LifeWatch V

Letter to our Shareholders

Third Quarter 2012 Results

LifeWatch®
Watching Life™

Dear Shareholders of LifeWatch,

LifeWatch is pleased to report on significant progress made during the third quarter and first nine months of 2012. Our U.S.-based monitoring services business, LifeWatch Services, Inc., continued to improve revenues and operating margins. The Company also returned to a positive cash flow position this quarter. During the first nine months of 2012, we completed 127 new and amended managed care contracts covering ACT and HST services. The Company is also pleased to report on the overwhelming interest from consumers, international TV and radio stations, Telco companies and healthcare providers of our innovative "LifeWatch V" health smartphone. As disclosed in our 2nd quarter of 2012 letter to shareholders, we are in discussions with a number of multi-national cell carriers, pharmaceutical and healthcare providers on partnership opportunities.

Third Quarter 2012 Financial Highlights

- Revenues of USD 19.86 million compared with USD 18.78 million in Q3 2011.
- Gross margin of 59.5% compared with 46.9% in Q3 2011.
- Total departmental expenses were 50.1% of revenues compared with 152.6% in Q3 2011.
- EBIT of USD 1.86 million compared with LBIT of USD 19.84 million in Q3 2011.
- EBITDA of USD 2.68 million compared with LBITDA of USD 18.37 million in Q3 2011.
- Positive cash flow from operations of USD 1.61 million compared with negative amount of USD 3.22 million in Q3 2011.

Key Figures per Quarter

In USD million	Q3 2012	Q2 2012	Q1 2012	Q4 2011	Q3 2011
Revenues	**19.86**	19.06	21.13	22.24	18.78
Gross Profit	**11.81**	10.49	12.26	13.48	8.81
As % of revenues	***59.5%***	*55.1%*	*58.0%*	*60.6%*	*46.9%*
EBITDA / (LBITDA)	**2.68**	1.04	2.85	1.08	(18.37)
As % of revenues	***13.5%***	*5.5%*	*13.5%*	*4.9%*	*NA*
EBIT/ (LBIT)	**1.86**	0.04	1.62	0.09	(19.84)
As % of revenues	***9.4%***	*0.2%*	*7.7%*	*0.4%*	*NA*
Net income / (loss)	**(0.57)**	(1.38)	0.60	(0.55)	(20.40)
As % of revenues	***NA***	*NA*	*2.8%*	*NA*	*NA*
Total fixed assets, net	**8.09**	8.65	9.00	8.82	9.11
Total equity	**34.51**	34.53	32.79	31.76	31.58
Employees	**482**	483	511	528	570

Q3 2012 Revenues

Revenues grew this quarter to USD 19.86 million an increase of 5.7% over Q3 2011 revenues. Our sales team is committed to meeting their goals for the year, despite the challenging reimbursement situation in the USA. Many of our accounts who are frustrated by the lack of insurance for some of their telemetry patients have welcomed our Elite service, which was launched in early 2012. While the Elite service can serve as a provisional solution, our goal is to validate the importance of our ACT remote telemetry platform with health insurers.

Gross Profit, EBITDA and LBIT

- Gross profit was USD 11.81 million in Q3 2012, showing a greatly improved margin of 59.5%, compared with gross profit of USD 8.81 million and a margin of 46.9% in Q3 2011.
- EBITDA of USD 2.68 million in Q3 2012 compared with a LBITDA of USD 18.37 million in Q3 2011.
- EBIT was USD 1.86 million this quarter compared with a LBIT of USD 19.84 million in Q3 2011.

The improved results are a result of increased revenues, effective cost cutting initiatives and careful management of all other operating expenses.

