

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The accompanying financial statements and related data are the responsibility of management.

Management is responsible for ensuring that the financial statements are prepared in accordance with accounting principles generally accepted in Canada.

The integrity of the financial process is also the responsibility of management. Management maintains systems of internal controls designed to provide reasonable assurance that transactions are authorized, assets are safeguarded, and reliable financial information is produced. Management selects accounting principles and methods that are appropriate to the Company's circumstances, and makes decisions affecting the measurement of transactions in which estimates or judgements are required to determine the amounts reported.

The Audit Committee has responsibility for reviewing the annual financial statements and the external auditors' report and recommending the annual financial statements to the Board of Directors for approval.

The Board of Directors is responsible for ensuring that management fulfils its responsibilities for financial reporting. The Board has responsibility for reviewing and approving the financial statements.

The external auditors audit the financial statements annually on behalf of the shareholders. The external auditors have free access to management, and the Audit Committee.



John A. Jacobson
President & Chief Executive Officer



John Sentjens
Corporate Controller

AUDITORS' REPORT

TO THE SHAREHOLDERS OF **Offshore Systems International Ltd.**

We have audited the consolidated balance sheet of Offshore Systems International Ltd. as at November 30, 2003 and the consolidated statement of earnings and deficit and cash flows, for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at November 30, 2003 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles. As required by the British Columbia Act, we report that, in our opinion, these principles have been applied on a consistent basis.

The consolidated financial statements as at November 30, 2002 and for the year then ended were audited by other auditors who expressed an opinion without reservation on those statements in their report dated January 17, 2003.

Ernst & Young LLP

Vancouver, Canada,
January 16, 2004

Chartered Accountants



**CONSOLIDATED
FINANCIAL STATEMENTS**

Offshore Systems International Ltd.

(Prepared in accordance with Canadian Generally Accepted Accounting Principles)

NOVEMBER 30, 2003 AND 2002

CONSOLIDATED BALANCE SHEETS

Offshore Systems International Ltd.

at November 30, 2003 and 2002

	2003	2002
	\$	\$
Assets		
Current assets		
Cash and cash equivalents	3,837,555	3,244,048
Accounts receivable (note 3)	4,621,836	3,968,639
Inventory (note 4)	665,503	1,266,806
Prepaid expenses and deposits	430,419	232,215
Future tax assets (note 12)	822,523	98,860
	10,377,836	8,810,568
Future tax asset (note 12)	-	554,856
Property, plant, and equipment (note 5)	1,350,421	1,401,014
	11,728,257	10,766,438
Liabilities and Shareholders' Equity		
Current liabilities		
Accounts payable and accrued liabilities (note 6)	2,126,061	2,584,409
Billing in excess of revenues	45,907	1,642,725
Rent payable	133,942	133,942
	2,305,910	4,361,076
Accrued long term royalties	187,384	372,717
	2,493,294	4,733,793
Commitments and contingencies (notes 10 and 11)		
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 8(b))	-	-
61,244 Class B preference shares – Series 1 (2002 – nil, note 8(c))	2,065,420	-
26,807,475 common shares (2002 - 26,043,243, note 8(a))	18,508,498	18,220,929
	20,573,918	18,220,929
Warrants (note 8(c))	661,575	-
Additional Paid in Capital	43,050	-
Deficit	(12,043,580)	(12,188,284)
	9,234,963	6,032,645
	11,728,257	10,766,438

See accompanying notes to the consolidated financial statements

Approved by the Board of Directors


 Helmut Lobemeier
 signed


 Tony Pezzotti
 signed

CONSOLIDATED STATEMENTS OF EARNINGS & DEFICIT

Offshore Systems International Ltd.

