

Offshore Systems International Ltd.

Consolidated Financial Statements (unaudited)
(Prepared in accordance with Canadian Generally
Accepted Accounting Principles)

May 31, 2003 and 2002
(expressed in Canadian dollars)

Offshore Systems International Ltd.

Consolidated Balance Sheets (unaudited)

(expressed in Canadian dollars)

	May 31, 2003 \$	November 30, 2002 \$
Assets		
Current assets		
Cash and cash equivalents	5,306,013	3,244,048
Accounts receivable (note 2)	3,477,158	3,968,639
Inventory (note 3)	645,275	1,266,806
Prepaid expenses and deposits	256,759	232,215
Future tax asset	98,860	98,860
	<u>9,784,065</u>	<u>8,810,568</u>
Future tax asset	554,856	554,856
Property, plant, and equipment (note 4)	<u>1,433,490</u>	<u>1,401,014</u>
	<u>11,772,411</u>	<u>10,766,438</u>
Liabilities and Shareholders' Equity		
Current liabilities		
Accounts payable and accrued liabilities (note 5)	2,290,980	2,584,409
Billing in excess of revenues	123,352	1,642,725
Rent payable	133,942	133,942
	<u>2,548,274</u>	<u>4,361,076</u>
Accrued long term royalties	<u>226,653</u>	<u>372,717</u>
	<u>2,774,927</u>	<u>4,733,793</u>
Capital stock		
Authorized		
100,000,000 Class A preference shares with no par value, issuable in series, of which 10,000,000 shares are designated series A voting non-cumulative retractable convertible at a ratio of 1:1, 1% preference shares		
100,000,000 Class B preference shares with a par value of \$50 each, issuable in series of which 10,000,000 are designated series 1 voting cumulative convertible shares at a ratio of 1:45.5, 6% preference shares.		
100,000,000 common shares without par value		
Issued and outstanding		
30,262 Class A preference shares – Series A (2002 – 41,296, Note 6(b))	-	-
61,244 Class B preference shares – Series 1 (2002 – nil, Note 6(c))	2,065,420	-
25,956,465 Common shares (2002 - 26,043,243, Note 6(a))	18,116,669	18,220,929
	<u>20,182,089</u>	<u>18,220,929</u>
Warrants	661,575	-
Additional Paid in Capital	43,050	-
Deficit	<u>(11,889,230)</u>	<u>(12,188,284)</u>
	<u>8,997,484</u>	<u>6,032,645</u>
	<u>11,772,411</u>	<u>10,766,438</u>

See accompanying notes to consolidated financial statements

Offshore Systems International Ltd.

Consolidated Statement of Earnings and Deficit (unaudited)

For the periods ended May 31, 2003 and 2002

(expressed in Canadian dollars)

	Three Months Ended May 31		Six Months Ended May 31	
	2003 \$	2002 \$	2003 \$	2002 \$
Revenue				
Systems and system components	1,837,497	3,116,609	4,422,014	5,670,565
Geomatics	914,768	465,618	1,606,962	844,890
Software	42,692	126,834	248,069	376,874
Other	163,070	118,391	244,157	220,641
	2,958,027	3,827,452	6,521,202	7,112,970
Cost of sales	1,235,146	2,094,764	2,909,883	3,696,901
Gross profit	1,722,881	1,732,688	3,611,319	3,416,069
Expenses				
General and administrative	599,816	649,247	1,294,260	1,226,395
Research and development	400,977	419,125	884,072	757,684
Sales and marketing	501,914	435,369	1,003,565	869,375
Amortization	87,371	101,507	169,936	197,951
Interest	39	1,299	289	3,044
Foreign exchange loss	46,255	1,349	183,223	18,869
Technology Partnerships Canada royalty	13,221	107,895	52,444	344,937
Technology Partnerships Canada contribution	(78,874)	(237,568)	(376,880)	(426,513)
	1,570,719	1,478,223	3,210,909	2,991,742
Earnings from operations	152,162	254,465	400,410	424,327
Future income tax recovery	-	57,000	-	154,990
Earnings for the period	152,162	311,465	400,410	579,317
Deficit – Beginning of period	(11,956,630)	(13,555,463)	(12,188,284)	(13,823,315)
Premium on purchase and cancellation of common shares	(84,762)	-	(101,356)	-
Deficit – End of period	(11,889,230)	(13,243,998)	(11,889,230)	(13,243,998)
Basic earnings per share	0.00	0.01	0.01	0.02
Diluted earnings per share	0.00	0.01	0.01	0.02
Weighted average number of common shares outstanding – basic	26,031,356	24,862,548	26,031,356	24,862,548
Weighted average number of common shares outstanding – diluted	26,922,951	27,066,424	26,922,951	27,066,424

