.

This MD&A was approved by the Board of Directors on February 3, 2017 and takes into account information available up to the filing date on SEDAR.

## Description and Objective

This MD&A is a narrative explanation, through the eyes of management, of the Corporation’s performance during the periods covered by the financial statements, and of the Corporation's financial condition and future prospects. This MD&A complements and supplements the Corporation’s financial statements, but does not form part of the Corporation’s financial statements.

The objective of this MD&A is to improve the Corporation's overall financial disclosures by providing a balanced discussion of the Corporation's financial performance and financial condition.

## Going concern assumption

The December 31, 2016 interim unaudited condensed consolidated financial statements have been prepared on a going concern basis, which assumes that the Corporation will continue to operate for the foreseeable future and will be able to realize its assets and discharge its liabilities in the normal course of business. The Corporation has not realized annual profit since its inception. The Corporation’s anticipated level of gross expenditures and ongoing commitments for the next twelve months exceeds its expected cash inflows over the same period as well as its cash and short-term investments on hand as at December 31, 2016 and as such, the realization of assets and the discharge of liabilities in the ordinary course of business remain uncertain. In order to address these uncertainties, the Corporation has implemented some or all of the following measures:

| Liquidity risk | Risk mitigation measures |
|---|---|
| Funding of operating and financing expenses | • Reduce operating costs with temporary staff lay-offs, curtail certain consulting and travel costs<br>• Continue to seek debt financing from private investors<br>• Continue to seek equity financing through private placements of common shares and stock purchase warrants<br>• Continue to evaluate possible M&A opportunities |

The Corporation believes that if it were to be successful in implementing some or all of the above risk mitigating measures, it will be able to continue as a going concern. There remains however, significant risk and uncertainty associated with implementing any of these measures which are dependent on a number of factors outside of the Corporation’s control.

The interim unaudited condensed consolidated financial statements as at December 31, 2016 do not reflect any adjustments that would be necessary if the going concern basis was not appropriate. Such adjustments, if required, may be material.

## Forward-looking statements

This MD&A contains certain forward-looking statements with respect to the Corporation. By their nature, these forward-looking statements necessarily imply risks and uncertainties that could cause actual results to differ materially from those contemplated by these forward-looking statements. These risks and uncertainties include risks associated with market acceptance, competitive developments, the world economic situation and other factors. Except for ongoing obligations under securities laws to disclose all material information to investors, we disclaim any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

## Non-GAAP financial measures

This MD&A contains certain non-GAAP financial measures. A non-GAAP financial measure is a numerical measure of an issuer's historical or future financial performance, financial position or cash flow that is not specified, defined or determined under the Corporation's GAAP (as that term is defined in *Regulation 52-107 respecting Acceptable Accounting Principles and Auditing Standards*) and is not presented in in the Corporation's financial statements.

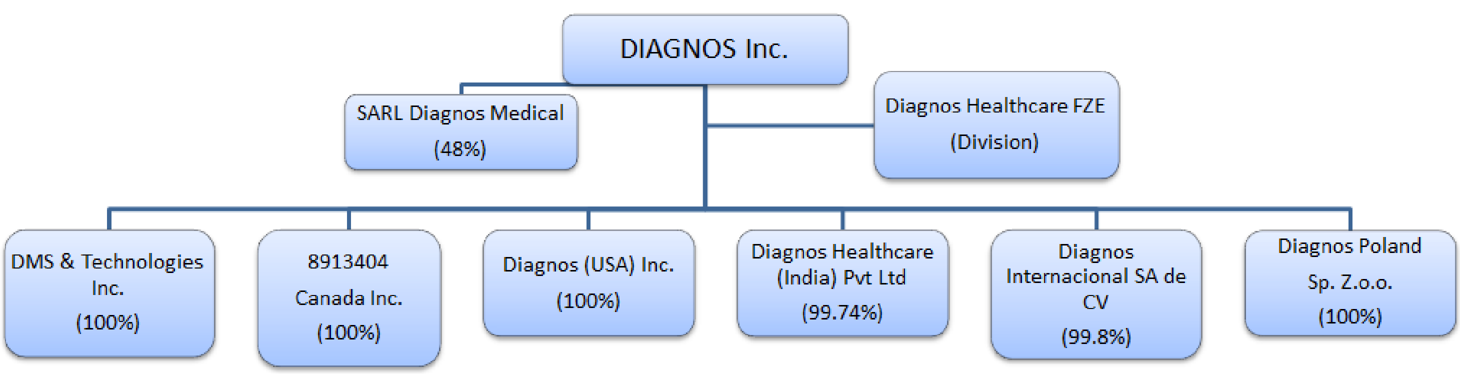
Non-GAAP financial measures presented in this document:

- Backlog: The backlog is composed of sales bookings for services not yet rendered.
- Bookings: Bookings represent signed agreements for which a value can be estimated.
- Research and development refundable tax credit provisions in proportion to research and development expenses.
- Working capital: Working capital is obtained by subtracting current liabilities from current assets.

