

Prism Medical Ltd.

Management's Discussion and Analysis of Financial Condition and Results of Operations

MANAGEMENT'S DISCUSSION AND ANALYSIS

Six months ended May 31, 2006 and May 31, 2005

The following discussion of the financial condition and results of operations of the Company should be read in conjunction with the audited consolidated financial statements and notes therein for the year ended November 30, 2005. We have prepared our unaudited consolidated financial statements in accordance with Canadian generally accepted accounting principles.

These interim financial statements, associated notes and Management Discussion and Analysis have not been reviewed by an external auditor.

All dollar figures are in Canadian dollars unless otherwise stated.

FORWARD-LOOKING STATEMENTS

This document contains forward-looking statements relating to our operations and to the environment in which we operate and our strategy, action plans and investments, which may involve estimates, forecasts and projections. These statements are not guarantees of future performance and involve risks and uncertainties that are difficult to predict and/or are beyond our control. A number of important factors could cause actual outcomes and results to differ materially from those expressed in these forward-looking statements. These factors include those set forth in this report and other public filings. Consequently, readers should not place any undue reliance on such forward-looking statements. In addition, these forward-looking statements relate to the date on which they are made. For a complete list of risks and uncertainties please consult the Company's annual information forms and Management's Discussion and Analysis filed with Canadian securities commissions, available on www.sedar.com

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.

In this discussion and analysis, "we", "our" and similar references include Prism Medical Ltd. and its subsidiaries.

CORE BUSINESS AND BUSINESS ENVIRONMENT

Prism Medical Ltd. (Prism or the Company) is a provider of durable medical equipment (DME) and related services to the mobility disadvantaged in Canada, the USA and the United Kingdom (UK). Since the mid 1980's Prism's subsidiaries have been servicing the mobility disadvantaged since the mid 1980's in their homes, long-term care facilities and acute care facilities.

In North America, our subsidiary Waverley Glen Systems Limited (Waverley) operates from a facility based in Concord, Ontario that includes manufacturing and a

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showroom/training centre. Waverley also has a showroom/sales centre in Orlando, Florida.

In the UK, our subsidiary Freeway Healthcare (Freeway) operates 2 manufacturing plants in North Wales. Westholme Limited (Westholme) and Care Free Lifting Limited (Care Free) provide estimating, installation, maintenance and training services pursuant to the installation and sale of DME to the homecare market in the UK from three locations on a scale that makes them, in management's estimate, the largest homecare dealer network of their kind in the UK.

Our mission is to save the healthcare system money and improve the quality of life of the mobility disadvantaged and their caregivers by providing superior services and products that most effectively solve the problems related to moving and handling people.

Products and Services

Our core product is a ceiling lift, both fixed and portable. Management believes ceiling lifts are a superior technology to other types of products used to move and handle people and that their use is considered 'best practice' in most jurisdictions. It performs its functions with less risk of injury to the end user and to the caregiver and at a lower cost to the healthcare system. We also sell other related durable medical equipment within the moving and handling segment through all three main customer channels (homecare, long-term care and acute care facilities).

We also provide services which are essential to the effective use of our products. These services include injury cost estimation, risk assessment, installation, training and ongoing preventative maintenance. Services are provided directly by company-owned operations and by high quality service oriented dealers.

Strategies

Prism pursues a differentiation strategy focused on providing a superior high quality integrated service to the customer that combines knowledge and products. In order to ensure the complete potential of our products is realized, we focus on the efficient installation of ceiling lifts and the thorough training of caregivers and end users. Prism provides this superior service by employing people who want to serve perfectly every time and who are trained to the highest standards possible. Prism also associates itself with dealers and distributors who share and consistently execute this vision of high quality service.

Sales growth is driven by geographic expansion of our Company-owned service capability, an association with a growing number of capable distributors, the addition of related products sold to our customer, and the continued recruitment of people with the knowledge and drive to provide a superior service.