See accompanying notes to consolidated financial statements

Offshore Systems International Ltd.
Consolidated Statements of Cash Flows (unaudited)
For the periods ended May 31, 2003 and 2002
(expressed in Canadian dollars)

	Three Months Ended		Six Months Ended	
	May 31		May 31	
	2003	2002	2003	2002
	\$	\$	\$	\$
Cash flows from operating activities				
Net earnings for the period	152,162	311,465	400,410	579,317
Items not affecting cash				
Amortization	87,371	101,507	169,936	197,951
Stock based compensation	21,000	-	43,050	-
Future tax asset	-	(57,000)	-	(154,990)
	<u>260,533</u>	<u>355,972</u>	<u>613,396</u>	<u>622,278</u>
Changes in non-cash working capital items				
Accounts receivable	(744,099)	610,941	491,481	(118,529)
Inventory	114,858	137,055	621,531	(274,774)
Prepaid expenses and deposits	23,523	(217,748)	(24,544)	(351,708)
Accounts payable and accrued liabilities	(184,478)	(588,907)	(293,429)	229,807
Billings in excess of revenues	(62,409)	208,831	(1,519,373)	(327,571)
Long term royalties	97,085	52,651	(146,064)	(61,532)
	<u>(755,520)</u>	<u>202,823</u>	<u>(870,398)</u>	<u>(904,307)</u>
	<u>(494,987)</u>	<u>558,795</u>	<u>(257,002)</u>	<u>(282,029)</u>
Cash flows from financing activities				
Issue of Common stock	56,432	88,206	65,560	238,628
Issue of Class B preference shares - Series 1 and warrants, net of issue costs	(14,540)	-	2,726,995	-
Share repurchases	(223,012)	-	(271,175)	-
	<u>(181,120)</u>	<u>88,206</u>	<u>2,521,380</u>	<u>238,628</u>
Cash flows from investing activities				
Additions to property, plant, and equipment	(172,659)	(194,464)	(202,413)	(292,292)
Increase (decrease) in cash and cash equivalents	(848,766)	452,537	2,061,965	(335,693)
Cash and cash equivalents – Beginning of period	6,154,779	1,249,395	3,244,048	2,037,625
Cash and cash equivalents – End of period	<u>5,306,013</u>	<u>1,701,932</u>	<u>5,306,013</u>	<u>1,701,932</u>

See accompanying notes to consolidated financial statements

Offshore Systems International Ltd.

Notes to the Consolidated Financial Statements (unaudited)

May 31, 2003

(expressed in Canadian dollars)

1 Basis of preparation

The accompanying interim unaudited consolidated financial statements include the accounts of Offshore Systems International Ltd. and its subsidiaries, collectively referred to as the company. These financial statements have been prepared by the company in Canadian dollars and in accordance with generally accepted accounting principles ("GAAP") in Canada with respect to interim financial statements, applied on a consistent basis, except as described in Note 7 with respect to the accounting for stock-based compensation. Accordingly, they do not include all the information and footnotes required for compliance with GAAP in Canada for annual financial statements. These interim unaudited consolidated financial statements and notes thereon should be read in conjunction with the audited financial statements and notes included in the company's Annual Report for the year ended November 30, 2002.