For the years ended November 30, 2003 and 2002

	2003 \$	2002 \$
Revenue		
Systems and system components	6,208,464	9,762,039
Geomatics	3,560,440	2,347,464
Software	1,036,417	970,323
Other	715,472	788,953
	11,520,793	13,868,779
Cost of sales	5,159,068	7,097,392
Gross profit	6,361,725	6,771,387
Expenses		
General and administrative	2,498,021	2,596,895
Research and development	1,548,523	1,516,528
Sales and marketing	2,000,238	1,761,669
Amortization	241,295	243,786
Interest	2,824	3,582
Foreign exchange loss	151,961	49,952
Technology Partnerships Canada royalty	50,473	476,189
Technology Partnerships Canada contribution	(376,880)	(863,851)
	6,116,455	5,784,750
Earnings from operations	245,270	986,637
Proceeds on settlement of claim	-	221,978
Earnings before income taxes	245,270	1,208,615
Income tax recovery		
Future income tax recovery	363,484	1,127,421
Current income tax expense	(223,385)	(701,005)
	140,099	426,416
Earnings for the year	385,369	1,635,031
Deficit – Beginning of year	(12,188,284)	(13,823,315)
Class B preference share dividends paid	(53,484)	-
Premium on purchase and cancellation of common shares	(187,181)	-
Deficit – End of year	(12,043,580)	(12,188,284)
Basic earnings per share	0.01	0.06
Diluted earnings per share	0.01	0.06
Weighted average number of common shares outstanding – basic	25,977,123	25,288,725
Weighted average number of common shares outstanding – diluted	27,142,492	27,285,617

See accompanying notes to the consolidated financial statements

CONSOLIDATED STATEMENTS OF CASH FLOWS

Offshore Systems International Ltd.

For the years ended November 30, 2003 and 2002

	2003 \$	2002 \$
Cash flows from operating activities		
Earnings for the year	385,369	1,635,031
Items not affecting cash		
Amortization	359,979	375,769
Stock based compensation	43,050	-
Gain on disposal of equipment	-	(15,447)
Future tax assets	(168,807)	(426,416)
	<u>619,591</u>	<u>1,568,937</u>
Changes in non-cash working capital items		
Accounts receivable	(653,197)	(1,111,269)
Inventory	601,303	(396,452)
Prepaid expenses and deposits	(198,204)	13,048
Accounts payable and accrued liabilities	(458,348)	1,168,334
Billings in excess of revenues	(1,596,818)	(74,995)
Rent payable	-	(37,725)
Long term royalties	(185,333)	132,534
	<u>(2,490,597)</u>	<u>(306,525)</u>
	<u>(1,871,006)</u>	<u>1,262,412</u>
Cash flows from financing activities		
Issue of common stock	606,069	568,252
Issue of Class B preference shares - Series 1 and warrants, net of issue costs	2,726,995	-
Class B preference share dividends paid	(53,484)	-
Share repurchases	(505,681)	-
	<u>2,773,899</u>	<u>568,252</u>
Cash flows from investing activities		
Additions to property, plant, and equipment	(309,386)	(704,241)
Proceeds from disposal of equipment	-	80,000
	<u>(309,386)</u>	<u>(624,241)</u>
Increase in cash and cash equivalents	593,507	1,206,423
Cash and cash equivalents – Beginning of year	3,244,048	2,037,625
Cash and cash equivalents – End of year	<u>3,837,555</u>	<u>3,244,048</u>

See accompanying notes to the consolidated financial statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Offshore Systems International Ltd.

November 30, 2003 and 2002

1 Nature of operations

Offshore Systems International Ltd. (OSIL) develops and markets military and commercial electronic navigation systems and produces and distributes geomatic data. Collectively, OSIL and its subsidiaries are referred to as the Company. The Company's systems line of business develops and produces electronic marine navigation systems for situational awareness. The Company's geomatics line of business produces and distributes land mapping and nautical charting products and services. Beginning in the Company's 2004 fiscal year, the systems line of business will be relabelled to navigation systems and the Company will introduce a new line of business named applications. The applications line of business will develop software applications and tools for situational awareness.

2 Summary of significant accounting policies

Principles of consolidation

These consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All material interCompany transactions and balances have been eliminated on consolidation.