Growth in profitability is also driven by manufacturing the key products that we sell.

We believe these strategies are relatively unique in the durable medical equipment marketplace. Most of our product competitors focus on low cost manufacturing and leave the service and sales to dealer organizations that are typically small regional companies with limited resources and knowledge. As such, they may lack the capability

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to provide ongoing services to institutions that purchase the products. However, some product competitors are very good at what they do and may enjoy a cost advantage. Some service provider competitors have special customer relationships which may limit our impact in certain segments of the market.

KEY PERFORMANCE DRIVERS

We hope to enhance shareholder value in 2006 by pursuing the following actions focused on sales and profit growth:

- Achieve broader coverage of the UK market by securing additional high quality dealers and by strategic acquisitions. With broader coverage, we believe additional service and product supply business from national accounts can be secured.
- Focus on securing market share in the high growth regions of the US market. Create the ability to provide the necessary services by using established independent dealers and distributors and acquiring same if opportunities arise. These sales and service organizations must have strong customer relationships and service capabilities.
- Add products and services that our customers need to resolve patient moving and handling issues that we have not historically emphasized. These efforts are focused on a new range of mobile floor lifts in 2006.
- Focus on long-term care and acute care market opportunities through expanded coverage in the UK and the US markets.
- Reorganize our manufacturing facilities and upgrade the features and cost effectiveness of our product design with the goal of lowering manufacturing costs
- Attract more good people with an emphasis on Americanizing our US operations and attracting additional high quality personnel in our service and design activity areas

CAPABILITY TO DELIVER RESULTS

Ability to Introduce New Products

New products that can achieve meaningful market share are scarce in the competitive business environment in which we operate. The products planned for 2006 introduction have been developed internally or sourced from reputable manufacturing companies. These products represent enhancements or improvements to our current core product offering.

Ability to Attract and Retain Key Knowledge Workers

Our sales and profits are largely dependent upon the quality of our sales efforts and the underlying service providers. We invest considerable time in the selection and recruitment of people with similar value systems to those the Company advocates. Even more time is devoted to training and managing our human resources so that they will grow as individuals and in their ability to contribute to the Company. Human resource policies are routinely updated and improved. Health and safety measures which

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enhance employee welfare are routinely upgraded. Incentive plans and compensation packages are competitive.

Ability to Attract Adequate Capital

Prism has adequate levels of capital. At May 31, 2006 the Company had cash of \$1.8 million and unutilized debt capacity of \$4.4 million to finance ongoing operations including planned fixed asset expenditures and research and development expenditures.

Further capital will be required to consummate any meaningful acquisitions. Historically, Prism has successfully financed acquisitions and other events that required capital infusions. Ultimately our ability to raise capital depends upon our rate of return on shareholders' equity being consistently above what investors can achieve with other lower risk alternatives.

CHANGE IN ACCOUNTING POLICY

The Canadian Institute of Chartered Accountants ["CICA"] Accounting Guideline Consolidation of Variable Interest Entities ["AcG-15"], applies to all fiscal years and interim periods beginning on or after November 1, 2004. The Company has reviewed the impact of AcG-15 with respect to a Management Services Agreement between it and Lift and Transfer Solutions LLC ["LTSU"] and has concluded that LTSU was a variable interest entity subject to consolidation starting December 1, 2004. In accordance with AcG-15 the Company has treated the initial application of the guideline as a change in accounting policy in accordance with CICA Handbook Section 1506 and has elected to provide retroactive application of the guideline with no restatement of prior periods.

There is no impact to the 2005 operating results of the Company from applying AcG-15, however the Goodwill previously reported by the Company would be decreased by \$1,087,715 at May 31, 2005, with a corresponding decrease in retained earnings.

On December 1, 2004 the Company acquired LTSU for \$1.00 and by virtue of having accounted for LTSU as a variable interest entity the acquired assets and assumed liabilities were recorded in the accounts of the Company and there was no purchase accounting adjustment resulting from the acquisition.