The preparation of these interim unaudited consolidated financial statements and the accompanying notes requires management to make estimates and assumptions that affect the amounts reported. In the opinion of management, these interim unaudited consolidated financial statements reflect all adjustments (which include only normal, recurring adjustments) necessary to state fairly the results for the periods presented. Actual results could vary from these estimates and the operating results for the interim periods presented are not necessarily indicative of the results expected for the full year.

2 Accounts receivable

	May 31, 2003	November 30, 2002
	\$	\$
Trade	1,941,516	2,785,531
Unbilled revenue	1,254,581	872,128
Technology Partnerships Canada contribution	238,490	157,708
Other	42,571	153,272
	<hr/>	<hr/>
	3,477,158	3,968,639
	<hr/>	<hr/>

3 Inventory

	May 31, 2003	November 30, 2002
	\$	\$
Materials and components	629,344	1,198,719
Work in progress	3,843	-
Finished goods	12,088	68,087
	<hr/>	<hr/>
	645,275	1,266,806
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Notes to the Consolidated Financial Statements (unaudited)

May 31, 2003

(expressed in Canadian dollars)

4 Property, plant, and equipment

	May 31, 2003		
	Cost	Accumulated Amortization	Net
	\$	\$	\$
Equipment	3,716,760	2,726,753	990,007
Computer software	672,253	334,191	338,062
Furniture and fixtures	124,388	81,465	42,923
Leasehold improvements	222,196	181,056	41,140
Licenses and patents	57,267	35,909	21,358
	4,792,864	3,359,374	1,433,490

	November 30, 2002		
	Cost	Accumulated Amortization	Net
	\$	\$	\$
Equipment	3,557,622	2,629,162	928,460
Computer software	630,036	272,235	357,801
Furniture and fixtures	123,331	76,771	46,560
Leasehold improvements	222,196	176,485	45,711
Licenses and patents	57,267	34,785	22,482
	4,590,452	3,189,438	1,401,014

5 Accounts payable and accrued liabilities

	May 31, 2003	November 30, 2002
	\$	\$
Trade	919,387	1,323,991
Accrued liabilities	755,791	431,563
Accrued employee costs	469,666	489,475
Accrued royalties	146,136	339,380
	2,290,980	2,584,409

Offshore Systems International Ltd.

Notes to the Consolidated Financial Statements (unaudited)

May 31, 2003

(expressed in Canadian dollars)

6 Capital Stock

(a) Issued and outstanding Common shares

	May 31, 2003		November 30, 2002	
	Number of common shares	Amount \$	Number of Common shares	Amount \$
Balance – Beginning of year	26,043,243	18,220,929	24,694,549	17,625,427
Issued during the year				
Exercise of stock options	144,788	65,560	1,206,664	495,752
Exercise of share purchase warrants	-	-	125,000	99,750
Class A preference shares converted	11,034	-	17,030	-
Common stock purchased and cancelled	(242,600)	(169,820)	-	-
Balance – End of year	25,956,465	18,116,669	26,043,243	18,220,929

(b) Class A preference shares

The company has 30,262 (November 30, 2002 - 41,296) Class A preference shares outstanding that have a nominal value for financial statement purposes. These Class A preference shares are being held in escrow and can be released subject to certain release provisions and obtaining approval from the appropriate regulatory authorities.

