



DIAGNOS inc.
knowledge extraction technologies

**Report of the first quarter (Q1) to Shareholders
for fiscal year 2007**

For the quarter ended June 30, 2006

TSX Venture: ADK

Message to Shareholders

Dear Shareholders:

DIAGNOS completed the first quarter ended June 30, 2006 reporting the highest revenue of any quarter to date. The Corporation is working on providing predictions for diamond, gold, copper and nickel exploration for its customers and is also acquiring mining properties for the purpose of reselling or developing partnership agreements with exploration companies.

DIAGNOS is increasing its customer base and also acquiring mineral exploration claims to properties outside the Province of Quebec. CARDS (Computer Aided Resource Detection Software), our flagship service, is getting more and more recognition from the mining world. The Corporation is continuing to acquire data from several countries, as well as from Quebec and Ontario, for its own usage in determining the mineral exploration claim acquisition strategy.

During the first quarter, the Corporation was able to resell five mineral exploration claims to properties to a private group in Quebec. The Corporation acquired an additional eight properties in its first quarter.

We have established a clear strategy for the natural resource market and we expect to have definitive drilling results during the next two quarters from our existing clients.

The Corporation is looking at expanding its marketing efforts through the addition of several sales professionals during the next quarter.

We have also started a media coverage strategy through the use of Paradox Public Relations Inc., an investor relations firm based in Montreal.



André Larente
President and Chief Executive Officer

August 29, 2006

DIAGNOS inc.

Management Discussion and Analysis

DIAGNOS inc. (TSX Venture Exchange: ADK) is a Canadian software corporation that develops and sells knowledge extraction software. DIAGNOS is demonstrating a new dimension in analyzing data, text and images simultaneously in a commercial environment.

You will find more information concerning DIAGNOS inc. by consulting SEDAR Web site at www.sedar.com.

Notice to readers

The following discussion, effective as of August 29, 2006, analyses the current financial situation of the Corporation as of June 30, 2006 and should be read with the interim consolidated financial statements and accompanying notes, which have been prepared in accordance with Canadian generally accepted accounting principles. The currency used is the Canadian dollar.

The attached unaudited interim consolidated financial statements have been reviewed by the Corporation's external auditors. The accompanying notes are an integral part of the interim consolidated financial statements.

Forward-looking statements

This MD&A contains certain forward-looking statements with respect to the Corporation. These forward-looking statements, by their nature, necessarily involve risks and uncertainties that could cause actual results to differ materially from those contemplated by these forward-looking statements. We consider the assumptions on which these forward-looking statements are based to be reasonable, but caution the reader that these assumptions regarding future events, many of which are beyond our control, may ultimately prove to be incorrect since they are subject to risks and uncertainties that affect us. These risks and uncertainties include risks associated with market acceptance, competitive developments 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.

Summary of quarterly results

	<i>Fiscal Year 2007</i>		<i>Fiscal Year 2006</i>			<i>Fiscal Year 2005</i>		
	<i>Q1</i>	<i>Q4</i>	<i>Q3</i>	<i>Q2</i>	<i>Q1</i>	<i>Q4</i>	<i>Q3</i>	<i>Q2</i>
	<i>June 30, 2006</i>	<i>March 31, 2006</i>	<i>Dec. 31, 2005</i>	<i>Sept. 30, 2005</i>	<i>June 30, 2005</i>	<i>March 31, 2005</i>	<i>Dec. 31, 2004</i>	<i>Sept. 30, 2004</i>
		\$	\$	\$	\$	\$	\$	\$
Revenue	295,728	266,019	90,419	172,667	180,082	(44,497)	47,775	4,504
Net loss	(92,341)	(62,906)	(297,680)	(140,477)	(80,801)	(382,341)	(415,797)	(542,262)
Loss per share	(0.01)	(0.01)	(0.01)	(0.01)	(0.01)	(0.02)	(0.01)	(0.02)