Acquisition of Care Free Lifting Limited in the third quarter of 2005

Midway through 2005, the Company acquired Care Free Lifting Limited (Care Free), a distributor of moving and handling devices in the greater Manchester UK area. While not a large acquisition in terms of sales (approximately \$3.0 million annually), Care Free derived most of its revenue from the sale of mobile floor lifts thus providing Prism access to a new pool of expertise and product knowledge.

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The allocation of the purchase price for the acquisition of Care Free, based on management's estimate, is as follows:

	\$
Current assets	1,081,546
Capital assets	240,222
Goodwill	2,110,712
Liabilities assumed	(576,926)
Total purchase consideration	2,855,554

The Company's consolidated results include the results of Care Free from June 1, 2005.

The former owner-managers of the acquired business have entered into employment contracts with the company. They will continue to be responsible for the day-to-day management of Carefree and to provide product, sales and service expertise to the Prism Group of Companies.

For the 3 months ended May 31, 2006

Sales

Sales for the second quarter ended May 31, 2006 decreased 30 percent to \$11.1 million, from \$15.9 million in 2005.

Sales to external customers based on the location of the sale is comprised of the following:

	Change in Period	Three Months ended			
		May 31, 2006		May 31, 2005	
United States	15%	\$ 769,314	7%	\$ 671,259	4%
Canada	(56%)	4,113,341	37%	9,398,731	59%
United Kingdom	6%	6,181,746	56%	5,821,241	37%
	(30%)	\$ 11,064,401	100%	\$ 15,891,231	100%

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North America

The Canadian sales decrease of \$5.2 million or 56 percent was caused by three main factors:

- An approximately 50% drop in Ontario government funding of patient lifts in 2006 from 2005
- Timing differences between quarters as 2006 Ontario institutional sales took place earlier in the year contributing to a more robust first quarter in 2006 and much weaker second quarter compared to last year.
- The BC government funding for ceiling lifts in 2006 has decreased from 2005 levels. This decrease is anticipated to continue for the rest of the year.

We see positive demand factors exhibited in the balance of the year for the Canadian and US market segments.

United Kingdom

UK sales increased 6 percent or \$0.4 million compared to 2005. The Care Free acquisition made in June 2005 contributed \$0.8 million in revenues.

First quarter sales were negatively affected by the strengthening of the Canadian dollar relative to the British Pound Sterling compared to 2005. This negative result occurred because the company translates foreign subsidiary operating performance at the average rate of exchange during the period.

Had the average rate of exchange between the Canadian dollar and the British Pound Sterling remained the same in 2006 compared to 2005, UK sales would have increased by \$1.2 million or 21%. Excluding both the impact of Care Free and the foreign exchange fluctuation, UK sales would have increased \$0.35 million or 6 percent.

Recent increases in government spending should continue to bolster sales as will newly secured service contracts and a steady flow of institutional installations.

Gross Profit

	Three Months ended	
	May 31, 2006	May 31, 2005
Gross profit	\$ 4,420,522	\$ 5,853,066
Percentage of sales	40.0%	36.8%

Our UK operations contributed 56 percent of total second quarter 2006 sales versus 37 percent in 2005. Gross profit from UK operations is higher than North American operations. This is caused by a higher proportion of relatively low margin institutional sales in North America and the positive effect in the UK of gross margins earned from manufacturing and distributing a large proportion of our core products. The stronger

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Canadian dollar in the second quarter 2006 versus 2005 lowered gross margin by \$0.4 million.

Selling and Administrative

Selling and administrative expenses – which include sales and marketing expenses, office expenses, non-manufacturing related salaries and professional fees – decreased \$0.16 million to \$3.15 million in the second quarter of 2006 notwithstanding the inclusion of Care Free costs in 2006 that were not incurred in the same quarter in 2005

A concerted and ongoing effort is being made to reduce these costs, particularly as sudden increases in product demand abate and we are able to plan our business on a more predictable basis.

