



**NIGHTINGALE INFORMATIX CORPORATION**

**MANAGEMENT'S DISCUSSION AND ANALYSIS ("MD&A")  
For the Fiscal Year Ended March 31, 2006**

*Management's Discussion and Analysis (MD&A) supplements, but does not form part of the annual consolidated financial statements and notes of Nightingale Informatix Corporation ("Nightingale" or the "Company") for the period.*

*This MD&A, prepared as of July 1, 2006, should be read in conjunction with the Company's March 31, 2006 consolidated annual financial statements and notes.*

# NIGHTINGALE INFORMATIX CORPORATION

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*This discussion and analysis provides an overview of significant developments that have affected Nightingale's performance during the fiscal year ended March 31, 2006. For the purpose of this MD&A, the Company does not provide comparatives to quarterly financial statements from the previous fiscal year since, for that period, financial statements were only prepared on an annual basis.*

*The unaudited interim consolidated financial statements referred to in this MD&A have been prepared in accordance with Canadian generally accepted accounting principles and are consistent with those used in the Company's year-end audited financial statements. All figures herein are expressed in Canadian dollars unless otherwise noted.*

*The Company's Chief Executive Officer and Chief Financial Officer are responsible for maintaining the Company's disclosure controls and procedures. Based on an evaluation of the Company's disclosure controls and procedures, the Chief Executive Officer and Chief Financial Officer have concluded that these controls and procedures operated effectively as of March 31, 2006.*

*This MD&A contains "forward-looking statements" within the meaning of the United States Private Securities Litigation Reform Act of 1995 and applicable Canadian securities legislation. Generally, forward-looking statements can be identified by the use of forward-looking terminology such as "plans", "expects" or "does not expect", "is expected", "budget", "scheduled", "estimates", "forecasts", "intends", "anticipates" or "does not anticipate", or "believes", or variations of such words and phrases or state that certain actions, events or results "may", "could", "would", "might" or "will be taken", "occur" or "be achieved". Forward-looking statements are subject to known and unknown risks, uncertainties and other factors that may cause the actual results, level of activity, performance or achievements of Nightingale to be materially different from those expressed or implied by such forward-looking statements, including but not limited to: risks related to the speculative nature of the medical software industry, which is affected by numerous factors beyond Nightingale's control; the existence of present and possible future government regulation; the significant and increasing competition that exists in the medical software industry; the early stage of Nightingale's business; and therefore it is subject to the risks associated with early stage companies, including uncertainty of revenues, markets and profitability and the need to raise additional funding. Although Nightingale has attempted to identify important factors that could cause actual results to differ materially from those contained in forward-looking statements, there may be other factors that cause results not to be as anticipated, estimated or intended. There can be no assurance that such statements will prove to be accurate, as actual results and future events could differ materially from those anticipated in such statements. Accordingly, readers should not place undue reliance on forward-looking statements. Nightingale does not undertake to update any forward-looking statements that are incorporated by reference herein, except in accordance with applicable securities laws.*

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### 1. OVERVIEW

#### ***Business Description***

Nightingale operates in a single business segment and its principal activities include the development, marketing and licensing of application software and services to customers in the healthcare industry in Canada and the United States.

Nightingale's Internet-based Electronic Health Record (EHR), Electronic Medical Record (EMR) and practice management solutions are designed to help physicians, clinics, hospitals and other healthcare organizations more efficiently manage their operations and patient records. Nightingale's products and services offer physicians in United States and Canada leading-edge functionality for clinical documentation, patient scheduling, resource scheduling, billing, transcription, end-to-end coding and claims processing, data management, work flow tools, laboratory interfaces, documentation management and patient portals, along with other real-time services. The company's proprietary offerings of software include myNightingale, Entity and Physician Workstation, providing physicians with a fully integrated, simple-to-use system that automates daily tasks and creates a single, accessible source of patient data.

Nightingale's revenue model consists of several different components dependant on the type of solution being provided. For its software solutions, Nightingale either charges up-front license fees for its software products, with annual support and maintenance fees charged to deliver software updates and support, or alternatively Nightingale charges a monthly utilization fee for access to the software, without any sale of license. In addition, Nightingale charges customers for training and implementation services, hardware and any ancillary services utilized. For data management and transcription services, Nightingale charges per report or per minute transcribed and for billing services the company charges a percentage of the customer charges billed.