Foreign currency translation

In prior years, the Company's U.S. based subsidiary provided sales, support and distribution services for a number of third-party manufacturers of navigation aids and marine technologies and was designated a self-sustaining operation. During the fiscal year ended November 30, 2002, the nature of the entity's operations changed such that it services the Company's U.S. market of the geomatics business line and is now designated as a fully integrated operation. As a result, the foreign currency translation method used for the financial statements of the subsidiary included in the consolidated financial statements was changed from the current method to the temporal method. Under the temporal method, monetary items are translated into Canadian dollars at the rates in effect at the balance sheet dates. Non-monetary items are translated at historical rates. Translation gains and losses are included in earnings. This change in method has been accounted for on a prospective basis.

The Company purchases foreign exchange forward contracts to hedge sales to customers denominated in the United States dollars and the related accounts receivable. Foreign exchange translation gains and losses on foreign currency denominated derivative financial instruments used to hedge anticipated U.S. dollar denominated sales are recognized as an adjustment of the revenues when the sale is recorded. The Company does not utilize derivative financial instruments for trading or speculative purposes.

Foreign currency denominated monetary assets and liabilities of Canadian operations are translated into Canadian dollars at rates of exchange in effect at the balance sheet date, and revenues and expenses at average rates of exchange during the year. Exchange gains and losses arising on translation are included in earnings.

Use of estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions which affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses for the years reported. Actual results could differ from these estimates.

Cash and cash equivalents

Cash and cash equivalents consist of cash and deposit instruments with an initial maturity of three months or less.

Inventory

Materials and components are stated at the lower of cost and replacement value as determined by the first-in first-out method. Work-in-process and manufactured parts are stated at the cost of materials and direct labour applied to the product and the applicable share of overhead. Finished goods are stated at the lower of cost and net realizable value.

Property plant and equipment

Property plant and equipment are recorded at cost. Amortization is provided using the declining balance method based on the assets' estimated useful lives as follows:

	%
Equipment	20– 25
Computer software	33
Furniture and fixtures	20
Leasehold improvements	20
Licenses and patents	10

Impairment loss is recognized when the undiscounted cashflows expected from use and eventual disposition of the asset are less than the carrying amount of the asset. An impairment charge is recorded to reduce the carrying value of the asset to its fair value.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Offshore Systems International Ltd.

November 30, 2003 and 2002

Income taxes

The Company accounts for income taxes using the liability method of tax allocation. Under the liability method, future income tax assets and liabilities are determined based on differences between their financial reporting and tax bases and are measured using substantively enacted tax rates and laws expected to be in effect when the differences are expected to reverse. The Company provides a valuation allowance against future tax assets to the extent that the Company does not consider them to be more likely than not of being realized.

Revenue recognition

Certain revenue from projects for navigation systems is recognized using the percentage of completion method of accounting, whereby revenue and profit in the period are based on the ratio of costs incurred to total estimated costs of the project for each segment of the project. Costs include all direct costs including material, labour and subcontracting costs and certain indirect costs related to contracts. A provision is made for the entire amount of future estimated losses, if any, on contracts in progress.

Certain other systems revenue and revenue from navigation software is recognized at the time of delivery of the system to the customer or the delivery of the software and software locks to the customer if persuasive evidence exists of an agreement with the customer, the price is fixed and determinable, collection is probable, and there are no ongoing obligations of the Company to provide future services.

Systems revenue under bill-and-hold arrangements, whereby revenue has been recognized but the goods have not been shipped, is recognized when the customer has a substantial business purpose for ordering the goods on a bill-and-hold basis and the Company does not retain any specific performance obligations such that the earnings process is not complete. Goods held under such arrangements are segregated, ready for shipment and not subject to being used to fill other orders. The customers are charged additional fees for storage and other associated costs until shipment occurs.

Certain revenue from the sale of geomatics services is recognized as the services are provided. Revenue from projects for certain other geomatics services is recognized using the percentage of completion method of accounting, whereby revenue and profit in the period are based on the ratio of costs incurred to total estimated costs of the project for each segment of the project. Costs include all direct costs including material, labour and subcontracting costs and certain indirect costs related to contracts. A provision is made for the entire amount of future estimated losses, if any, on contracts in progress.

Revenue from the sale of geomatics products is recorded at the time of delivery.