## Description of the Corporation and activities

DIAGNOS is a Canadian corporation that offers data interpretation services based on its suite of proprietary software products used to extract knowledge from historical data.

DIAGNOS group of entities is organized as follows:



DIAGNOS operates in the following sectors:

Healthcare: Image analysis services through CARA (Computer Assisted Retinal Analysis), a software tool which assists health specialists in the detection of diabetic retinopathy. CARA is an in-house hosted web-based application that integrates fundus cameras with an image processing engine over a secure internet connection. CARA has been developed by, and is proprietary to, DIAGNOS.

Natural resources: Data mining consulting services through CARDS (Computer Aided Resource Detection System), a software tool used to assist exploration companies in identifying mining deposits. In combination with modern exploration techniques, CARDS is a useful tool intended to save both money and time by targeting priority (or prioritizing) areas for exploration. In addition to data mining and target generation, DIAGNOS offers project management services. CARDS has been developed by, and is proprietary to, DIAGNOS.

## Healthcare (CARA)

The Corporation has developed a proprietary set of algorithms and associated software platforms to assist eye specialists in the detection of diabetic retinopathy. According to the Canadian Diabetes Association, diabetic retinopathy is the most common cause of blindness in people under age 65 and the most common cause of new blindness in North America. Also according to the Canadian Diabetes Association, it is estimated that approximately 2 million individuals in Canada (i.e. almost all people with diagnosed diabetes) have some form of diabetic retinopathy. According to the World Health Organization, the number of people with diabetes worldwide has risen from 108 million in 1980 to 422 million in 2014.

The application is named CARA, which stands for “Computer Assisted Retinal Analysis”. The Corporation’s management view is that this application will contribute to the increase in revenue streams based on the fact that automating the screening process for diabetic retinopathy will benefit the healthcare system.

CARA can be deployed in many countries and has received certifications from Health Canada, the US Food and Drug Administration in the United States of America and CE in the European Union.

The CARA suite of applications allows an eye care specialist to more clearly visualize both normal retinal landmarks (optic nerve, vascular system, macula, fovea), as well as pathological changes (exudates, haemorrhages, micro-aneurisms, neo-vascularisation). Services vary from image enhancement only, to turn-key solutions including deploying imaging equipment on a mobile basis using the Corporation’s staff.

During the period covered by this document, our Healthcare business unit remains focused on continuing its business development efforts internationally, including development of relationships with prospective clients and governments, in addition to attending various medical conferences and industry events that drive awareness of our business platform and program offerings while continuiously developing our CARA platform.

Unchanged from the last reporting period, for the commercialization of CARA, we currently have a presence either directly or through resellers in North America (Canada, USA and Mexico), Africa (Algeria), Middle-East (some countries of the Gulf Cooperation Council) and India. We intend to continue increasing our presence in Europe and the Middle-East. CARA has proven its value to patients in these markets. Our focus going forward is to leverage that proven ability to, (i) continue to build revenue and sales in emerging markets, and, (ii) to substantially grow our sales and marketing successes in the US and Canada, where we believe CARA offers a unique value proposition to payers and patients.

Net profit (loss) for the healthcare sector:

| | Three-month period ended December 31, | | |
|---|---|---|---|
| | 2016 | 2015 | Variance |
| | | $ | |
| Revenue | 1,302,519 | 289,083 | 1,013,436 |
| Costs of services and research and development | (321,259) | (395,207) | 73,948 |
| Selling and administrative | (703,099) | (393,290) | (309,809) |
| Profit (loss) before interest | 278,161 | (499,414) | 777,575 |
| Interest expense | (215,825) | (138,623) | (77,202) |
| Net profit (loss) | 62,336 | (638,037) | 700,373 |

| | Nine-month period ended December 31, | | |
|---|---|---|---|
| | 2016 | 2015 | Variance |
| | | $ | |
| Revenue | 1,480,531 | 540,588 | 939,943 |
| Costs of services and research and development | (828,362) | (672,262) | (156,100) |
| Selling and administrative | (1,796,530) | (1,744,639) | (51,891) |
| Loss before interest | (1,144,361) | (1,876,313) | 731,952 |
| Interest expense | (506,588) | (295,270) | (211,318) |
| Net loss | (1,650,949) | (2,171,583) | 520,634 |

The main variances are discussed in the overall performance section of this document.