(c) Class B preference shares

The company completed a private placement on February 13, 2003 consisting of 61,244 units for total gross proceeds of \$3,004,200. Each unit consists of one Class B Series 1 preference share and 22.75 common share purchase warrants. The preference shares are voting convertible shares at a ratio of 1:45.5 and have a cumulative dividend of 6% per annum. The company has the right to redeem the preference shares after five years. The share purchase warrants are convertible to common shares at a ratio of 1:1 and expire five years after issue. The private placement incurred share issue costs of \$277,205. The gross proceeds were allocated between the preference shares and warrants based on their relative fair value at the date of issuance, with the value allocated to the warrants presented as additional paid in capital. The fair value of the preference share has been estimated based on the fair value of the underlying common stock. The fair value of the warrants has been estimated using the Black-Scholes option pricing model. Assumptions used in the pricing model included: (i) risk free rate of 2.7%, (ii) expected volatility of 66%, (iii) an estimated life of 5 years and (iv) an expected dividend rate of 0%.

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Notes to the Consolidated Financial Statements (unaudited)

May 31, 2003

(expressed in Canadian dollars)

(d) Earnings per share

	Three months ended		Six Months Ended	
	May 31		May 31	
	2003	2002	2003	2002
	\$	\$	\$	\$
Basic earnings per share				
Net earnings	152,162	311,465	400,410	579,317
Less: preferred share dividends	45,933	-	45,933	-
Net earnings available to common shareholders	106,229	311,465	354,477	579,317
Weighted average number of common shares outstanding	26,031,356	24,862,548	26,031,356	24,862,548
Basic earnings per share	0.00	0.01	0.01	0.02
Diluted earnings per share				
Net earnings	152,162	311,465	400,410	579,317
Less: preferred share dividends (*1)	45,933	-	45,933	-
Net earnings available to common shareholders	106,229	311,465	354,477	579,317
Weighted average number of common shares outstanding	26,031,356	24,862,548	26,031,356	24,862,548
Dilutive effect of Class A preference shares – Series A	30,262	58,326	30,262	58,326
Dilutive effect of Class B preference shares – Series 1 (*1)	-	-	-	-
Dilutive effect of stock options	861,333	2,124,565	861,333	2,124,565
Dilutive effect of warrants	-	20,985	-	20,985
Adjusted weighted average number of common shares outstanding	26,922,951	27,066,424	26,922,951	27,066,424
Diluted earnings per share	0.00	0.01	0.01	0.02

(*1) The Class B preference shares – Series 1 are anti-dilutive for the purposes of calculating diluted earnings per share for both the three and six months ended May 31, 2003.

(e) Normal course issuer bid

In January 2003, the Company received approval for a normal course issuer bid that entitles the Company to repurchase up to 1,300,000 common shares for cancellation between January 16, 2003 and January 15, 2004. The purchases are made on the open market.

During the period January 16 to May 31, 2003, the Company purchased 242,600 of its common shares under the normal course issuer bid at an average cost of \$1.12 per share for an aggregate consideration of \$271,175. The amount by which the cost of reacquiring the shares exceeded the average carrying value has been charged to the deficit.

7 Stock based compensation

Effective December 1, 2002 the Company adopted CICA 3870 Stock-based Compensation and Other Stock-based payments. As permitted by CICA 3870 the Company has applied this change prospectively for new awards granted on or

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(expressed in Canadian dollars)

after December 1, 2002. The Company has chosen to recognize no compensation when stock options are granted to employees and directors under stock option plans with no cash settlement features. However, direct awards of stock to employees, stock option and stock awards granted to non-employees have been accounted for in accordance with the fair value method of accounting for stock-based compensation. Had compensation cost for these grants been determined based on the fair value at the grant date consistent with the provisions of CICA 3870, the Company's net earnings and net earnings per share would have been adjusted to the pro forma amounts indicated below:

	May 31, 2003 \$	May 31, 2002 \$
Net earnings	400,410	579,317
Additional compensation expense	399,713	416,432
Pro forma net earnings	697	162,885
Pro forma basic earnings per share	0.00	0.01
Pro forma diluted earnings per share	0.00	0.01

The pro forma compensation expense reflected above has been estimated using the Black-Scholes option pricing model. Assumptions used in the pricing model included: (i) risk free interest rate between 2.6% and 2.9% (2002 - 2.1% and 2.6%); (ii) expected volatility between 45% and 114% (2002 - 50% and 73%); (iii) an estimated average life of 1 to 5 years (2002 - 3 to 5 years); and (iv) an expected dividend yield of 0% (2002 - 0%).