Operating Expenses

LifeWatch continues to improve its operational expenses in all areas of our business. Operating expenses for the third quarter of 2012 are as follows:

- Research & Development (R&D) expenses decreased to USD 1.52 million or 7.7% of revenues compared with USD 1.83 million or 9.8% of revenues in Q3 2011. Q3 2012 R&D expenses were mainly associated with the continuous development of the LifeWatch V smartphone, and an additional breakthrough technology that will be presented by the Company towards the end of 2012.
- Sales and Marketing (S&M) expenses decreased slightly to USD 4.02 million or 20.2% of revenues.
- General and Administration (G&A) expenses decreased to USD 4.38 million or 22.1% of revenues, compared with USD 4.89 million or 26.0% of revenues in Q3 2011. G&A costs in Q3 2012 were down mainly due to reductions in professional consulting and legal fees.

Net Loss

LifeWatch reported a small net loss of USD 0.57 million compared to a net loss of USD 20.40 million in Q3 2011. Our net loss was mainly affected by deferred, non-cash income tax expenses related to LifeWatch Services, Inc. Loss per share was USD 0.004 (fully diluted), compared to a loss per share of USD 1.64 (fully diluted) reported in the third quarter of 2011.

Cash Flows

We report on a positive cash flow position in this reporting quarter with cash received from operations in the amount of USD 1.61 million. The balance of cash, cash equivalents, marketable securities and structures in the third quarter of 2012 was USD 8.19 million compared with USD 7.20 million in Q3 2011, and USD 6.82 million in Q2 2012. The improvement to cash flow is mainly attributed to the cost cutting measures introduced in Q2 of 2011.

Managed Care Updates:

LifeWatch continues to prove to providers the value of our cost effective health monitoring services. In Q3 2012, we signed 34 new or amended contracts for our ACT and NiteWatch services. For the full nine months, LifeWatch completed 127 new or amended managed care contracts covering ACT and HST services, compared to 111 contracts completed in all of 2011.

As announced in September, LifeWatch has filed an antitrust lawsuit against Highmark BCBS, the BlueCross Blue Shield Association and several other BlueCross BlueShield entities in the United States District Court in the Eastern District of Pennsylvania. LifeWatch is seeking damages in excess of USD 60 million due to an alleged conspiracy among the BlueCross BlueShield Association, Highmark BCBS and other BlueCross BlueShield entities to deny reimbursement payments for wireless cardiac monitoring services and other medical services of LifeWatch offered in the U.S. The Company will disclose any additional information when it becomes available.

Monitoring Services Update

Recently, some U.S. hospitals have acquired private cardiology clinics. These hospital cardiologists are paid for services at hospital rates, which are more than what insurers pay independent cardiologists. Additionally, some services that these physicians had performed at private facilities can be billed by hospitals as hospital outpatient procedures. These hospitals have stated that the acquisitions will increase efficiencies, yet the Wall Street Journal has reported the following:

- Patients will have higher prices as their co-payments will rise
- Major health insurers are reporting a growing number of rate increases
- The elevated prices will affect employers, many of which pay for their workers' coverage
- A federal watchdog agency said it will likely result in higher Medicare spending, as Medicare pays more to hospitals than private cardiology practices for the same services

Some of these same hospitals which acquired cardiology practices have also started to purchase cardiac monitors and sub-contract the “technical component” (24/7/365 monitoring services) at reduced rates to IDTFs such as LifeWatch. This may not be a sustainable model, as under the proposed CMS ruling for 2013, hospitals may be faced with a drastic reduction in many of their reimbursement codes, including telemetry provided in hospital outpatient settings. This will render remote cardiac monitoring unprofitable for hospitals.

Technology Update

Following the unveiling of the LifeWatch V healthcare smartphone at two launch events in June and July of 2012, the Company was overwhelmed with positive feedback and interest in the health and wellness platform. As announced in Q2 2012, the Company is in discussions with a number of multi-national companies. We are pleased with the reception of the LifeWatch V and will disclose more details in the coming months. A fourth breakthrough product is to be announced towards the end of the fourth quarter of 2012.

Outlook 2012

Our third quarter results prove our commitment in growing revenues while improving profitability. Reimbursement continues to be an issue, as does the impact of the presidential elections this November. While we cannot give a precise forecast for full fiscal year 2012, we are in a strong position and will cope with these current conditions. Our new service and technology pipeline will provide us with opportunities that create more service and geographical diversification, improve revenue streams and lower our reliance on our current business focus.

