



MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE YEAR ENDED NOVEMBER 30, 2003

Forward-Looking Statements - Statements in this report, or any document filed by Offshore Systems International Ltd. (the "Company") with the different governing authorities, or in any other written or oral communication by or on behalf of the Company, to the extent not directly and exclusively based on historical events, constitute forward-looking statements. These statements represent the Company's intentions, plans, expectations, and beliefs, and no assurance can be given that the results described in such statements will be achieved.

Forward-looking statements include, without limitation, statements evaluating market and general economic conditions in the following sections, and statements regarding future-oriented costs and expenditures. Investors are cautioned not to place undue reliance on these forward-looking statements, which reflect management's analysis only as of the date thereof. These forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially. Such risks and uncertainties with respect to the Company include the effects of general economic conditions, changing foreign exchange rates, actions by government authorities, uncertainties associated with legal proceedings and negotiations, industry supply levels, competitive pricing pressures and misjudgements in the course of preparing forward-looking statements.

The Company disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Vision, Core Businesses and Strategy

VISION

The Company has strong capabilities in geographic data production, manipulation and display and has established itself as one of the leading suppliers of navigation chart systems for naval fleets. The Company is commercializing both its software and its capabilities as naval and major commercial fleets follow the evolution from manual, paper based charts to electronic navigation.

The Company's vision for future developments is centered upon:

- ◇→ Capitalizing upon our presence in naval navigation by securing additional fleet procurements as they come to market;
- ◇→ Expanding the Company's experience in geographic data beyond marine applications;
- ◇→ Identifying segments of the broad Defence market where the addition of electronic geography can reduce risks and add significant value; and
- ◇→ Diversifying the Company's business beyond the Defence market.

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The Company intends to bring forward and integrate electronic geography into the management of mission critical applications for Defence and commercial customers.

CORE BUSINESSES

Founded in 1977, the Company has two lines of business - systems and geomatics. The systems line of business designs, develops and markets the proprietary ECPINS® (Electronic Chart Precise Integrated Navigation System) line of electronic chart navigation aids for ships. ECPINS® is designed, developed and marketed by Offshore Systems Ltd., a wholly owned subsidiary. ECPINS® helps to reduce the risk of navigation-related incidents by giving bridge crews a precise, real-time display of their position, course and speed, against a background of fixed obstacles and other navigational hazards. Offshore Systems has developed a market position in military navigation, and has ECPINS® systems deployed with the United States Coast Guard, the Canadian Navy, the Royal Danish Navy, the New Zealand Royal Navy and the United States Navy. The geomatics line of business, which is operated through OSI Geomatics Ltd. and OSI Geomatics Inc. (wholly owned subsidiaries), produces and markets both land and nautical mapping data products for the military, governmental and commercial marketplace in North America.

In the Company's 2004 fiscal year, it will add a new line of business – applications, which will develop software applications and tools for situational awareness. The applications business unit will provide products and services to military forces, government agencies and systems integrators to enable improved situational awareness. The business unit's initial product is Common Operational Picture – Integrated Display Server (COP-IDS®). COP-IDS® facilitates the integration of information from multiple geo-spatial sources – such as land maps, nautical charts, aerial and space photo imagery and special military information – into a single fused display.

STRATEGY FOR GROWTH AND SHAREHOLDER VALUE CREATION

The Company will employ a combination of strategies and competitive advantages to capitalize on the market conditions that exist in the various market sectors of its business.

Distribution Strategy

The Company's distribution strategy relies on a combination of direct sales and indirect sales through teaming relationships, strategic partnerships and distributorships to obtain major orders from both new and existing customers. The Company's direct sales force focuses on the domestic markets and its indirect sales channels focus on the international and global markets for the Company's products and services. This strategy has resulted in the Company's navigation systems business winning five consecutive open procurement competitions.

Engineering and Product Development Strategy

The Company develops and maintains its proprietary intellectual property (IP). The Company uses a number of forms of licenses and other agreements to make its IP available to its customers, its partners and the development community that use the Company's IP for their operations.

The product development process is inherently resource constrained and decisions about product priorities are market-based decisions. Development is focused on niches in which the Com-

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pany believes will result in competitive advantages, increased market share and positive gross margins. The Company makes market-driven decisions to allow product features to be added when required.

Quality Strategy

The Company's complex products fall under the purview of a number of international standards. The Company's overall qualification target is ISO9001:2000 worldwide. This target was achieved in fiscal 2003.