The weighted average fair value of the options granted during the six month period ended May 31, 2003 was \$0.56 per option.

8 Segmented information

The company's reportable segments are as outlined below. Accounting policies used by these segments are the same as those described in the significant accounting policies as disclosed in note 2 of the company's audited financial statements for the year ended November 30, 2002.

	Three Months Ended May 31, 2003			Six Months Ended May 31, 2003		
	Systems \$	Geomatics \$	Total \$	Systems \$	Geomatics \$	Total \$
Revenue	2,045,284	912,743	2,958,027	4,914,240	1,606,962	6,521,202
Technology Partnerships Canada - net	(65,653)	-	(65,653)	(324,436)	-	(324,436)
Interest expense	-	39	39	-	289	289
Net earnings	62,185	89,977	152,162	292,674	107,736	400,410
Property, plant and equipment expenditures	145,361	27,298	172,659	164,428	37,985	202,413
Amortization	62,249	25,122	87,371	120,948	48,988	169,936

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Notes to the Consolidated Financial Statements (unaudited)

May 31, 2003

(expressed in Canadian dollars)

	Three Months Ended			Six Months Ended		
	May 31, 2002			May 31, 2002		
	Systems	Geomatics	Total	Systems	Geomatics	Total
	\$	\$	\$	\$	\$	\$
Revenue	3,360,488	466,964	3,827,452	6,266,734	846,236	7,112,970
Technology Partnerships Canada - net	(129,763)	-	(129,763)	(81,576)	-	(81,576)
Interest expense	1,112	187	1,299	2,592	452	3,044
Income Tax Recovery	57,000	-	57,000	154,990	-	154,990
Net earnings	284,978	26,487	311,465	554,586	24,731	579,317
Property, plant and equipment expenditures	190,574	3,890	194,464	227,123	65,169	292,292
Amortization	57,346	44,161	101,507	105,158	92,793	197,951

	May 31, 2003		
	Systems	Geomatics	Total
	\$	\$	\$
Total assets employed	10,765,685	1,006,726	11,772,411

	November 30, 2002		
	Systems	Geomatics	Total
	\$	\$	\$
Total assets employed	9,633,345	1,133,093	10,766,438

Geographically, revenues reported are based on the location of the company's customers.

	Three months ended		Six months ended	
	May 31		May 31	
	2003	2002	2003	2002
	\$	\$	\$	\$
Canada	1,090,284	1,018,385	1,937,245	2,873,814
United States	995,649	1,734,797	2,600,443	2,538,391
Denmark	872,094	1,074,270	1,983,514	1,700,765
Total	2,958,027	3,827,452	6,521,202	7,112,970

Geographically, property, plant and equipment are reported based on location. At May 31, 2003 and 2002, all of the company's property, plant and equipment was located in Canada.

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Notes to the Consolidated Financial Statements (unaudited)

May 31, 2003

(expressed in Canadian dollars)

9 Financial instruments

Fluctuations in foreign currency exchange rates

The company enters transactions denominated in U.S. dollars and as such its revenue, expenses, monetary assets and liabilities will be affected by fluctuations in the U.S. dollar relative to the Canadian dollar.

The company uses foreign exchange forward contracts to hedge transactions denominated in United States dollars. The purpose of the Company's hedging activities is to reduce the level of exposure to exchange rate movements, most significantly in the United States. At May 31, 2003, the Company had forward exchange contracts maturing in the following year to sell United States dollars in the amount of US\$1,786,000. The exchange rates set in the forward exchange contracts ranged between \$1.3508 to \$1.4029 for US\$1.00. The contracts mature between June 2003 and May 2004.

10 Reclassifications

Certain balances for the six months ended May 31, 2002 have been reclassified to conform to the presentation adopted for the current period.