Sincerely,

Dr. Yacov Geva
Chairman of the Board
and Chief Executive Officer

Urs Wettstein
Vice Chairman

Information for our investors

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Valor-No.:	1281545
Reuters:	LIFE.S

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LIFEWATCH AG

CONDENSED CONSOLIDATED FINANCIAL STATEMENTS FOR SEPTEMBER 30, 2012

Unaudited

Contents

Condensed Consolidated Balance Sheets

USD thousands	September 30, 2012	September 30, 2011	December 31, 2011
	Unaudited	Unaudited	Audited
Assets			
Cash and cash equivalents	**8,091**	7,109	13,840
Restricted cash	**385**	-	-
Marketable securities and structures	**43**	43	43
Accounts receivable (trade and other), net	**15,089**	21,080	10,156
Deferred income taxes	**10,592**	5,997	7,938
Inventories	**1,264**	2,253	2,035
Total current assets	**35,464**	36,482	34,012
Marketable securities and structures	**52**	52	52
Deferred income taxes	**6**	8,499	6,410
Other investments and non-current receivables (trade and others)	**714**	738	721
Total non-current investments	**772**	9,289	7,183
Fixed Assets	**8,088**	9,108	8,821
Goodwill, intangible and other assets, net	**15,007**	15,016	15,013
Total assets	**59,331**	69,895	65,029
Liabilities and stockholders' equity			
Current maturities of long-term loans and other liabilities	**82**	546	163
Accounts payable and accruals (trade and other)	**12,633**	19,156	14,454
Provision for settlement	**1,377**	6,600	6,600
Total current liabilities	**14,092**	26,302	21,217
Loans and other liabilities, net of current maturities	**110**	7	53
Liability for employee rights upon retirement, net	**97**	109	99
Provisions for settlement	**10,523**	11,900	11,900
Total non-current liabilities	**10,730**	12,016	12,052
Total liabilities	**24,822**	38,318	33,269
Share capital, warrants, treasury stock and capital surplus	**147,067**	142,752	143,482
Accumulated deficit	**(111,722)**	(79,752)	(79,752)
Net loss for the period	**(836)**	(31,423)	(31,970)
Total stockholders' equity	**34,509**	31,577	31,760
Total liabilities and stockholders' equity	**59,331**	69,895	65,029

Condensed Consolidated Statements of Operations

USD thousands (except share and per share data)	3 months ending September 30, 2012 Unaudited	3 months ending September 30, 2011 Unaudited	9 months ending September 30, 2012 Unaudited	9 months ending September 30, 2011 Unaudited
Revenues	**19,856**	**18,778**	**60,043**	**60,007**
Cost of revenues	8,047	9,969	25,479	30,048
Gross profit	**11,809**	**8,809**	**34,564**	**29,959**
Research and development expenses	1,524	1,834	5,044	5,569
Selling and marketing expenses	4,018	4,036	12,428	15,759
General and administrative expenses	4,379	4,888	14,050	15,372
Costs associated with restructuring and other	28	17,889	(478)	21,570
Total operating expenses	**9,949**	**28,647**	**31,044**	**58,270**
Income (loss) from operation	**1,860**	**(19,838)**	**3,520**	**(28,311)**
Financial and other income (expenses), net	(57)	125	(52)	293
Income (loss) before taxes	**1,803**	**(19,713)**	**3,468**	**(28,018)**
Tax expense	(1,860)	(687)	(4,304)	(3,405)
Net loss for the period	**(57)**	**(20,400)**	**(836)**	**(31,423)**

WEIGHTED AVERAGE NUMBER OF SHARES IN THOUSANDS USED IN COMPUTATION OF LOSS PER SHARE				
Basic and Diluted	13,083	12,409	12,865	12,482
LOSS PER SHARE (USD)				
Basic and Diluted	(0.004)	(1.64)	(0.06)	(2.52)