Nightingale's solutions are currently being utilized by an established customer base of physicians, clinics and hospitals across North America.

Nightingale intends to continue growing organically in Canada and the U.S. through continued sales to hospitals, health associations, regional health authorities and clinical networks ("Enterprise" customers), and sales to small/ medium sized clinics ("SMB" customers). The Company also intends to grow through an acquisition strategy focused on complementary healthcare software solution or service companies in Canada and the U.S.

#### ***Significant Events***

##### **a. Amalgamation with Venquest Capital Ltd. and Private Placement**

On September 1, 2005, the Company completed an amalgamation with Venquest Capital Ltd. ("Venquest"), resulting in the Company becoming a publicly traded company on the TSX Venture exchange (TSX Venture: NGH). The amalgamation constituted a Qualifying Transaction for Venquest.

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Venquest acquired all of the issued and outstanding Common Shares of Nightingale. In exchange the shareholders of Nightingale received Common Shares of Venquest representing approximately 88% of the Common Shares of the combined entity. Immediately subsequent to the acquisition, Venquest amalgamated with Nightingale and continues under the name of Nightingale.

For accounting purposes, the amalgamation of Nightingale and Venquest has been accounted for using the reverse take-over method of purchase accounting. Nightingale is deemed to be the acquirer and is assumed to be purchasing the assets and liabilities of Venquest, since the original shareholders of Nightingale have become owners of more than 50% of the voting shares of Venquest on a full diluted basis. The results of the operations of Venquest are included from the date of the transaction.

Immediately prior to the completion of the amalgamation, the Company concluded a private placement through Canaccord Capital Corporation. The Company converted subscription receipts from this private placement into 975,200 common shares, at a value of \$1.00 per share.

#### **b. Amalgamation with 2043385 Ontario Inc.**

On October 1, 2005, the Company amalgamated its wholly owned subsidiary, 2043385 Ontario Inc. into the parent company. Though the subsidiary did not conduct any business, the purpose of this amalgamation was to transfer the assets of the subsidiary into the parent company.

#### **c. Acquisition of HealtheNet**

On March 16, 2006, the Company completed the acquisition of the business and assets of Scribes Inc., Scribes (USA) Inc., Healthenet inc. (a Delaware company) and HealtheNet Inc., (collectively referred to as HealtheNet), providers of data management and transcription services to the healthcare community. The aggregate consideration paid was \$7,125,000 and is comprised of \$1,000,000 in a Promissory Note and the issuance of 5,104,167 Common Shares valued at \$6,125,000. Included in the 5,104,167 common shares issued are 1,666,667 Common Shares, valued at \$2,000,000, which are subject to a performance based escrow whereby the shares may be released subject to the Company meeting earn-out targets over the four fiscal years following the date of the acquisition. Since the outcome of the contingency cannot be determined beyond reasonable doubt, the \$2,000,000 contingent consideration has been excluded in the recorded purchase price. Therefore the aggregate recorded purchase price, including the transaction cost of \$210,224, is \$5,335,224. Once the outcome of the contingency is determined beyond reasonable doubt, contingent consideration recognized, if any, will be added to the purchase price.

The acquisition is accounted for by the purchase method whereby the results of operations of HealtheNet, from the date of acquisition, are included in the consolidated statements of operations and deficit and cash flows of the Company.

## **2. DISCUSSION OF OVERALL PERFORMANCE, RESULTS OF OPERATIONS AND FINANCIAL CONDITION**

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During fiscal 2006, the Company generated revenue of \$4,213,039, a 123% increase over \$1,884,286 generated in fiscal 2005. The increase in revenue can be attributed to revenue recognized from the delivery of projects to several major Enterprise customers, increased sales and marketing efforts, and Nightingale's growing reputation as a leading provider of solutions in the marketplace.

The Company generated a gross profit of \$3,608,295, with a gross profit margin of 86%, for fiscal 2006, compared to \$1,500,247, or a gross profit margin of 80%, for fiscal 2005. Approximately half of the improvement in the gross profit margin was due to a change in accounting policy related to the expensing of commissions expense (see Changes in Accounting Policies section below) while the remainder was due to a higher proportion of revenue being generated from software versus hardware sales, and a larger proportion of revenue being generated from Enterprise customers, on which the Company pays a reduced commission rate versus revenue from SMB customers.