## Natural resources (CARDS)

DIAGNOS uses its proprietary software application CARDS (Computer Aided Resources Detection System) to help mineral exploration professionals identify areas of similarity to known areas of mineralization with a high statistical probability. In combination with modern exploration techniques, CARDS is a tool intended to save both money and time by generating priority targets for exploration. These target areas are presented in either two dimensional or three dimensional images to help target and prioritize exploration efforts. In addition to target generation, DIAGNOS offers project management services including geological consulting services. Under specific agreements, DIAGNOS is entitled to receive royalty payments arising from economic resource discoveries realized as a result of using CARDS. These royalties are payable in either shares, cash and/or in net smelter returns on revenues derived from mining operations within the limits of the properties as defined in the agreements. So far, no revenues were earned from royalties.

During the year ended March 31, 2016, this sector has shown signs of recovery with an increase in revenues of 187% over the year ended March 31, 2015. We continue to closely monitor the expenses and to believe that our solution CARDS can benefit mining companies in reducing their explorations costs.

Net profit (loss) for the natural resources sector:

| | Three-month period ended December 31, | | |
|---|---|---|---|
| | 2016 | 2015 | Variance |
| | | $ | |
| Revenue | 100,752 | 75,000 | 25,752 |
| Costs of services and research and development | (50,488) | 85,549 | (136,037) |
| Selling and administrative | (50,421) | (223,233) | 172,812 |
| Loss before interest | (157) | (62,684) | 62,527 |
| Interest expense | - | (15,908) | 15,908 |
| Net loss | (157) | (78,592) | 78,435 |

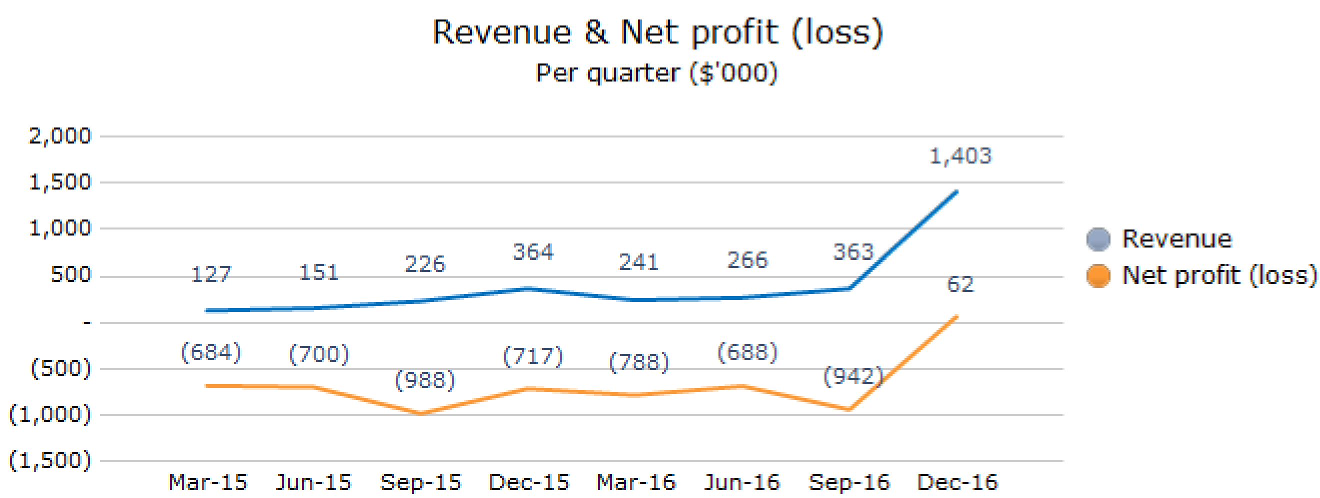
| | Nine-month period ended December 31, | | |
|---|---|---|---|
| | 2016 | 2015 | Variance |
| | | $ | |
| Revenue | 551,541 | 200,000 | 351,541 |
| Costs of services and research and development | (393,125) | (82,886) | (310,239) |
| Selling and administrative | (75,421) | (318,398) | 242,977 |
| Profit (loss) before interest | 82,995 | (201,284) | 284,279 |
| Interest expense | - | (31,676) | 31,676 |
| Net profit (loss) | 82,995 | (232,960) | 315,955 |

The main variances are discussed in the overall performance section of this document.