Financial highlights

	<i>Fiscal Year 2006</i>	<i>Fiscal Year 2005</i>	<i>Fiscal Year 2004</i>
	\$	\$	\$
Revenue	709,187	111,746	387,720
Income taxes	-	-	-
Net loss	(581,864)	(1,746,088)	(130,059)
Loss per share	(0.02)	(0.07)	(0.01)
Total assets	964,273	376,770	711,902
Total long-term liabilities	170,592	215,159	840,656

Revenue

During the first quarter of 2007, DIAGNOS registered revenue of \$96,535 and \$199,193 in other income for a total of \$295,728, an increase of 64% over the first quarter of 2006, where we registered \$180,082 in revenue. The other income consists of a gain on the sale of options granted on certain mineral exploration claims to properties in the amount of \$197,168 and \$2,025 in interest income. The Corporation signed its largest contract, related to the sale of options on mineral exploration claims to properties since the beginning of its operation during the quarter.

Expenses

As a result of our efforts to gain market share, our general, sales and administration expenses increased by \$60,935 during the quarter ended June 30, 2006, an increase of 26% over the same quarter of the last fiscal year.

The main contributions to this increase are: consulting services, legal fees and increases in salaries.

Research and development

The Corporation has incurred \$84,349 in research and development costs during the quarter ended June 30, 2006, an increase of \$63,927 compared to the quarter ended June 30, 2005. This increase is mainly due to the fact that we hired new consultants for development of our security and natural resource products.

DIAGNOS inc.

Net loss

During the first quarter ended June 30, 2006, the Corporation incurred a net loss of \$92,341 (\$0.01 per share) compared to a net loss of \$80,801 (\$0.01 per share) for the period ended June 30, 2005. This increase in net loss compared to the quarter ended June 30, 2005 is due to an increase in R&D and general, selling and administrative expenses partially offset by the increase in sales.

Financing activities

During the first quarter ended June 30, 2006, no warrants were exercised.

Working capital

As at June 30, 2006, our working capital was \$662,730 compared to \$715,648 at March 31, 2006. DIAGNOS anticipates financing its activities in the future from revenue, which will cover a portion of the expenses incurred and cash on hand. If for any reason DIAGNOS should require additional cash to pay expenses, the Corporation may have to raise additional cash from a private placement to its existing Shareholders or new investors. The Corporation also anticipates purchasing additional assets in the form of mineral exploration claims for approximately \$50,000 and computer equipment for approximately \$30,000 during this fiscal year.

Share information

As at June 30, 2006, the outstanding shares are common shares and convertible securities:

Common shares	33,693,019
Convertible securities:	
Warrants	13,611,332
Options on shares	<u>3,888,949</u>
Total	51,193,300

Significant accounting policy

Gains on the sale of options to mineral exploration claims to properties are recognized net of the remaining unamortized cost of the related mining asset, included in intangible assets, and net of any unrecoverable costs from the optionee, required to be incurred by the Corporation in order to retain valid title to those mineral exploration claims during the period of the option.

The Corporation recognizes stock-based compensation and other stock-based payments as compensation expense determined in accordance with the Black & Scholes valuation model, with a corresponding accretion to contributed surplus.

Outlook

The Corporation's Artificial Intelligence (AI) engine is expected to be the driving force behind building applications for new vertical markets. Our natural resource application CARDS (Computer Aided Resource Detection Software) was our first vertical market development. The Corporation is focused on delivering solutions for the natural resource market and also on building a royalty based business. This will be accomplished by the acquisition of claims and participating with existing clients in new projects. Secondly, the Corporation acquired data from several sources including the Quebec and Ontario governments which it anticipates to use in the identification of potential claims for purchase.

The Corporation delivered a solution for the Oil & Gas exploration market during fiscal year 2006. This new application generated our first customer in the Oil & Gas market and we will be increasing our sales activities in the Oil & Gas market in quarters to come. Finally, the Corporation is pursuing other markets that require AI technology to resolve complex problems within different industries. The Corporation signed a development contract related to the security market with Optosecurity during fiscal year 2006. This development contract is expected to continue and should be completed by the end of the calendar year of 2006. DIAGNOS has been approached by other AI companies from Spain and other countries to create partnerships covering North America. The Corporation is working with a group of radiologists based in the Province of Quebec to continue the original work done by DIAGNOS in the medical field. Our MAMMO application for breast cancer identification is an example of the work that could be reactivated for our development department. DIAGNOS is also working with a group of ophthalmologists to develop a retinopathy screening application. All these new applications will re-enforce DIAGNOS' market penetration and diversify the Corporation's exposure to any one market, should there be economic downturns.