Expenses totalled \$6,608,488, or 157% of revenue, in fiscal 2006, and were higher as a percentage of revenue versus fiscal 2005, when they were at 140% of revenue. This was largely due to the fact that the Company continued to invest in building out its capabilities across the entire organization. Included in expenses were non-cash expenses of \$566,100 for new stock options and commons shares granted to officers, employees and consultants. Without this charge, expenses totalled \$6,042,388, or 143% of revenue.

	Q1 Ended June 30 2006	Q2 Ended Sept. 31 2006	Q3 Ended Dec. 31 2006	Q4 Ended March 31 2006	Fiscal Year Ended March 31, 2006	Fiscal Year Ended March 31, 2005	Fiscal Year Ended March 31, 2004
<b>Revenue</b>	1,011,290	1,168,269	1,204,190	829,290	4,213,039	1,884,286	542,627
<b>Gross Profit</b>	867,756	1,062,191	1,093,034	585,314	3,608,295	1,500,247	174,999
<b>Expenses</b>	1,021,783	1,341,009	1,564,609	2,681,088	6,608,488	2,630,747	1,426,446
<b>Net Loss for the Period</b>	(154,027)	(278,818)	(471,574)	(2,095,775)	(3,000,193)	(1,130,500)	(1,251,447)
<b>Net Loss per Common Share</b>	(0.006)	(0.010)	(0.017)	(0.069)	(0.11)	(0.17)	(0.28)
<b>Weighted Average # of Common Shares</b>	24,999,998	26,468,386	27,049,117	3,0171,627	27,650,877	6,577,695	4,455,647
<b>Total Assets</b>	2,270,572	4,620,167	4,757,802	9,521,507	9,521,507	2,696,362	1,009,738
<b>Total Long Term Liabilities</b>	1,298,600	1,538,325	1,590,486	1,795,520	1,795,520	1,071,713	1,263,055

In Sales and Marketing, by the end of the fiscal year, Nightingale had fully built out its sales team across Canada, with a local sales presence in each of the markets in which the Company sells its

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solutions. In the U.S., during the fourth quarter, the Company began working with the management teams of the HealtheNet and the IHPS acquisitions (closed post-fiscal year end) to develop the sales and marketing strategy for the U.S. target market.

In Research and Development and Client Services, Nightingale delivered on several major Enterprise customer requirements and during the latter half of the fiscal year, began rolling out these Enterprise customers. The Company added several resources across each of these areas as it continued to build out its capabilities to deliver.

Overall, the Company significantly increased expenses in the fourth quarter of fiscal 2006 as it increased its investment across all areas of the Company in anticipation of its entry into the U.S. market with expenses rising from \$1,564,609 in the third quarter to \$2,681,088 in the fourth quarter.

Net loss for fiscal year 2006 was \$3,000,193, or 71% of revenue. This compared to a net loss of \$1,130,500, or 60% of revenue, for fiscal 2005.

### **3. LIQUIDITY AND CAPITAL RESOURCES**

Cash and cash equivalents available to Nightingale at the end of the year was \$373,691.

Cash flow used in operations in fiscal 2006 totalled \$770,903, compared to \$1,596,608 for fiscal 2005. The most significant areas adjusting net income to cash flow from operations included an increase in accounts payable and accrued liability of \$1,147,418, an adjustment for stock based compensation of \$566,100, an increase in deferred revenue of \$612,921, and an increase in prepaid expenses of \$274,969.

During fiscal 2006, cash flow used in investing activities was \$1,223,191. In total, cash flow used in investing activities included \$239,724 attributed to the HealtheNet acquisition and \$735,022 used in the purchase of property and equipment, with an increase in deferred cost of \$248,445 related to the IHPS acquisition that was subsequently concluded in April 2006.

Cash flow from financing activities in fiscal 2006 totalled \$2,178,903, with the largest components reflecting the amalgamation with Venquest of \$1,515,654, shares issued for the private placement concluded September 1, 2005 through Canaccord Capital Corporation for net proceeds of \$857,613 and the \$158,640 repayment of a line of credit used by the Company, but held and secured by a shareholder and director.