## Summary of quarterly results

The following financial information for the eight most recently completed three-month periods is derived from the Corporation's financial statements.

| | 2017 | | | 2016 | | | | 2015 |
|---|---|---|---|---|---|---|---|---|
| | ***Q3*** | ***Q2*** | ***Q1*** | ***Q4*** | ***Q3*** | ***Q2*** | ***Q1*** | ***Q4*** |
| | **Dec. 31, 2016** | **Sept. 30, 2016** | **June 30, 2016** | **March 31, 2016** | **Dec. 31, 2015** | **Sept. 30, 2015** | **June 30, 2015** | **March 31, 2015** |
| | $ | | | | | | | |
| Revenue | 1,403,271 | 363,261 | 265,540 | 240,892 | 364,083 | 225,889 | 150,616 | 127,364 |
| Net profit (loss) | 62,179 | (941,698) | (688,435) | (787,888) | (716,629) | (988,230) | (699,684) | (683,718) |
| Comprehensive income (loss) | 15,274 | (957,614) | (573,098) | (746,082) | (729,129) | (971,395) | (656,596) | (692,509) |
| Comprehensive income (loss) per share | 0.00 | (0.01) | (0.01) | (0.01) | (0.01) | (0.01) | 0.00 | 0.00 |



## Overall performance

This section provides an analysis of the Corporation's financial performance, financial condition and resulting cash flows during the periods covered by this MD&A.

*Net profit (loss)*

The comparative financial information for the three-month and nine-month periods ended December 31, 2016 contained in this section is derived from the Corporation's financial statements.

| | Three-month period ended December 31, | | Nine-month period ended December 31, | |
|---|---|---|---|---|
| | **2016** | **2015** | **2016** | **2015** |
| | $ | | $ | |
| Revenue | 1,403,271 | 364,083 | 2,032,072 | 740,588 |
| Operating expenses | 1,125,267 | 926,181 | 3,093,438 | 2,818,185 |
| Interest expense | 215,825 | 154,531 | 506,588 | 326,946 |
| | 1,341,092 | 1,080,712 | 3,600,026 | 3,145,131 |
| **Net profit (loss)** | **62,179** | **(716,629)** | **(1,567,954)** | **(2,404,543)** |
| Variation in net profit (loss) | 778,808 | | 836,589 | |

The variation in net profit (loss) is attributable to:

| | Three-month period ended | Nine-month period ended |
|---|---|---|
| | **December 31, 2016** | |
| | $ | |
| Increase in revenue | 1,039,188 | 1,291,484 |
| Increase in costs of services and research and development | (62,091) | (466,339) |
| (Increase) decrease in selling and administrative expenses | (136,995) | 191,086 |
| Increase in interest expense | (61,294) | (179,642) |
| | 778,808 | 836,589 |

- The increases in revenue are mainly attributable to one contract with a Mexican government organization in the Healthcare sector.
- The increases in costs of services and research and development are mainly due to the increases in delivery costs related to the Healthcare agreement signed with a Mexican government organization in the three-month period ended September 30, 2016 and the increases in delivery of services costs attributable to the increase in revenue from the Mining division.
- The increase in selling and administrative expenses for the three-month period ended December 31, 2016 is mainly attributable to an increase in sales commissions following the global increase in revenue.
- The decrease in selling and administrative expenses for the nine-month period ended December 31, 2016 is mainly attributable to a decrease in legal fees.
- The increases in interest expense are mainly attributable to the issuance of secured convertible debentures in the past two years.

When evaluating its overall financial performance, the Corporation's analysis is based on the following key performance indicators:

- capacity to increase revenues
- capacity to generate positive cash flows from operating activities
- capacity to deliver results
- capacity to innovate

## Capacity to increase revenues

To increase its revenues, the Corporation strives to generate sales from CARA (healthcare) and CARDS (natural resources) in existing and new geographic markets.

*Bookings, Revenues and Backlog*

The Corporation's backlog provides an indicator when forecasting its short term revenues. The backlog is mainly composed of sales bookings for products and services not yet delivered or rendered at the end of the period.

The following table presents the comparative evolution of the backlog for the three-month and nine-month periods ended December 31, 2016 and is followed by an analysis of the material variances.