Condensed Consolidated Statements of Comprehensive Loss

Net loss	(57)	(20,400)	(836)	(31,423)
Other comprehensive income (loss)				
Unrealized loss on marketable securities	-	(25)	-	(12)
Foreign currency translation adjustment	-	1	(1)	(2)
Total other comprehensive loss	-	(24)	(1)	(14)
Comprehensive loss	(57)	(20,424)	(837)	(31,437)

Condensed Consolidated Statement of Changes in Stockholders' Equity

	Paid in share capital including premium	Warrants	Accumulated deficit	Treasury stock	Accumulated other comprehensive loss	Total
BALANCE AT JANUARY 1, 2012 (AUDITED)	**146,899**	**958**	**(111,722)**	**(4,209)**	**(166)**	**31,760**
Changes During The Nine Months Ended September 30, 2012 (Unaudited):						
Net loss			**(836)**			**(836)**
Other comprehensive loss					**(1)**	**(1)**
Treasury stock	**(425)**			**3,922**		**3,497**
Issuance of shares in respect of exercise of options granted to employees	**6**					**6**
Stock-based compensation expense	**45**	**38**				**83**
BALANCE AT SEPTEMBER 30, 2012 (UNAUDITED)	**146,525**	**996**	**(112,558)**	**(287)**	**(167)**	**34,509**
BALANCE AT JANUARY 1, 2011 (AUDITED)	**158,506**	**953**	**(79,752)**	**(5,342)**	**(157)**	**74,208**
Changes During The Nine Months Ended September 30, 2011 (Unaudited):						
Net loss			(31,423)			**(31,423)**
Other comprehensive loss					(14)	**(14)**
Issuance of shares in respect of exercise of options granted to employees	66					**66**
Treasury stock	(375)			(1,746)		(2,121)
Capital reduction	(9,063)					**(9,063)**
Stock-based compensation income, net	(76)					**(76)**
BALANCE AT SEPTEMBER 30, 2011 (UNAUDITED)	**149,058**	**953**	**(111,175)**	**(7,088)**	**(171)**	**31,577**

Condensed Consolidated Statements of Cash Flows

	3 months ending September 30		9 months ending September 30	
USD thousands	2012 Unaudited	2011 Unaudited	2012 Unaudited	2011 Unaudited
CASH FLOWS FROM OPERATING ACTIVITIES:				
Net loss for the period	(57)	(20,400)	(836)	(31,423)
Adjustments required to reconcile net loss for the period to net cash provided by (used in) operating activities:				
Income and expenses not involving cash flows:				
Depreciation and amortization	825	1,465	3,055	4,314
Compensation expenses charged in respect of options and warrants granted to employees and service providers	31	21	83	(76)
Change in deferred income tax	1,557	777	3,750	2,624
Changes in operating assets and liabilities:				
Increase in accounts receivable, including non-current portion	(195)	(116)	(4,926)	(7,801)
Decrease (increase) in inventories	109	18	771	(737)
Increase (decrease) in accounts payable and accruals:				
Provision for settlement	-	15,340	(6,600)	18,500
Trade and others	(664)	(328)	(1,916)	(927)
Net cash provided by (used in) operating activities	**1,606**	**(3,223)**	**(6,619)**	**(15,526)**
CASH FLOWS FROM INVESTING ACTIVITIES:				
Purchase of fixed assets	(260)	(650)	(2,316)	(2,472)
Restricted bank deposit	(1)	-	(385)	-
Proceeds from marketable securities	-	4,241	-	4,241
Net cash provided by (used in) investing activities	**(261)**	**3,591**	**(2,701)**	**1,769**
CASH FLOWS FROM FINANCING ACTIVITIES:				
Issuance of shares in respect of exercise of employee stock options	-	66	6	66
Proceeds from sale of treasury stock	-	-	4,017	438
Buying trading stock	-	(10)	(520)	(2,559)
Capital reduction	-	-	-	(9,063)
Discharge of long term loan - received from a bank and others	(8)	(60)	(55)	(169)
Obligations under capital leases	(11)	(375)	31	(1,356)
Net cash provided by (used in) financing activities	**(19)**	**(379)**	**3,479**	**(12,643)**
Translation differences on cash balances of subsidiaries	40	(63)	92	-
Increase (decrease) in cash and cash equivalents	1,366	(74)	(5,749)	(26,400)
Balance of cash and cash equivalents at beginning of period	**6,725**	**7,183**	**13,840**	**33,509**
Balance of cash and cash equivalents at end of period	**8,091**	**7,109**	**8,091**	**7,109**