Revenue from systems components and other revenues are recorded at the time of delivery or as the services are provided.

Research and development

Research costs are expensed in the period incurred. Development costs are expensed in the period incurred unless, in the opinion of management, the deferral criteria are satisfied in all material respects, in which case development expenditures are capitalized and amortized over the estimated life of the related products.

Government assistance

Government assistance is recorded in the accounts when there is reasonable assurance that the Company has complied with, and will continue to comply with, all conditions necessary to obtain the grants. Government assistance towards current research expenditures is recorded as a reduction of expenses in the consolidated statement of earnings. The liability to repay government assistance is recognised as an expense in the period in which conditions arise that cause the government assistance to be repayable.

Stock-based compensation

The Company has stock option plans as described in note 9. No compensation expense is recognized when stock options are issued to directors and employees. Compensation expense measured at fair value is recognized when stock options are issued to third parties approved by the board of directors. Consideration paid on exercise of the stock options is credited to capital stock.

Earnings per share

Basic earnings per share are computed using the weighted average number of common shares outstanding during the year. The treasury stock method is used for the calculation of diluted earnings per share. Under the treasury stock method, the weighted average number of common shares outstanding for the calculation of diluted earnings per share assumes that the proceeds to be received on the exercise of dilutive stock options and warrants are applied to repurchase common shares at the average market price for the period. Stock options and warrants are dilutive when the average market price of the common shares during the period exceeds the exercise price of the options and warrants.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Offshore Systems International Ltd.

November 30, 2003 and 2002

3 Accounts receivable

	2003	2002
	\$	\$
Trade	1,691,685	2,785,531
Unbilled revenue	2,854,942	872,128
Technology Partnerships Canada contribution	-	157,708
Other	75,209	153,272
	<u>4,621,836</u>	<u>3,968,639</u>

4 Inventory

	2003	2002
	\$	\$
Materials and components	620,429	1,198,719
Finished goods	45,074	68,087
	<u>665,503</u>	<u>1,266,806</u>

5 Property, plant, and equipment

	2003		
	Cost	Accumulated Amortization	Net
	\$	\$	\$
Equipment	3,772,026	2,838,400	933,626
Computer software	721,250	401,909	319,341
Furniture and fixtures	126,534	86,378	40,156
Leasehold improvements	222,737	185,673	37,064
Licenses and patents	57,267	37,033	20,234
	<u>4,899,814</u>	<u>3,549,393</u>	<u>1,350,421</u>
	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
	<u>4,590,452</u>	<u>3,189,438</u>	<u>1,401,014</u>

6 Accounts payable and accrued liabilities

	2003	2002
	\$	\$
Trade	1,171,353	1,323,991
Accrued liabilities	362,681	431,563
Accrued employee costs	408,592	489,475
Accrued royalties	183,435	339,380
	<u>2,126,061</u>	<u>2,584,409</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Offshore Systems International Ltd.

November 30, 2003 and 2002

7 Credit facilities

In November 2002, the Company renewed certain credit facilities with a Canadian chartered bank. The credit facilities consist of an operating line, a forward exchange contract facility and standby letters of credit. The operating line bears interest at the chartered bank's prime lending rate plus 1.25% with interest payable monthly. The standby letters of credit are denominated in U.S. dollars and bear interest at rates between 1% and 2% per annum. Funds drawn on the operating line and the standby letters of credit are repayable on demand. As of November 30, 2003, letters of credit, relating principally to customer contracts, amounting to US\$127,000 (2002 – US\$859,000) have been issued. The Company utilizes letters of credit to back certain performance obligations with its customers. These standby letters of credit have been insured through Export Development Canada.

The maximum amounts available to the Company under the operating line and forward exchange contract facility are \$1,000,000, and US\$2,000,000, respectively. The credit facilities are collateralized by a general assignment of book debts, a general security agreement and a guarantee, also secured by general security agreements, from each of OSL, OSI Geomatics Ltd and OSI Geomatics Inc. In addition, the Company is required to meet certain covenants as outlined in the credit facilities agreement. As at November 30, 2003, the Company had drawn on its foreign exchange contract facility in the amount of US\$1,343,705 (2002 – US\$350,000). The Company has not drawn on the operating line facility.