Risk analysis

Several business risks exist such as the market adoption of AI technology, the Corporation's ability to hire and retain top scientific resources and our ability to convince customers in these new vertical markets of the benefit of our technology and its results. The Corporation also relies on its Shareholders to provide funding, in the event it should experience shortfalls, to sustain continued operations.


DIAGNOS inc.

Interim Consolidated Balance Sheets

	As at June 30, 2006 (Unaudited) \$	As at March 31, 2006 (Audited) \$
ASSETS		
Current assets		
Cash and cash equivalents	27,203	52,911
Temporary investments (Note 3)	220,539	418,540
Amounts receivable (Note 4)	591,827	406,977
Prepaid expenses (Note 5)	12,492	7,812
	852,061	886,240
Capital assets (Note 6)	55,914	56,920
Intangible assets (Note 7)	17,979	21,113
	925,954	964,273
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities (Note 8)	189,331	170,592
SHAREHOLDERS' EQUITY		
Share capital (Note 9)	8,955,959	8,955,959
Contributed surplus (Note 10)	249,752	214,469
Deficit	(8,469,088)	(8,376,747)
	736,623	793,681
	925,954	964,273

SEE ACCOMPANYING NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS.

Approved on behalf of the Board of Directors



André Larente
Chairman



Me David Crevier
Secretary

DIAGNOS inc.

Interim Consolidated Statements of Income

	For the quarter ended June 30, 2006	For the quarter ended June 30, 2005
	(Unaudited)	(Unaudited)
	\$	\$
Revenue	96,535	180,082
Expenses		
General, sales and administrative	294,732	233,797
Research and development, net of tax credits	84,349	20,422
Amortization of capital assets	6,330	4,408
Amortization of intangible assets	2,487	2,111
Financial charges	171	145
	388,069	260,883
Loss for the quarter	(291,534)	(80,801)
Other income		
Gains on the sale of options to mineral exploration claims to properties	197,168	-
Interest	2,025	-
	199,193	-
Net loss for the quarter	(92,341)	(80,801)
Basic and diluted loss per share	(0,01)	(0,01)
Weighted average number of shares outstanding	33,693,019	29,169,441

SEE ACCOMPANYING NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS.

DIAGNOS inc.

Interim Consolidated Statements of Deficit

	For the quarter ended June 30, 2006	For the quarter ended June 30, 2005
	(Unaudited)	(Unaudited)
	<u>\$</u>	<u>\$</u>
Balance at the beginning of the quarter	<u>(8,376,747)</u>	<u>(7,794,883)</u>
Add:		
Net loss for the quarter	<u>(92,341)</u>	<u>(80,801)</u>
Balance at the end of the quarter	<u>(8,469,088)</u>	<u>(7,875,684)</u>

SEE ACCOMPANYING NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS.

DIAGNOS inc.

Interim Consolidated Statements of Cash Flows

	For the quarter ended June 30, 2006	For the quarter ended June 30, 2005
	(Unaudited)	(Unaudited)
	\$	\$
Cash flows from operating activities		
Net loss for the quarter	(92,341)	(80,801)
Items not affecting cash and cash equivalents		
Amortization of capital assets	6,330	4,408
Amortization of intangible assets	2,487	2,111
Stock-based compensation expense	35,283	29,640
Gain on sale of intangible assets	(197,168)	-
	(153,068)	36,159
	(245,409)	(44,642)
Net change in non-cash operating working capital items	27,210	(47,645)
	(218,199)	(92,287)
Cash flows from investing activities		
Additions to capital assets	(5,324)	(6,055)
Additions to intangible assets	(2,185)	(675)
Proceeds from sale of intangible assets	200,000	-
	192,491	(6,730)
Cash flows from financing activities		
Issuance of shares, net of share issue expenses	-	6,000
	-	6,000
Decrease in cash and cash equivalents	(25,708)	(93,017)
Cash and cash equivalents – Beginning of the quarter	52,911	258,008
Cash and cash equivalents – End of the quarter	27,203	164,991

SEE ACCOMPANYING NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS.