Current assets at fiscal year end March 31, 2006 increased by \$298,207 over the previous year. During the period, cash and cash equivalents increased by \$184,809, to \$373,691, and accounts receivable increased by \$101,043, to \$1,371,981. Other changes include a \$12,614 decrease in investment tax credits receivable, and a \$274,969 increase in prepaid expenses

Current liabilities at fiscal year end March 31, 2006 increased by \$2,181,770, including an increase of \$1,000,000 due to a note payable that formed part of the HealtheNet acquisition. Accounts payable and accrued liabilities increased by \$1,147,418 while amounts due to shareholders were reduced by \$158,640, attributable to the repayment of a line of credit

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referenced earlier. Bank loan payable also decreased by \$35,724 during the fiscal year, and subsequent to the year end, the Company repaid this bank loan in full.

#### 4. CONTRACTUAL OBLIGATIONS

Nightingale continued its primary facilities lease obligation, as per its lease dated March 29, 2005 with RedCliff Realty Management Inc. for the lease of its head office at Suite 200, 3760 Fourteenth Avenue, Markham, Ontario L3R 3T7. In addition, the Company continued its lease obligations for computer equipment, leased through a related party, Asadi Lewis and Associates (see Transactions with Related Parties below).

In the fourth quarter of fiscal 2006, as part of the HealthNet acquisition, the Company took over \$391,076 in existing capital leases for computer equipment, furniture and fixtures.

The minimum lease commitments payable under long-term operating leases for all equipment and premises, for which the Company is responsible, are as follows:

<b>Fiscal Year</b>	<b>Amount (\$)</b>
2007	\$211,982
2008	221,817
2009	209,668
2010	201,866
2011	149,976

The minimum lease commitments payable under capital leases for all equipment are as follows:

<b>Fiscal Year</b>	<b>Amount (\$)</b>
2007	\$ 229,446
2008	180,267
2009	34,007
2010	11,452
Total	<u>455,172</u>

#### 5. CHANGES IN ACCOUNTING POLICIES

Effective April 1, 2006, the Company changed its method of expensing the sales commission. Instead of expensing the commission when paid, commission is allocated and expensed in proportion to various stream of revenues recognized by the Company. Since the necessary financial data for retroactive application of the new accounting policy is not reasonably determinable, the change has been accounted for prospectively. The adoption of this new policy has resulted in a reduction in sales commission expense of \$121,206 in fiscal 2006.

#### 6. SHARE CAPITAL STRUCTURE

The Company authorized to issue an unlimited number of common shares without par value and an unlimited number of preferred shares without par value.

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	<b>Authorized</b>	<b>Issued as at March 31, 2006</b>
Common Shares*	Unlimited	33,123,972
Preferred Shares	Unlimited	-
Stock Options - Issued and Outstanding		2,755,570
Agent Options (Broker Warrants) – Issued and Outstanding		273,020

\* 5,104,167 common shares were issued on the purchase of HealtheNet. Only 3,437,500 common shares are included in the above table because 1,666,667 common shares with value of \$2,000,000 are subject to the performance escrow and have been excluded in the purchase price of the acquisition. Including the 1,666,667 common shares issued, the total common share outstanding at March 31, 2006 is 34,790,639.

#### 7. TRANSACTIONS WITH RELATED PARTIES

The Company continued to make payments on four year leases held by a related party, Asadi Lewis & Associates, for equipment utilized by Nightingale. These leases, with a term from October 15, 2004 to September 15, 2008 are for computer hardware utilized as part of Nightingale's production infrastructure, with a total obligation of \$157,651, resulting in monthly payments of \$3,346 and interest paid of \$11,039 during fiscal 2006. In addition, during the period, interest paid on a line of credit used by the Company, but held and secured by a director and shareholder equalled \$2,017, outstanding accounts payable to officers and directors at year end totalled \$20,225, previously deferred compensation to an officer and director totalled \$402,012, and other receivables from an officer and director equalled \$145,107.