Included in the second quarter of 2006 selling and administrative expenses are \$0.1 million of marketing costs incurred to improve our strategies, tactics and techniques in all markets. As well, in the second quarter 2006 the Company incurred \$0.15 million of severance and termination costs mainly to streamline Canadian operations as demand spikes ended and to complete the UK cost reduction programme. In the second quarter 2005 the Company incurred \$0.2 million of severance and termination costs to streamline the UK operations.

During the third and fourth quarter of 2005, the Company issued stock options under its incentive stock option plan. Accordingly, \$0.03 million compensation expense was recorded in the second quarter 2006 compared to Nil in 2005. There have been no options issued in 2006.

Amortization

The amortization expense in the quarter consists of the following:

	Three Months ended	
	May 31, 2006	May 31, 2005
Cost of sales - property, plant and equipment	\$ 135,204	\$ 127,740
Deferred development costs	67,547	74,888
Operations - property, plant and equipment	91,748	84,625
Deferred financing fees	49,837	90,644
	<u>\$ 344,336</u>	<u>\$ 377,897</u>

The decrease in the amortization of deferred financing fees is due to having fully amortized bank financing fees in 2005.

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Interest Expense

Prism's interest expense of \$0.4 million remained virtually unchanged compared to the second quarter 2005.

Income Taxes

The Company has operations in countries that have differing tax laws and rates. The provision for income taxes is based on a number of estimates and assumptions made by management including its understanding of domestic and international tax rules. Advice is also sought from professional tax advisors.

The annual tax provision made in the fourth quarter of 2005 included an additional provision of \$569,000 for potential tax liabilities related to the deductibility of interest and foreign exchange losses arising from inter-company loans made between the Company and its subsidiaries. The Company is undertaking a study to determine the extent of the tax liability that may exist in respect to its 2005 fiscal year. Until the study is completed, the Company will continue to record this tax provision. To the extent the tax liabilities are different than the provision, the difference will be reflected and recorded in the 2006 accounts.

Had the additional 2005 tax provision been recorded in each of the preceding fiscal 2005 interim periods, the effect on those periods would have been as follows:

Interim Period	Impact on Net Income \$	Impact on EPS \$	Impact on Fully Diluted EPS \$
Q1 2005	(107,000)	(0.02)	(0.01)
Q2 2005	(117,000)	(0.02)	(0.01)
Q3 2005	(177,000)	(0.03)	(0.02)
Q4 2005	(168,000)	(0.03)	(0.03)

In the second quarter 2006 the effective tax rate is 61% compared to 31% in 2005.

Income from foreign currency translation on inter-company debt was recorded in the UK. Although, this amount is eliminated on consolidation, and therefore does not appear in pre-tax income, the local tax effect does appear as part of the tax provision.

Income

In the second quarter 2006, the Company's net income was \$0.22 million compared to \$1.30 million in 2005. Net earnings per share for the quarter were \$0.04 compared to \$0.25 in 2005. On a diluted basis, second quarter 2006 net earnings per share were \$0.04 compared to \$0.22 in 2005.

Second quarter net income was negatively affected by the strengthening of the Canadian dollar relative to the British Pound Sterling compared to 2005. Had the average rate of

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exchange been consistent from 2005 to 2006, net income would have been \$0.1 million or \$0.02 per share basic [\$0.02 per share fully diluted] higher in the second quarter of 2006.

For the 6 months ended May 31, 2006

Sales

Sales for the first six months ended May 31, 2006 decreased 17 percent to \$21.4 million, from \$25.6 million in 2005.

Sales to external customers based on the location of the sale is comprised of the following:

	Change in Period	Six Months ended			
		May 31, 2006		May 31, 2005	
United States	7%	\$ 1,306,700	6%	\$ 1,221,351	5%
Canada	(31%)	8,662,709	41%	12,638,755	49%
United Kingdom	(3%)	11,399,254	53%	11,773,528	46%
	(17%)	\$ 21,368,663	100%	\$ 25,633,634	100%

North America

The Canadian sales decrease of \$4.0 million or 31 percent was primarily caused by three main factors:

- An approximately 50% drop in Ontario government funding of patient lifts in 2006 from 2005
- The BC government funding for ceiling lifts in 2006 has decreased from 2005 levels. This decrease is anticipated to continue for the rest of the year.