DIAGNOS inc.

Notes to Interim Consolidated Financial Statements

As at June 30, 2006 and March 31, 2006

1. Statutes and nature of activities

The shares of the Corporation are listed on the TSX Venture Exchange. DIAGNOS inc. develops and markets data mining software. The Corporation designed and developed MCubiX, a data mining software suite capable of extracting knowledge from historical data - in the form of images, text or traditional databases - and making predictions that improve business processes and decision making ability. CARDS (Computer Aided Resource Detection Software), the first vertical application, is dedicated to the natural resources market and can be applied to several areas of mineral prospecting, including diamond, gold, zinc, copper and, Oil & Gas.

2. Summary of significant accounting policy

a) Use of estimates

The preparation of interim consolidated financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates that affect the amounts of assets and liabilities reported in the interim consolidated financial statements. Those estimates also affect the disclosure of contingencies at the date of the interim consolidated financial statements and the reported amounts of revenues and expenses during the quarter. Significant estimates include tax credits recoverable, the useful lives of capital assets and intangible assets and certain accrued liabilities. Actual results could differ from those estimates.

b) Consolidation

These interim consolidated financial statements include the accounts of the Corporation and those of its wholly-owned subsidiary, DMS & Technologies Inc.

c) Foreign currency translation

The accounts are translated into the functional currency using the temporal method. Under this method, monetary assets and liabilities are translated at the exchange rates in effect at the balance sheet date. Non-monetary assets and liabilities are translated at historical rates. Revenue and expenses are translated at the average rate for the period. Income and losses resulting from translation are reflected in the statement of income.

d) Government assistance

The Corporation obtained tax credits from the government of Quebec according to the research and development concerning the development of software. The tax credits received are accounted for as a deduction of the related expenses.

e) Revenue recognition

Revenue from software is recognized upon delivery in accordance with the contractual conditions in effect with customers.

f) Recognition of gains on the sale of options to mineral exploration claims to properties

Gains on the sale of options to mineral exploration claims to properties are recognized net of the remaining unamortized cost of the related mining asset, included in intangible assets, and net of any unrecoverable costs from the optionee, required to be incurred by the Corporation in order to retain valid title to those mineral exploration claims during the option period.

g) Cash and cash equivalents

Cash and cash equivalents consist of cash on hand and balance with banks as well as all highly liquid short-term investments having a term of less than three months from the acquisition date.

h) Investments

Investments are recorded at cost.

i) Capital assets and amortization

Capital assets are recorded at cost less accumulated amortization and related tax credits. Amortization is calculated using the declining balance method at the following annual rates:

	<u>Annual rates</u>
Office furniture and equipment	- 20%
Computer equipment	- 50%

DIAGNOS inc.

j) Intangible assets and amortization

- a) The mining assets, consisting of mining concessions, are amortized using the straight-line method over their useful life, which is two years.
- b) Software is amortized using the declining balance method at the annual rate of 50%.

k) Income taxes

The Corporation provides for income taxes using the liability method of tax allocation. Under this method, future income tax assets and liabilities are determined based on deductible or taxable temporary differences between financial statement values and tax values of assets and liabilities using enacted income tax rates expected to be in effect for the year in which the differences are expected to reverse.

The Corporation establishes a valuation allowance against future income tax assets if, based on available information, it is more likely than not that some or all the future income tax assets will not be realized.

l) Research and development expenses

All expenses related to development activities, which do not meet generally accepted criteria for deferral, and research are expensed as incurred. Development expenses, which meet generally accepted criteria for deferral, are capitalized and amortized against income over the estimated period of benefit.

m) Loss per share

The loss per share is determined using the weighted average number of common shares outstanding during the quarter.