#### 8. SUBSEQUENT EVENTS

##### a. Acquisition of IHPS

On April 1, 2006, the Company completed its purchase of the assets of Integrated Healthware Inc, a healthcare software provider for the U S market and its affiliate. Physician Strategies LLC, a Massachusetts-based practice management firm focused on providing claims processing services to U S physicians (collectively referred to as "IHPS") The agreement to acquire IHPS was originally announced on January 12, 2006 IHPS shareholders received total consideration of US\$6 million, which included US\$2.5 million in cash, US\$0.6 million in a promissory note, US\$0.9 million in common shares of Nightingale and US\$2 million in the form of a performance-based earnout The earnout is contingent on meeting revenue targets over a three-year period and will be paid on a basis of 80% in shares and 20% in cash, with share price of these earnout shares based on the 20-day average closing price of Nightingale's common shares prior to the release of the fiscal 2007, 2008 and 2009 financial statements IHPS generated revenue as of year ending December 31; 2006, of US\$3.7 million, based on its audited financial statements.

##### b. Debt Financing

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On April 27, 2006, Nightingale closed a non-brokerage \$7 million debt financing. The financing was led by VRG Capital, a division of the Vimy Ridge Group, representing a syndicate of lenders, and consisted of \$5 million in subordinated debt and \$2 million line of credit facility provided by Greenfield Commercial Credit Inc., both of which were secured against assets of the Company and its subsidiaries. The subordinated debt has a two-year term at a rate of 10% with no rights and included the issuance of 1.25 million common share purchase warrants ("Warrants"). Each Warrant entitles the holder to purchase one common share of Nightingale for a purchase price of \$1.50 per common share for up to two years from the date of closing. The line of credit has a maximum one year term at floating prime rate plus 2%. The proceeds of the financing was used to fund the IHPS acquisition and for general working capital purposes. Subsequent to the private placement below, the \$5 million in subordinate debt was fully repaid. A director of the Company is a director to both the Vimy Ridge Group Ltd. and Greenfield Commercial Credit Inc.

#### c. Private Placement

On June 20, 2006, Nightingale completed a private placement financing comprised of a total of 7,700,000 Units (the "Units") of the Company at a price of \$1.30 per Unit for aggregate gross proceeds of \$10,010,000. Each Unit consists of one common share (the "Common Shares") of the Company and one half of one common share purchase warrant (the "Warrants"), with each whole Warrant being exercisable to acquire an additional Common Share at a price of \$1.60 for a period of 24 months following the closing of the Offering. All securities issued under the Offering were subject to hold periods until October 21, 2006.

The Offering was underwritten by Clarus Securities Inc. ("Clarus") who was paid a cash commission of 7% on closing of the Offering and granted 770,000 compensation options (the "Compensation Options"). Each Compensation Option entitles the holder to acquire one Unit under the same terms and conditions as the Offering, for a period of 24 months following the closing of the Offering. The net proceeds of the offering were to be used by the Company for working capital, retirement of debt and general corporate purposes. A director of the Company is a director to Clarus Securities Inc.

## 9. RISKS AND UNCERTAINTIES

- a. The market for Nightingale's products and services has only recently begun to develop. As is typical for a new and rapidly evolving industry, demand and market acceptance for recently introduced services and products are subject to a high level of uncertainty. There is no assurance that Nightingale's sales will continue to increase or that it will even be able to maintain current levels. Market conditions will determine Nightingale's success in the future. There is also no assurance that Nightingale will earn profits in the future or that any profitability will be sustained.
- b. Direct competition among providers of medical software products and services is likely to increase as demand for these products increases. Increased competition is likely to result in price reductions, reduced gross margins, longer sales cycles and loss of market share, any of which would seriously harm Nightingale's business and results of operations. Management of Nightingale cannot be certain that Nightingale will be able to compete successfully against current or future competitors or that competitive pressure will not seriously harm its business.