| | **Three-month period ended December 31, 2016** | | | **Nine-month period ended December 31, 2016** | | |
|---|---|---|---|---|---|---|
| | CARA | CARDS | Total | CARA | CARDS | Total |
| | | $ | | | $ | |
| Opening backlog | 218,849 | 83,250 | 302,099 | 310,586 | 78,250 | 388,836 |
| Bookings | 1,174,763 | 45,752 | 1,220,515 | 1,293,602 | 501,541 | 1,795,143 |
| Amendments | - | - | - | (32,564) | - | (32,564) |
| Revenues | (1,302,519) | (100,752) | (1,403,271) | (1,480,531) | (551,541) | (2,032,072) |
| Ending backlog | 91,093 | 28,250 | 119,343 | 91,093 | 28,250 | 119,343 |

| | **Three-month period ended December 31, 2015** | | | **Nine-month period ended December 31, 2015** | | |
|---|---|---|---|---|---|---|
| | CARA | CARDS | Total | CARA | CARDS | Total |
| | | $ | | | $ | |
| Opening backlog | 697,576 | 72,000 | 769,576 | 889,563 | - | 889,563 |
| Bookings | 54,000 | 60,000 | 114,000 | 183,600 | 257,000 | 440,600 |
| Amendments | - | - | - | (70,082) | - | (70,082) |
| Revenues | (289,083) | (75,000) | (364,083) | (540,588) | (200,000) | (740,588) |
| Ending backlog | 462,493 | 57,000 | 519,493 | 462,493 | 57,000 | 519,493 |

| | **Variations for the three-month period ended December 31, 2016** | | | **Variations for the nine-month period ended December 31, 2016** | | |
|---|---|---|---|---|---|---|
| | CARA | CARDS | Total | CARA | CARDS | Total |
| | | $ | | | $ | |
| Net Bookings | 1,120,763 | (14,248) | 1,106,515 | 1,147,520 | 244,541 | 1,392,061 |
| Revenues | 1,013,436 | 25,752 | 1,039,188 | 939,943 | 351,541 | 1,291,484 |

Analysis of the material variances for the three-month and nine-month periods ended December 31, 2016:

- For the nine-month period ended December 31, 2016, net Bookings from CARDS increased by $244,541 and revenues increased by $351,541 over the nine-month period ended December 31, 2015, due to the signature of eight new agreements during the period in comparison to four agreements for the nine-month period ended December 31, 2015.
- The increases in revenues and bookings from CARA for the three-month and nine-month periods ended December 31, 2016 are mainly attributable to a healthcare contract with a Mexican government. As of December 31, 2016, the revenues from that agreement were recognized in the three-month period ended December 31, 2016.

*Net profit (loss) per sector:*

| | Nine-month period ended December 31, 2016 | | | Nine-month period ended December 31, 2015 | | |
|---|---|---|---|---|---|---|
| | Healthcare | Natural resources | Total | Healthcare | Natural resources | Total |
| | | $ | | | $ | |
| Revenue | 1,480,531 | 551,541 | 2,032,072 | 540,588 | 200,000 | 740,588 |
| Costs of services and research and development | (828,362) | (393,125) | (1,221,487) | (672,262) | (82,886) | (755,148) |
| Selling and administrative | (1,796,530) | (75,421) | (1,871,951) | (1,744,639) | (318,398) | (2,063,037) |
| Profit (loss) before interest | (1,144,361) | 82,995 | (1,061,366) | (1,876,313) | (201,285) | (2,077,597) |
| Interest expense | (506,588) | - | (506,588) | (295 270) | (31 676) | (326,946) |
| Net profit (loss) | (1,650,949) | 82,995 | (1,567,954) | (2,171,583) | (232,960) | (2,404,543) |

- 77% of revenues earned from the healthcare sector for the nine-month period ended December 31, 2016 were attributable to one governmental organization (nine-month period ended December 31, 2015, 80% of revenues earned from the healthcare sector were attributable to one global pharmaceutical corporation).
- Revenues earned from the natural resources sector arose from 8 clients for the nine-month period ended December 31, 2016 (nine-month period ended December 31, 2015 – 4).

*Geographical segments*

The following table presents the comparative revenues by country for the three-month and nine-month periods ended December 31, 2016:

| | Three-month period ended December 31, | | | Nine-month period ended December 31, | | |
|---|---|---|---|---|---|---|
| | **2016** | **2015** | **Variance** | **2016** | **2015** | **Variance** |
| | | $ | | | $ | |
| Mexico | 1,144,028 | 74,094 | 1,069,934 | 1,181,553 | 74,094 | 1,107,459 |
| Canada | 110,501 | 75,001 | 35,500 | 561,415 | 200,121 | 361,294 |
| India | 45,351 | 40,937 | 4,414 | 144,943 | 63,871 | 81,072 |
| United Arab Emirates | 12,000 | 91,774 | (79,774) | 48,000 | 267,978 | (219,978) |
| Turkey | 47,525 | - | 47,525 | 47,525 | - | 47,525 |
| Kenya | 36,297 | - | 36,297 | 36,297 | - | 36,297 |
| Colombia | 6,022 | - | 6,022 | 6,022 | - | 6,022 |
| United States of America | (493) | 20,355 | (20,848) | 3,257 | 51,161 | (47,904) |
| Poland | 2,040 | 16,012 | (13,972) | 3,060 | 35,848 | (32,788) |
| Switzerland | - | 45,910 | (45,910) | - | 47,515 | (47,515) |
| | 1,403,271 | 364,083 | 1,039,188 | 2,032,072 | 740,588 | 1,291,484 |

*Mexico*
All of the revenues were derived from the healthcare sector (CARA) and are essentially attributable to one Mexican government organization.