During the quarter, only the warrants and stock options whose exercise price was equal or lower than the average stock market during the exercise were taken into account.

The fully diluted loss per share, which is calculated according to the repurchase of shares method, is equal to the basic loss per share due to the anti-dilution effect of the stock option plan.

n) Share issue expenses

Share issue expenses have been applied against the proceeds from the issuance of share capital.

o) Stock-based compensation plan

The Corporation maintains a stock-based compensation plan, which is described in note 9. Any consideration from plan participants upon the exercise of stock options is credited to share capital.

Stock-based compensation is recorded as a charge to income, using the fair-value obtained by applying the Black & Scholes valuation model, with a corresponding credit to contributed surplus.

	As at June 30, 2006	As at March 31, 2006
	(Unaudited)	(Audited)
	\$	\$
3. Temporary investments		
Certificate of deposit, interest at 2.87%, maturing October 12, 2006	208,289	406,380
Certificate of deposit, interest at 3%, maturing October 21, 2006	12,250	12,160
	<u>220,539</u>	<u>418,540</u>
4. Amounts receivable		
Customers	591,417	391,834
Commodity taxes	-	14,733
Other	410	410
	<u>591,827</u>	<u>406,977</u>
Allowance for doubtful accounts	-	-
	<u>591,827</u>	<u>406,977</u>

DIAGNOS inc.

		As at June 30, 2006	As at March 31, 2006
		(Unaudited)	(Audited)
		\$	\$
5. Prepaid expenses			
Prepaid insurance		5,243	2,880
Other		7,249	4,932
		<u>12,492</u>	<u>7,812</u>
6. Capital assets			
	Cost	Accumulated amortization	Net Value
	\$	\$	\$
Office furniture and equipment	65,045	33,867	31,178
Computer equipment	168,102	145,366	22,736
	<u>233,147</u>	<u>179,233</u>	<u>53,914</u>
			<u>56,920</u>
7. Intangible assets			
	Cost	Accumulated amortization	Net value
	\$	\$	\$
Mining assets	11,808	2,080	9,728
Software	37,516	29,265	8,251
	<u>49,324</u>	<u>31,345</u>	<u>17,979</u>
			<u>21,113</u>
8. Accounts payable and accrued liabilities			
Accounts payable and accrued liabilities		40,362	90,730
Salaries and benefits		110,440	78,766
Commodity taxes		38,529	-
Other		-	1,096
		<u>189,331</u>	<u>170,592</u>
9. Share capital			
Authorized			
Unlimited number of common shares, without par value, voting and participating			
Subscribed and issued: 33,693,019 shares (33,693,019 shares as at March 31, 2006)		8,955,959	8,955,959
Subscribed and not issued: Nil (Nil as at March 31, 2006)		-	-
		<u>8,955,959</u>	<u>8,955,959</u>

Stock option plan

The Corporation has a stock option plan for its employees, directors and consultants by virtue of which they can acquire common shares. The conditions of exercise are determined by the Board of Directors following the rules of the TSX Venture Exchange. The options are granted at a price equal to the share price at the closing of market the day preceding the date of grant.

DIAGNOS inc.

The stock option plan provides that the maximum number of common shares, which may be reserved for issuance to any one optionee pursuant to share options, may not exceed 5% of the common shares outstanding. The maximum number of common shares that may be reserved for issuance to insiders of the Corporation is limited to 20% of the common shares outstanding on the grant date. The maximum number of options, which the Corporation is authorized to issue as at June 30, 2006 is 4,909,611.

The following table presents the changes, which have occurred during the quarter with regard to the stock option plan and summarizes information relating to the stock options outstanding at June 30, 2006.

	<u>Number</u>
Outstanding as at March 31, 2006	3,423,949
Granted	665,000
Exercised	-
Forfeited	<u>(200,000)</u>
Outstanding as at June 30, 2006	<u><u>3,888,949</u></u>

Under the Corporation's stock option plan, 400,000 options with an exercise price of \$0.25 and 265,000 options with an exercise price of \$0.20 were granted during the quarter ended June 30, 2006. The compensation cost that has been charged against income is \$35,283 for the quarter ended June 30, 2006, and the counterpart has been credited to contributed surplus in the Shareholders' equity.