We see positive demand factors exhibited in the balance of the year for the Canadian and US market segments.

United Kingdom

UK sales decreased 3 percent or \$0.4 million compared to 2005. The Care Free acquisition made in June 2005 contributed \$1.5 million in revenues in 2006.

Six month sales were negatively affected by the strengthening of the Canadian dollar relative to the British Pound Sterling compared to 2005. This negative result occurred because the company translates foreign subsidiary operating performance at the average rate of exchange during the period.

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Had the average rate of exchange between the Canadian dollar and the British Pound Sterling remained the same in 2006 compared to 2005, sales would have been \$1.67 million higher in the first six months of 2006.

Gross Profit

	Six Months ended			
		May 31, 2006		May 31, 2005
Gross profit	\$	8,356,944	\$	10,073,506
Percentage of sales		39.1%		39.2%

Our UK operations contributed 55 percent of 2006 year to date sales verses 46 percent in 2005. Gross profit from UK operations is higher than North American operations. This is caused by a higher proportion of relatively low margin institutional sales in North America and the positive effect in the UK of gross margins earned from manufacturing and distributing a larger proportion of our core products. The stronger Canadian dollar lowered gross margin in the six months ended May 31, 2006 verses 2005 by \$0.7 million.

Selling and Administrative

Selling and administrative expenses – which include sales and marketing expenses, office expenses, non-manufacturing related salaries and professional fees – decreased \$0.29 million to \$6.12 million in the first six months of 2006, notwithstanding the inclusion of Care Free costs in 2006 that were not incurred in the same period in 2005.

A concerted and ongoing effort is being made to reduce these costs, particularly as sudden increases in product demand pass and we are able to plan our business on a more predictable basis.

Included in the first six months of 2006 selling and administrative expenses are \$0.1 million of marketing costs incurred to improve our strategies, tactics and techniques in all markets. As well in 2006 the company incurred \$0.25 million of severance and termination costs mainly to streamline Canadian operations as demand spikes ended and to complete the UK cost reduction programme. In the 2005 period the company incurred \$0.2 million of severance and termination costs to streamline the UK operations.

During the third and fourth quarter of 2005, the Company issued stock options under its incentive stock option plan. Accordingly, \$0.08 million compensation expense was recorded in the first six months of 2006 compared to Nil in 2005. There have been no options issued in 2006.

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Amortization

The amortization expense in the quarter consists of the following:

	Six Months ended	
	May 31, 2006	May 31, 2005
Cost of sales - property, plant and equipment	\$ 268,201	\$ 251,588
Deferred development costs	145,909	169,984
Operations - property, plant and equipment	179,296	194,609
Deferred financing fees	99,675	165,354
	\$ 693,081	\$ 781,535

This decrease in the amortization of deferred financing fees is due to having fully amortized bank financing fees in 2005.

Interest Expense

Prism's interest expense of \$0.79 million remained virtually unchanged compared 2005.

Income Taxes

The Company has operations in countries that have differing tax laws and rates. The provision for income taxes is based on a number of estimates and assumptions made by management including its understanding of domestic and international tax rules. Advice is also sought from professional tax advisors.

The annual tax provision made in the fourth quarter of 2005 included an additional provision of \$569,000 for potential tax liabilities related to the deductibility of interest and foreign exchange losses arising from inter-company loans made between the Company and its subsidiaries. The Company is undertaking a study to determine the extent of the tax liability that may exist in respect to its 2005 fiscal year. Until the study is completed, the Company will continue to record this tax provision. To the extent the tax liabilities are different than the provision, the difference will be reflected and recorded in the 2006 accounts.