8 Capital Stock

(a) Issued and outstanding common shares

	2003		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	1,208,198	606,069	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	(455,000)	(318,500)	-	-
Balance – End of year	26,807,475	18,508,498	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 exercisable at \$1.10. 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%.

(d) Stock option plans

The Company has established three stock option plans under which options to purchase common shares may be granted to directors, officers and employees of the Company and to any other person or Company permitted by the applicable regulatory authorities to purchase unissued common shares. The number of common shares authorized for grant under the Company's stock option plans is 10,930,732. The exercise price of options granted pursuant to the plans may not be less than the market price of the common shares at the time of grant. The plans provide that options may be granted with vesting periods and expiry dates at the discretion of the board of directors. Options granted to directors vest immediately and options granted to employees vest one year after the date granted.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Offshore Systems International Ltd.

November 30, 2003 and 2002

A summary of the status of the Company's stock option plans at November 30 is as follows:

	2003		2002	
	Number of shares	Weighted average exercise price \$	Number of shares	Weighted average exercise price \$
Outstanding - Beginning of year	3,130,047	0.83	3,497,496	0.59
Granted	1,290,601	1.07	865,000	1.19
Exercised	(1,208,198)	0.50	(1,206,664)	0.41
Forfeited	(122,404)	0.96	(15,897)	0.96
Expired	(200,000)	1.50	(9,888)	0.28
Outstanding - End of year	2,890,046	1.02	3,130,047	0.83

A summary of the Company's stock options outstanding and exercisable at November 30, 2003 is as follows:

Range of exercise prices \$	Options outstanding			Options exercisable	
	Number outstanding at November 30, 2003	Weighted average remaining contractual life (years)	Weighted average exercise price \$	Number exercisable at November 30, 2003	Weighted average exercise price \$
	0.42 – 0.60	140,862	0.32	0.48	140,862
0.61 – 0.90	485,000	0.73	0.76	485,000	0.76
0.91 – 1.35	2,093,934	1.57	1.07	1,623,688	1.08
1.36 – 2.00	170,250	0.84	1.62	70,250	1.42
0.42 – 2.00	2,890,046	1.32	1.02	2,319,800	0.99

A summary of the Company's stock options outstanding and exercisable at November 30, 2002 is as follows:

Range of exercise prices \$	Options outstanding			Options exercisable	
	Number outstanding at November 30, 2003	Weighted average remaining contractual life (years)	Weighted average exercise price \$	Number exercisable at November 30, 2002	Weighted average exercise price \$
	0.40 – 0.60	1,133,138	1.02	0.45	1,133,138
0.61 – 0.90	695,250	1.51	0.76	695,250	0.76
0.91 – 1.35	1,031,409	2.23	1.12	1,031,409	1.12
1.36 – 1.50	270,250	1.38	1.48	270,250	1.48
0.40 – 1.50	3,130,047	1.56	0.83	3,130,047	0.83

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Offshore Systems International Ltd.

November 30, 2003 and 2002

Shareholder Rights Plan

On April 18, 2001, the board of directors of the Company adopted a shareholder rights plan (the "Rights Plan"). The Rights Plan was approved by the Toronto Stock Exchange in accordance with its policies, and was also approved by the shareholders of the Company by ordinary resolution at the annual general meeting of the Company held on May 28, 2001.

The objectives of the Rights Plan are to ensure, to the extent possible, that all shareholders of the Company are treated equally and fairly in connection with any take-over offer for the Company. Take-over offers may not always result in shareholders receiving equal or fair treatment or full value for their investment. In addition, current Canadian securities legislation only requires a take-over offer to remain open for 21 days. The board believes that this period may be insufficient for the shareholders to evaluate a bid, or for the board to pursue alternatives that could maximize shareholder value and to make informed recommendations to shareholders.