*Canada*
Essentially all of the revenues were derived from the natural resources sector (CARDS).

*India*
All of the revenues were derived from the healthcare sector (CARA) and are attributable to one client with activities in the pharmaceutical industry.

*United Arab Emirates*
All of the revenues were derived from the healthcare sector (CARA) and are attributable to one client with activities in the pharmaceutical industry.

*Turkey*
All of the revenues were derived from the healthcare sector (CARA) and are attributable to one client with activities in the pharmaceutical industry.

*Kenya*
All of the revenues were derived from the healthcare sector (CARA) and are attributable to one client with activities in the pharmaceutical industry.

*Colombia*
All of the revenues were derived from the healthcare sector (CARA) and are attributable to one client with activities in the pharmaceutical industry.

*United States of America*
The revenues were derived from the healthcare sector (CARA) and are attributable to two clients with activities in the primary care sector and in the pharmaceutical industry.

*Poland*
All of the revenues were derived from the healthcare sector (CARA) and are attributable to one client with activities in the pharmaceutical industry.

*Switzerland*
All of the revenues were derived from the healthcare sector (CARA) and are attributable to one client with activities in the pharmaceutical industry.

Type of revenue
Service-type revenues account for essentially all of the Corporation's revenues per sector.

Assets
All material capital and intangible assets are currently located in Canada and Mexico.

## Capacity to generate positive cash flows from operating activities

To generate positive cash flows from its operating activities, the Corporation strives to increase sales receipts and continues to monitor operating costs and related disbursements. The following table contains information taken from the Corporation's consolidated financial statements and details the cash flows derived from operating activities:

| | **Nine-month period ended December 31,** | | |
|---|---|---|---|
| | **2016** | **2015** | **Variance** |
| | | $ | |
| Net loss | (1,567,954) | (2,404,543) | 836,589 |
| Items not affecting cash | 315,601 | 423,767 | (108,166) |
| Payment of interest | 208,059 | 68,500 | 139,559 |
| Net change in non-cash operating working capital items | 142,194 | 40,893 | 101,301 |
| Cash flows from operating activities | **(902,100)** | **(1,871,383)** | **969,283** |

The positive variance in cash flows from operating activities of $969,283 is mainly attributable to the decrease in net loss of $836,589 for the nine-month period ended December 31, 2016. Based on the current level of liquidities and sales activities, the capacity to generate positive cash flows from operating activities remains uncertain. In order to address this uncertainty, the Corporation is evaluating the implementation of some or all of the measures described in the following section – Capacity to deliver results.

## Capacity to deliver results

The Corporation’s sales agreements usually imply rendering services over a defined period of time. Consequently, sufficient working capital and cash liquidities are required to execute the sales agreements and to continue supporting business development initiatives. The Corporation’s current level of revenues is not sufficient to cover its expenses and ongoing commitments, thereby resulting in negative cash flows generated from operating activities. The Corporation's ability to generate positive cash flows from operating activities is dependent on achieving and maintaining profitable operations. Since inception, the Corporation has been able to finance its activities and operate on a going concern basis through issuances of shares, stock warrants and debt. To raise additional funds if and when required, the Corporation’s current strategy is expected to be, but not limited, to the issuance of common shares, convertible financial instruments and stock warrants.

Based on the current level of liquidities and sales activities, the realization of assets and the discharge of its liabilities in the ordinary course of business remain uncertain. In order to address these uncertainties, the Corporation has implemented some or all of the following measures:

- Reduce operating costs with temporary staff lay-offs, curtail certain consulting and travel costs
- Continue to seek debt financing from private investors
- Continue to seek equity financing through private placement of common shares and stock purchase warrants
- Continue to evaluate possible M&A opportunities

The Corporation believes that the above measures will help improving its capacity to deliver results. There is, however, significant risk and uncertainty associated with the measures described above.

## Capacity to innovate

To improve existing products and continue to innovate, the Corporation has in place a team of scientists dedicated to the development of CARA and CARDS. The Corporation benefits from research and development (R&D) tax credits where, historically, approximately 15% of its overall R&D expenses are refunded by the Government of Quebec.