Had the additional 2005 tax provision been recorded in each of the preceding fiscal 2005 interim periods, the effect on those periods would have been as follows:

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Interim Period	Impact on Net Income \$	Impact on EPS \$	Impact on Fully Diluted EPS \$
Q1 2005	(107,000)	(0.02)	(0.01)
Q2 2005	(117,000)	(0.02)	(0.01)
Q3 2005	(177,000)	(0.03)	(0.02)
Q4 2005	(168,000)	(0.03)	(0.03)

In the first six months of 2006 the effective tax rate is 53% compared to 30% in 2005.

Income from foreign currency translation on inter-company debt was recorded in the UK. Although, this amount is eliminated on consolidation, and therefore does not appear in pre-tax income, the local tax effect does appear as part of the tax provision.

Income

In the first six months of 2006, the Company's net income was \$0.4 million compared to \$1.64 million in 2005. Net earnings per share for the period were \$0.07 compared to \$0.33 in 2005. On a diluted basis, net earnings per share were \$0.07 compared to \$0.22 in the first six months of 2005.

Year to date net income was negatively affected by the strengthening of the Canadian dollar relative to the British Pound Sterling compared to 2005. Had the average rate of exchange been consistent from 2005 to 2006, net income would have been \$0.15 million or \$0.03 per share basic [\$0.03 per share fully diluted] higher in the first six months of 2006.

Liquidity and Capital Resources

At May 31, 2006, the Company had cash and cash equivalents of \$1.8 million compared to \$0.7 million at November 30, 2005. The Company maintains cash balances in the UK in interest bearing deposit accounts for operating requirements. Management is currently implementing treasury options to reduce the need to maintain UK cash balances.

Cash flow from non-cash working capital balances was (\$0.4) million compared to (\$2.3) million in the first six months of 2005. This reduced requirement is due to efforts to better manage working capital. Accounts receivable, in 2006, have increased as a result of the Ontario funding initiative impacting sales while inventory has remained comparable to year end. Working capital investments in accounts receivable should decrease in the third quarter as collections are made for institutional sales in Ontario.

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The Company's working capital position at May 31, 2006 was unchanged at \$9.7 million, compared to November 30, 2005.

During the first six months of 2006, cash provided by financing activities was \$0.8 million consisting of a share capital increase of \$0.1 million, a bank indebtedness increase of \$1.2 million and a long-term debt decrease of \$0.5 million which was caused substantially by a stronger Canadian dollar relative to the British Pound Sterling. The share capital increase was related to the exercise of stock options.

Cash used in investing activities represented outflows of \$0.6 million for the six months ended May 31, 2006, compared to outflows of \$0.7 million in 2005.

In the first six months of 2006, expenditures on capital spending decreased to \$0.38 million compared to \$0.68 million in 2005.

Also in the first six months of 2006 expenditures on deferred charges increased from \$0.06 million in 2005 to \$0.26 million.

Prism's net debt position of \$16.4 million at May 31, 2006, consisting of bank indebtedness and long-term debt less cash and cash equivalents, decreased \$0.3 million from November 30, 2005.

OUTLOOK

The Company intends to grow sales, profitability and return on shareholders' equity. We believe that performance will be positively affected by a continued and more orderly Canadian institutional demand for our products, improved manufacturing efficiencies, and revenues and profits from new product introductions. Through the addition of more distributors, both as independents and by strategic accretive acquisition, we hope to achieve a gradual growth in UK and US service and institutional profits.

The demand for our core products and services, in management's estimation, continues to experience organic growth at different rates in the geographic markets in which we participate. While government funding for our products is a significant sales driver and may vary quarter to quarter or even over longer periods, we believe that the long term trend continues to be favourable.

Andrew A. McIntyre
Chairman, President
and Chief Executive Officer
July 13, 2006

John C. Charles
Vice Chairman and Chief
Financial Officer
July 13, 2006

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