The Rights Plan is designed to discourage discriminatory or unfair take-over offers for the Company and gives the board time, if appropriate, to pursue alternatives to maximize shareholder value in the event of an unsolicited take-over bid for the Company. The Rights Plan will encourage an offeror to proceed by way of a permitted bid or to approach the board with a view to negotiation by creating the potential for substantial dilution of the offeror's position. The permitted bid provisions of the Rights Plan are designed to ensure that, in any take-over bid, all shareholders are treated equally, receive the maximum value for their investment and are given adequate time to properly assess the take-over bid on a fully informed basis.

(e) Earnings per share

	2003	2002
Basic earnings per share		
Net earnings	\$ 385,369	\$ 1,635,031
Less: Class B preferred share dividends	145,350	-
Net earnings available to common shareholders	\$ 240,019	\$ 1,635,031
Weighted average number of common shares outstanding	25,977,123	25,288,725
Basic earnings per share	\$ 0.01	\$ 0.06
Diluted earnings per share		
Net earnings	\$ 385,369	\$ 1,635,031
Less: Class B preferred share dividends	145,350	-
Net earnings available to common shareholders	\$ 240,019	\$ 1,635,031
Weighted average number of common shares outstanding	25,977,123	25,288,725
Dilutive effect of Class A preference shares – Series A	30,262	41,296
Dilutive effect of Class B preference shares – Series 1 (*1)	-	-
Dilutive effect of stock options	1,135,107	1,955,596
Adjusted weighted average number of common shares outstanding	27,142,492	27,285,617
Diluted earnings per share	\$ 0.01	\$ 0.06

(*1) The Class B preference shares – Series 1 are anti-dilutive for the purposes of calculating diluted earnings per share for twelve months ended November 30, 2003.

(f) 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 November 30, 2003, the Company purchased 455,000 of its common shares under the normal course issuer bid at an average cost of \$1.11 per share for an aggregate consideration of \$505,681. The amount by which the cost of reacquiring the shares exceeded the average carrying value has been charged to the deficit.

9 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 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 earnings and earnings per basic and diluted share would have been adjusted to the pro forma amounts indicated below:

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Offshore Systems International Ltd.

November 30, 2003 and 2002

	2003	2002
	\$	\$
Earnings for the year	385,369	1,635,031
Additional compensation expense	517,891	452,083
Pro forma net earnings (loss)	(132,522)	1,182,948
Pro forma basic earnings (loss) per share	(0.01)	0.05
Pro forma diluted earnings (loss) per share	(0.01)	0.04

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 year ended November 30, 2003 was \$0.45 per option (November 30, 2002 - \$0.52).

10 Technology Partnerships Canada

Effective December 23, 1998, the Company entered into an agreement with Technology Partnerships Canada (TPC). TPC is a technology investment fund of the Canadian federal government established to contribute to the achievement of increasing economic growth, creating jobs and wealth, and supporting sustainable development in Canada. TPC granted financial assistance to the Company for the purpose of funding research and development activities to be completed on or before March 31, 2003. To receive the financial assistance, the Company must submit claims to TPC for eligible costs. Eligible costs include labour, material and other costs directly attributable to the research and development activities. Under the agreement with TPC, the Company is eligible to receive contributions to a maximum of \$4,000,177 over the period from December 23, 1998 to March 31, 2003. As of March 31, 2003, the Company has received the maximum allowed under the agreement. During 2003, the Company incurred eligible costs of \$376,880 (2002 - \$863,851) and has claimed the full amount from TPC. These amounts have been applied to reduce expenses in the consolidated statements of earnings.

In addition, the Company is required to pay a royalty of 3% to TPC on all revenues that OSL, the Company's wholly owned subsidiary, earns from December 1, 1999 to November 30, 2008. The royalty payments do not relate to the ownership of the intellectual property (IP). Ownership of the IP remains with the Company. Royalty payments will continue until the cumulative royalties paid or payable to November 30, 2008 are at least \$7,810,230 or until November 30, 2014.