For the nine-month period ended December 31, 2016, refundable tax credit provisions in proportion to the overall R&D expenses represent:

| | Nine-month period ended December 31, | |
|---|---|---|
| | **2016** | **2015** |
| R&D expenses ($) | 673,263 | 655,983 |
| R&D tax credit provisions ($) | 85,000 | 125,000 |
| R&D tax credit in proportion to R&D expenses | 13% | 19% |

Based on current activities and current legislation, the R&D tax credit percentage in proportion to R&D expenses is expected to be approximately 13% for the foreseeable future.

## Expenses analysis

The comparative financial information on expenses, for the three-month and nine-month periods ended December 31, 2016, contained in this table, is derived from the Corporation's financial statements and is followed by an analysis of the material variances.

| | Three-month period ended December 31, | | Nine-month period ended December 31, | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| | $ | | $ | |
| Costs of services and research and development | 371,747 | 309,656 | 1,221,487 | 755,148 |
| Selling and administrative | 753,520 | 616,525 | 1,871,951 | 2,063,037 |
| | 1,125,267 | 926,181 | 3,093,438 | 2,818,185 |

| | Variations for the three-month period ended December 31, 2016 | | Variations for the nine-month period ended December 31, 2016 | |
|---|---|---|---|---|
| | $ | % | $ | % |
| Costs of services and research and development | (62,091) | (20%) | (466,339) | (62%) |
| Selling and administrative | (136,995) | (22%) | 191,086 | 9% |
| | (199,086) | (21%) | (275,253) | (10%) |

*Costs of services and research and development*

The increase of $466,339, or 62%, for the nine-month period ended December 31, 2016 is mainly due to the increase in delivery of services costs attributable to the global increase in revenues.

*Selling and administrative*

The increase of $136,995, or 22%, for the three-month period ended December 31, 2016, is mainly attributable to an increase in sales commissions and consulting fees.

The decrease of $191,086, or 9%, for the nine-month period ended December 31, 2016, is mainly attributable to a general decrease in legal fees.

## Financial position analysis

The comparative financial information contained in this section is derived from the Corporation's consolidated condensed financial statements.

| | As at | |
|---|---|---|
| | December 31, 2016 | March 31, 2016 |
| | $ | |
| Cash | 880,389 | 477,015 |
| Other current assets | 805,245 | 501,323 |
| Non-current assets | 263,988 | 292,284 |
| **Total assets** | **1,949,622** | **1,270,622** |
| Accounts payable and accrued liabilities | 747,343 | 342,382 |
| Other current liabilities | 1,883,916 | 1,640,904 |
| Non-current liabilities | 2,028,735 | 2,436,297 |
| Shareholders' deficiency | (2,710,372) | (3,148,961) |
| **Total liabilities and shareholders' deficiency** | **1,949,622** | **1,270,622** |
| **Working capital deficiency (current assets less current liabilities)** | **(945,625)** | **(1,004,948)** |
| Decrease in working capital deficiency | 59,323 | |

The decrease of $59,323 in working capital deficiency is mainly attributable to:

| | $ |
|---|---|
| Net proceeds from a private placement of rights | 968,965 |
| Net proceeds from short term loans | 500,000 |
| Net proceeds from disposals of investments | 322,878 |
| Net proceeds from the exercise of stock warrants | 257,000 |
| Net proceeds from convertible debentures | 185,250 |
| Net loss for the nine-month period ended December 31, 2016 | (1,567,954) |
| Repayment of short term loans | (350,000) |
| Additions to capital assets | (190,843) |
| Repayment of convertible notes | (130,000) |
| Others | 64,027 |
| | 59,323 |

Based on the current level of liquidities and sales activities, the realization of assets and the discharge of liabilities in the ordinary course of business remain uncertain. In order to address these uncertainties and improve its financial position, the Corporation has implemented some or all of the following measures:

| Liquidity risk | Risk mitigation measures |
|---|---|
| Funding of operating and financing expenses | • Reduce operating costs with temporary staff lay-offs, curtail certain consulting and travel costs<br>• Continue to seek debt financing from private investors<br>• Continue to seek equity financing of common shares and stock purchase warrants<br>• Continue to evaluate possible M&A opportunities |

The Corporation believes that with the above measures, it will be able to improve its financial position. There is, however, significant risk and uncertainty associated with the measures described above.

## Commitments and off-balance sheet arrangements

Under the terms of an operating lease agreement, which will expire in September 2019, the Corporation is committed to making minimum annual lease payments of $108,000 for the duration of the lease.