The options have a term to maturity during which they can be exercised with dates ranging from November 2, 2006 to June 13, 2011. Grants made prior to June 3, 2004 were subject to exercise periods ranging between one and half years and five years from the date of grant. For options granted subsequent to June 3, 2004, they will vest at 33.33% per year, commencing with the first anniversary of the grant.

Stock warrants

- a) As part of a private placement process, the Corporation issued 2,500,000 warrants entitling the holder to purchase one common share at the price of \$0.14 per share. They will expire on dates ranging from September 7, 2006 to December 14, 2006.
- b) As part of a private placement process, the Corporation issued 8,000,000 warrants entitling the holder to purchase one common share at the price of \$0.20 per share. 545,000 warrants were exercised in 2006 and 177,000 in 2005. They will expire on dates ranging from August 8, 2006 to December 10, 2006.
- c) As part of a private placement process, the Corporation issued 1,833,332 warrants entitling the holder to purchase one common share at the price of \$ 0.40 per share. They will expire on August 30, 2006.
- d) As part of a private placement process, the Corporation issued 2,000,000 warrants entitling the holder to purchase one common share at the price of \$ 0.35 per share. They will expire on October 4, 2007.

10. Consolidated contributed surplus

	<u>As at June 30, 2006 (Unaudited) \$</u>	<u>As at March 31, 2006 (Audited) \$</u>
Balance at beginning of the quarter	214,469	86,634
<u>Add: Stock-based compensation expense</u>	<u>35,283</u>	<u>127,835</u>
Balance at end of the quarter	<u><u>249,752</u></u>	<u><u>214,469</u></u>

DIAGNOS inc.

11. Commitments

- a) Under the terms of operating lease agreements for its premises, the Corporation is committed to make payments of \$210,339, allocated as follows for the next four years:

2007	\$56,120	2009	\$60,435
2008	\$58,530	2010	\$35,254

- b) Under the terms of operating lease agreements for office equipment, the Corporation is committed to make payments of \$14,784, allocated as follows for the next five years:

2007	\$3,388	2009	\$3,696
2008	\$3,696	2010	\$3,696
		2011	\$ 308

12. Financial instruments

a) Fair value

Cash and cash equivalents, temporary investments, amounts receivable, accounts payable and accrued liabilities are financial instruments whose fair value approximates their carrying value due to their short-term maturity.

b) Credit risk

Financial instruments, which potentially subject the Corporation to concentrations of credit risk, consist primarily of cash and cash equivalents. These financial instruments are held with high-credit quality financial institutions. Consequently, management considers the concentration of risk related to cash and cash equivalents to be minimal.

c) Interest rate risk

As at June 30, 2006, the Corporation's exposure to interest rate risk is summarized as follows:

Cash and cash equivalents	- Fixed and variable interest rate
Amounts receivable	- Non-interest bearing
Accounts payable and accrued liabilities	- Non-interest

General information

Stock Exchange Listing

Shares of DIAGNOS inc. are listed on the TSX Venture Exchange under the symbol ADK.

Transfer Agents and Registrar

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Electronic Delivery

The Shareholders of DIAGNOS inc. can elect to receive DIAGNOS' documents (such as Quarterly and Annual Reports and the Proxy Circular) in electronic form on the Internet rather than in hard copy by mail. Shareholders wishing to use this service should contact Computershare Trust Company of Canada.

Directors

André Larente
Chairman of the Board

David Crevier
Secretary

Olivier Lerolle
Director

Livia Masnagheti
Director

Timothy R. Murdoch
Director

Investor Relations

If you have inquiries, please visit DIAGNOS' Web site at www.diagnos.ca or contact:

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Definitions

In this report all currencies are in Canadian dollars unless specified.

Additional copies are available upon request.

Un exemplaire français du présent rapport annuel est disponible sur demande.

www.diagnos.ca