TPC royalties paid and accrued are as follows:

	2003	2002
	\$	\$
Royalties paid	391,752	213,704
Accrued royalties		
Short term	183,435	339,380
Long term	187,384	372,717
	370,819	712,097

If the Company causes an event of default, as defined in the agreement, TPC can suspend or terminate any obligation to contribute to the costs of the project or require the Company to repay all or part of the contributions made, together with interest, from the date of demand.

11 Commitments and contingencies

The Company has entered into operating leases for its office premises in Canada and for certain equipment. Minimum lease payments required under the remaining terms of the leases are as follows:

	\$
Years ending November 30	
2004	274,828
2005	273,384
2006	265,501
2007	179,933
2008	3,665
	997,311

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In addition to basic rent, the Company is required to pay a portion of certain costs and property taxes for the above commitments. In 2003, the Company paid \$77,719 (2002 - \$79,973) for these costs.

In July 2002, the Company's subsidiary OSL and three employees became subject to a lawsuit by Triathlon Ltd., a subsidiary of MacDonald, Dettwiler and Associates Ltd., related to use of confidential information and breach of fiduciary duty. No amount had been accrued at November 30, 2003 in respect of this claim because it is the opinion of management that the claim is without merit and the amount of loss, if any, cannot be reasonably estimated.

12 Future income taxes

The Company is subject to Canadian federal and British Columbia provincial taxes in Canada. The Company is also subject to federal income taxes in the U.S. and Danish income taxes.

Earnings before income taxes consisted of the following:

	2003	2002
	\$	\$
Canadian income (loss)	(5,992)	1,064,690
U.S. income	251,262	143,925
	<u>245,270</u>	<u>1,208,615</u>

The Company has non-capital losses for Canadian income tax purposes of approximately \$4,502,648 (2002 -\$4,855,787), which are available for carry forward to reduce future years' taxable income. These income tax losses expire as follows:

	2003	2002
	\$	\$
Year ending November 30		
2003	-	172,395
2004	-	-
2005	1,600,105	1,759,504
2006	2,506,280	2,533,022
2007	137,945	193,676
2008	-	-
2009	<u>258,318</u>	<u>197,190</u>

The Company has net operating losses for U.S. income tax purposes of approximately \$451,030 (2002 - \$787,062), which are available for carry forward to reduce future years' taxable income of the U.S. Company. These income tax losses expire as follows:

	2003	2002
	\$	\$
Year ending November 30		
2018	138,259	426,172
2019	-	-
2020	277,141	319,778
2021	<u>35,630</u>	<u>41,112</u>

The Company also has investment tax credits of approximately \$782,041 (2002 - \$329,410), which can be used to offset future income taxes otherwise payable and expire as follows:

	2003	2002
	\$	\$
Year ending November 30		
2005	117,678	117,678
2006	130,114	130,114
2007	-	-
2008	-	-
2009	-	-
2010	-	-
2011	219,680	81,618
2012	139,499	-
2013	<u>175,070</u>	<u>-</u>

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The Company has capital losses for Canadian income tax purposes of approximately \$354,466 (2002 - \$354,466), which are available for carry forward to reduce future years' income from capital gains. These capital losses carry forward indefinitely.

The Company has undeducted scientific research and experimental development expenses for Canadian income tax purposes of approximately \$4,334,409 (2002 - \$2,038,365), which are available for carry forward to reduce future years' income for tax purposes. These expenses carry forward indefinitely.

The net future tax asset consists of the following:

	2003	2002
	\$	\$
Future tax assets		
Non-capital loss carry-forwards and net operating losses	1,742,868	2,027,491
Net capital loss carry-forwards	63,130	126,261
Scientific research and experimental development costs	1,543,916	700,718
Investment tax credits	569,579	212,074
Property, plant and equipment	555,339	544,893
Other	105,763	28,119
	4,580,595	3,639,556
Valuation allowance	(3,758,072)	(2,985,840)
Net future tax asset	822,523	653,716

The Company reduced its valuation allowance against future income tax assets to reflect the amount of the future tax benefit that was more likely than not to be realized. A valuation allowance continues to be provided against future income tax assets for which the more likely than not criteria of future realization has not been met. During the year, the future income tax recovery related to the release of the valuation allowance was \$168,807 (2002 - \$426,416).