NOTE 1
Basis of presentation

The unaudited condensed consolidated interim financial statements for LifeWatch AG and its subsidiaries (the "Company") have been prepared on the basis of accounting principles generally accepted in the Unites States of America ("US GAAP") for interim financial information. Accordingly, such financial statements do not include all the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. These interim financial statements should be read in conjunction with the audited consolidated financial statements of the Company for the year ended December 31, 2011.

NOTE 2
Fixed Assets

a. Composition of assets, grouped by major classifications, is as follows:

USD thousands	September 30, 2012	September 30, 2011	December 31, 2011
	Unaudited	**Unaudited**	**Audited**
Cost			
Manufacturing and peripheral equipment	10,515	10,713	10,432
Office furniture and equipment	2,830	2,802	2,813
Monitoring units	13,278	14,072	13,986
Motor vehicles	186	186	186
Leasehold improvements	1,468	1,461	1,464
Total cost	**28,277**	**29,234**	**28,881**
Less – accumulated depreciation and amortization	**(20,189)**	**(20,126)**	**(20,060)**
Total	**8,088**	**9,108**	**8,821**

b. Depreciation expenses in respect of fixed assets totalled USD 3,049,000; USD 4,305,000 and USD 5,296,000 for the nine months ended September 30, 2012, September 30, 2011, and for the year ended December 31, 2011, respectively.

NOTE 3
Segment and geographic information

The Company operates in three reportable operating segments:

- Sales of Systems – Development, manufacture and marketing of trans-telephonic and wireless diagnostic equipment for the medical industry.
- Services – Cardiac event monitoring, ambulatory heart monitoring device and sleep disorder services.
- Other – Company activities and expenses that are not assigned directly to either of the above segments.

The table below presents information about reported segments:

Information to segment reporting

USD thousands	Sales of Systems	Services	Other	Reconciling items	Consolidated total
For the 9 months ended September 30, 2012 (Unaudited):					
Revenues from external customers	210	59,833	-	-	60,043
Inter-segments revenues	1,411	-	-	(1,411)	-
Total	**1,621**	**59,833**	**-**	**(1,411)**	**60,043**
Operating income (loss)	(14,120)	12,199	(3,617)	9,058	3,520
Depreciation and amortization	176	12,227	-	(9,348)	3,055
Goodwill	-	14,976	-	-	14,976
Capital investments	181	3,118	-	(983)	2,316
Total assets	107,339	87,859	2,580	(138,447)	59,331
For the 9 months ended September 30, 2011 (Unaudited):					
Revenues from external customers	752	59,255	-	-	60,007
Inter-segments revenues	631	-	-	(631)	-
Total	**1,383**	**59,255**	**-**	**(631)**	**60,007**
Operating income (loss)	(41,451)	1,091	(2,618)	14,667	(28,311)
Depreciation and amortization	202	18,774	-	(14,662)	4,314
Goodwill	-	14,976	-	-	14,976
Capital Investments	101	2,494	-	(123)	2,472
Total assets	135,157	138,646	1,307	(205,215)	69,895

NOTE 3
Segment and geographic information (*continued)*

Following are data regarding revenues and long-lived assets classified by geographical location of the customers:

USD thousands	USA and Canada	Europe	Asia	Other	Total
For the 9 months ended September 30, 2012 (Unaudited)					
Revenues	59,833	66	141	3	60,043
Long-lived assets	7,445	109	4	530	8,088
For the 9 months ended September 30, 2011 (Unaudited)					
Revenues	59,361	219	425	2	60,007
Long-lived assets	8,491	35	11	571	9,108