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- c. Some of Nightingale's potential competitors are larger than Nightingale and have greater financial, sales, marketing, technical, manufacturing and other resources. These competitors may be able to respond more rapidly to new or emerging products and changes in customer requirements or devote greater resources to the development, promotion and sale of their products than Nightingale can. Furthermore, some of these competitors may make strategic acquisitions or establish cooperative relationships among themselves or with third parties in the industry to increase their ability to rapidly gain market share by addressing the needs of prospective customers.
- d. Nightingale, like any other business, faces an inherent risk of exposure to product and service liability claims in the event that the use of its products and services results in loss of a customer's data or ability to effectively operate their own business. Although Nightingale believes it has sufficient liability insurance coverage in accordance to the standards of its industry, such coverage is subject to standard limitations and exclusions. Product liability claims could have a material adverse effect on Nightingale. The successful assertion or settlement of any uninsured claim, a significant number of insured claims or a claim exceeding Nightingale's insurance coverage could have a material adverse effect on Nightingale.
- e. Nightingale is dependent on its management. This dependence can be expected to continue over the short and medium term as Nightingale's business expands and matures. Nightingale's ability to develop, market and sell its products and services and to maintain its competitive position depends on its ability to attract, retain and motivate highly skilled technical, sales and marketing and other personnel. Nightingale plans to expand its sales and marketing efforts, particularly in Canada, in order to increase market awareness. Nightingale also plans to increase its research and development personnel to develop new products, and to increase its customer service and support personnel in North America to support the growth of its business. There are a limited number of people with the necessary technical skills and understanding, and competition for their services is intense. If Nightingale fails to recruit or retain these personnel, its ability to develop new products, obtain new customers and provide an acceptable level of customer service could suffer.
- f. The healthcare information technology industry is susceptible to technological advances and the introduction of new technologies. Further, this industry is also subject to changing industry standards, market trends and customer preferences and to competitive pressures which can, among other things, necessitate revisions in pricing strategies, price reductions and reduced profit margins. The success of Nightingale will depend, in part, on its ability to secure technological superiority in its products and operations and maintain such superiority in the face of new technologies. No assurance can be given that further modification of product offerings of Nightingale will not be required in order to meet demands or to make changes necessitated by developments made by competitors that might render services and operations of Nightingale less competitive. The future success of Nightingale will be influenced by its ability to continue to adapt its products. Although Nightingale has committed resources to improve its products, there can be no assurance that these efforts will increase profits.
- g. Nightingale may experience fluctuations in future quarterly operating results that may be caused by many factors, including: (i) variability of sales to new and existing customers, (ii)

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changes in the level of marketing and other operating expenses to support future growth, (iii) competitive factors; and (iv) the timing of delivery. Consequently, Nightingale believes that period-to-period comparisons of its operating results will not necessarily be meaningful and should not be relied upon as an indication of future performance. It is likely that Nightingale's future quarterly operating results from time to time will not meet the expectations of securities analysts or investors, which may have a material adverse effect on the market price of the Company Common Shares.

- h. The sales cycle of Nightingale's products and services is lengthy and unpredictable. While customers are evaluating Nightingale's product offering, Nightingale may incur expenses and expend management effort. The result of making these expenditures, with no corresponding revenue in any given quarter, could further exacerbate fluctuations of the quarterly operating results of Nightingale.
- i. Nightingale plans to further increase its presence in the United States. Its efforts may not be successful to the degree that management expects. Further, international operations are influenced by numerous inherent risks, including: unexpected changes in regulatory requirements, tax rate or tariffs that make Nightingale's products and services more expensive and therefore less attractive to potential customers; longer accounts receivable payment cycles and possible difficulties in collecting payments that may increase its operating costs and impair its financial performance; political and economic instability; and fluctuations in currency exchange rates and the imposition of currency exchange controls.
- j. The adoption of medical software may occur at a much slower rate than current market data suggests. With rapid growth currently expected due to the industry's evolution from early adopters to the mainstream market, the slowdown in growth would have an adverse effect on companies attempting to sell their products and services to this audience. Therefore, a slowdown in the adoption rate could potentially result in reduced revenues and sales for healthcare information technology suppliers in this space, including Nightingale.
- k. Security is always a major concern for any software system dealing with confidential records. Security risks include unauthorized access to confidential information, such as patient records and a customer's enterprise data. If either of these events occur to Nightingale, its reputation in the marketplace would be damaged, potentially resulting in lost sales of new or existing customers.
- l. If Nightingale's system is unavailable for any significant period of time, physicians and healthcare providers will be unable to access critical patient records and other information required to perform daily duties. Nightingale may have its reputation in the marketplace damaged, potentially resulting in lost sales of new or existing customers.
- m. In Canada and the United States, government funding programs are helping to fuel the market for Nightingale's solutions. There is a risk that if funding commitments from eHealth initiatives are halted, then the demand for EMR, clinical and practice management could significantly decrease, which could have a material adverse effect

## 10. ADDITIONAL INFORMATION

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Additional information on Nightingale can be found disclosed at [www.sedar.com](http://www.sedar.com) under Nightingale Informatix Corporation.