A reconciliation of the combined Canadian federal and provincial income tax rate with the Company's effective income tax rate is as follows:

	2003	2002
	\$	\$
Expected statutory rate	37.79%	40.04%
Expected provision for income taxes	92,688	483,929
Change in tax rates applied in valuation allowance	25,235	(41,915)
Change in valuation allowance	772,232	(972,234)
Foreign tax differentials	9,135	(39,828)
Temporary differences arising during the year	(1,052,335)	126,313
Non-deductible expenses and other	12,946	17,319
	(140,099)	(426,416)

As a result of a Canadian federal tax reassessment non-capital loss carry forwards, scientific research and experimental development costs and related income tax credits have been adjusted resulting in an increase of available deductible temporary differences of approximately \$2,090,000.

13 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.

	2003		
	Systems	Geomatics	Total
	\$	\$	\$
Revenue	7,927,166	3,593,627	11,520,793
Technology Partnerships Canada - net	(326,407)	-	(326,407)
Interest expense	624	2,200	2,824
Income tax recovery	2,917	137,182	140,099
Earnings for the year	124,594	260,775	385,369
Property, plant and equipment expenditures	201,540	107,846	309,386
Amortization	255,462	104,517	359,979

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	2002		
	Systems	Geomatics	Total
	\$	\$	\$
Revenue	11,521,314	2,347,465	13,868,779
Technology Partnerships Canada - net	(387,662)	-	(387,662)
Interest expense	2,869	713	3,582
Income tax recovery	426,416	-	426,416
Earnings for the year	1,460,124	174,907	1,635,031
Property, plant and equipment expenditures	397,244	306,997	704,241
Amortization	242,362	133,407	375,769

	2003		
	Systems	Geomatics	Total
	\$	\$	\$
Total assets employed	10,103,117	1,625,140	11,728,257

	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.

	2003	2002
	\$	\$
Canada	3,296,257	3,315,510
United States	5,103,062	7,366,982
Denmark	2,083,953	3,178,644
Other	1,037,521	7,643
Total	11,520,793	13,868,779

Approximately 65% of revenue for the year ended November 30, 2003 (2002 - 84%) is derived from three ultimate customers at 27%, 20% and 18%, respectively (2002 - 38%, 23%, 23%).

Geographically, property, plant and equipment are reported based on location. At November 30, 2003 and 2002, all of the Company's property, plant and equipment was located in Canada.

14 Financial instruments

Fluctuations in foreign currency exchange rates

The Company enters into 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 its functional currency, 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 November 30, 2003, the Company had forward exchange contracts maturing in the following year to sell United States dollars in the amount of US\$1,343,705. The exchange rates set in the forward exchange contracts ranged between \$1.3047 to \$1.4029 for US\$1.00. The contracts mature between January and May 2004.

The fair value of derivative instruments generally reflects the estimated amounts that the Company would receive or pay to settle the contracts at November 30, 2003. The fair value of the above derivative financial instruments was \$82,097.

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15 Supplemental cash flow information

	2003	2002
	\$	\$
Cash paid during the year for interest	2,824	3,582
Cash received for interest	103,564	20,192
Cash paid during the year for income taxes	-	-
Non-cash financing and investing activities		
Inventory transferred to plant and equipment	10,121	62,741

16 Reclassifications

Certain balances for the year ended November 30, 2002 have been reclassified to conform to the presentation adopted for the current year.

17 Subsequent events

On December 1, 2003, the Company declared dividends of \$1.50 per share on the issued and outstanding Class B Series 1 preference shares. The total amount of the dividend declared was \$91,866.

On January 8, 2004, the Company announced that it had been selected for a major fleet-wide contract with the Royal Navy of the United Kingdom. The Company, as part of a successful teaming arrangement with Lockheed Martin UK and Kelvin Hughes Ltd., will begin to deliver ECPINS-M™ software to the Royal Navy fleet in mid-2004. The initial purchases total approximately CDN \$3 million. The total contract value, including long term support and options for auxiliary systems and software development is approximately CDN \$17.5 million.