## Share information

As at December 31, 2016, the number of common shares and convertible securities outstanding is:

| | |
|---|---|
| Common shares | 140,619,786 |
| Stock warrants | 9,147,833 |
| Conversion options | 37,066,667 |
| Stock options | 10,051,349 |
| | 196,885,635 |

## Transactions between related parties

The Corporation's related parties include its subsidiaries and associate entity as well as the Corporation's key management personnel. Key management personnel include directors and officers.

Transactions with key management personnel, directors and officers are as follows:

| | Three-month period ended December 31, | | | Nine-month period ended December 31, | | |
|---|---|---|---|---|---|---|
| | 2016 | 2015 | Δ | 2016 | 2015 | Δ |
| | $ | | | $ | | |
| Base Salary | 131,250 | 142,500 | (8%) | 405,417 | 427,500 | (5%) |
| Stock based compensation | 5,028 | 9,590 | (48%) | 12,085 | 28,770 | (58%) |
| Incentives | 35,000 | 80,000 | (56%) | 35,000 | 80,000 | (56%) |
| Sales commissions | 63,743 | 4,000 | 1494% | 78,932 | 15,500 | 409% |
| Interest on demand loan | 405 | 405 | 0% | 1,275 | 1,275 | 0% |
| Payment of interest on demand loan | (405) | (405) | 0% | (1,275) | (1,275) | 0% |
| | 235,021 | 236,090 | (0%) | 531,434 | 551,770 | (4%) |

The decreases in stock based compensation are due to a decrease in the number of stock options granted over the last two financial years.

The increase in sales commissions of 409%, for the nine-month period ended December 31, 2016, is attributable to the overall increase in revenues for the same period.

Incentives were paid to two offcers in the form of cash bonuses.

During the nine-month period ended December 31, 2015, an entity related to a director of the Corporation loaned $400,000 to the Corporation in the form of a secured convertible demand loan, annual interest of 10%. On July 29, 2015, the holder of the demand loan proceeded with the conversion of the principal amount owing of $400,000 into secured convertible debentures of the Corporation as part of the private placement described in note 13 of the December 31, 2016 unaudited interim condensed consolidated financial statements.

The following table presents the balances outstanding with key management personnel as at:

| | December 31, 2016 | March 31, 2016 |
|---|---|---|
| | $ | |
| Demand loan receivable, annual interest rate of 4% | 43,500 | 43,500 |
| Convertible Debentures, annual interest rate of 10% | (500,000) | (500,000) |

## Critical accounting judgements and key sources of estimation uncertainty

In the application of the Corporation's significant accounting policies, management is required to make judgments, estimates, and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from those estimates.

The following are the key estimates concerning the future, and other key sources of estimation uncertainty at the end of the reporting period, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial period.

*Going concern assumption*

The Corporation's ability to continue as a going concern is dependent on completing an additional financing, achieving and maintaining profitable operations and other factors, all of which are outside of management's control. Management has to assess the outcome of these matters when preparing the Corporation's consolidated financial statements. The Corporation's current level of revenues is not sufficient to cover its expenses and ongoing commitments, resulting in the negative cash flows generated from operating activities. The Corporation's ability to generate positive cash flows from operating activities is dependent on achieving and maintaining profitable operations. The Corporation believes that it will be able to continue as a going concern and therefore the financial statements do not reflect any adjustments that would be necessary if the going concern basis was not appropriate.

*Tax credits on research and development expenses*

The Corporation receivables include refundable tax credits on R&D expenses. Management has to make certain careful judgments related to the eligibility of R&D expenses with regards to the provisions of the current tax credit programs.

*Stock-based compensation*

Stock-based compensation involves the valuation of grants of stock options. The Corporation relies on the fair value obtained by applying the Black - Scholes option pricing model. This model requires making assumptions related to the risk-free interest rate (with a term that matches the expected life of the options), the expected stock price volatility, the expected life of the options and the expected dividend yield on the Corporation's shares. Management also has to estimate the number of options that will eventually vest.

*Fair value of financial instruments*

Financial instruments are presented at fair value. In the absence of active markets in the evaluation of financial assets and financial liabilities, the Corporation relies on evaluation techniques based on inputs that are not based on observable market data which could cause the actual results to differ from the estimates.

## Risk management

The Corporation is exposed to risks which could have an impact on its capacity to reach its strategic growth objectives. The Corporation strives to control and mitigate the risks through management practices that require the identification and analysis of the risks related to its operations. A detailed description of these risks can be found in the latest annual report, dated March 31, 2016 available on the SEDAR website at www.sedar.com.

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**Stock Exchange Listing**
DIAGNOS Inc. shares are listed on the TSX Venture Exchange under the symbol ADK.

**Transfer Agents and Registrar**
Computershare Trust Company of Canada

**Auditor**
Deloitte LLP