Each operating entity will have to adopt and adhere to such environmental, physical, electrical and performance standards as are relevant to its products. For example, navigation systems have to comply with one or more standards from the International Hydrographic Organization, the International Maritime Organization, the International Electrotechnical Commission, NATO, and the United States Navy.

Human Resource Strategy

The human resource strategy revolves around developing sustained core competencies in key areas to support the business vision. The Company's human resource base will be managed to ensure that the core competency and skills portfolio requirements to support the business are met. New hires will be selected based on attitude, aptitude, experience and credentials.

Capitalization Strategy

The Company strives to maintain a strong balance sheet with an adequate level of liquidity. The Company monitors key ratios and balances regularly. The Company establishes limits on its total debt load and established targets for its current asset to current liability ratio, cash and accounts receivable to current liabilities ratio, and accounts receivable and inventory balances.

Shareholder Value Strategy

The Company is a publicly traded company listed on the Toronto Stock Exchange and quoted for trading in the U.S. on the Over The Counter Bulletin Board (OTCBB).

The Company's target shareholder is an investor interested in the technology sector, either an individual or a small-cap fund that invests in technology companies on a growth and value basis. The Company plans to develop earnings growth to support investor valuations, and to market the Company as an investment through investor relations programs in Canada and the USA.

GROWTH PERFORMANCE DRIVERS

The following discussion on growth performance drivers and measures is not intended as investment advice to the reader. Before making any investment decision, the reader should seek professional advice from an independent accredited investment advisor.

The Company views the following indicators as growth indicators:

- Successful major enterprise wins from both new and existing navigation systems business unit customers;

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- Establishing key partner or prime-contract relationships with international or global organizations; and
- Design wins in the applications business unit.

The Company measures success by the number and frequency of new prime contract and key sub-contract awards for the Company's geomatics business unit, new design wins for the applications business unit, new fleet wide and follow-on orders for the navigation systems business unit and new strategic alliances for all three business units.

REQUIRED CAPABILITIES

The Company's ability to meet its targets relies on two primary resources: its liquidity and capital resources, and its human resources.

Liquidity and Capital Resources

The Company strives to maintain cash-contributing profitable operations that provide an adequate liquidity and capital resource base for growth. Every business endeavour the Company develops or acquires targets a positive cash flow from the outset.

The Company believes that cash flow from operating activities, together with cash on hand and borrowings available under its revolving credit facilities, will be sufficient to fund currently anticipated working capital, planned capital spending and debt service requirements for the next 12 months. There can be no assurance that these resources will be adequate or that additional financing will be available to the Company.

Human Resources

The Company strives to maintain a long-term investment in its human resource base. Experienced, capable resources trained in the Company's methodologies and standards are a requirement. This training requires a significant time investment, particularly for the Company's research and development resources. Employees are encouraged to or are required to constantly upgrade their skills.

Maintaining the Company's existing employee base and adding the right people in the right position at the right time has been a factor in the Company's performance over the past two years. To augment its core employee base, the Company is building offshore production and engineering partnerships that will allow it to more effectively manage the fluctuations in the resource requirements demanded by its customers. The partner organizations will be required to meet and maintain our professional standards.

The Company has entered into employment contracts with its executive and key management personnel.

The Company believes that the current employee base will be sufficient to meet the planned growth of the existing operations for the next 12 months. There can be no assurance that these resources will be adequate and that additional staff will be available to the Company.

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RESULTS

The Company's financial statements are prepared in accordance with generally accepted accounting principles in Canada ("CDN GAAP") and are presented in Canadian dollars unless otherwise indicated. All references in this report to financial information concerning the Company refer to such information in accordance with CDN GAAP and all dollar amounts in this report are in Canadian dollars unless otherwise indicated.

The following discussion and analysis provides a review of activities and results of operations of the Company for the fiscal year ended November 30, 2003 in comparison with those for the fiscal year ended November 30, 2002. This discussion should be read in conjunction with the Company's 2003 Audited Consolidated Financial Statements.

The Company has had a volatile operating history making an evaluation of the Company and its prospects complex and challenging. The Company's prospects must be evaluated keeping in mind the risks, expenses and difficulties encountered by companies seeking to introduce new products into rapidly evolving niche markets with a limited number of competitors, only a few of which are well financed. To address these risks and uncertainties, the Company must, among other things, successfully market its existing products and technologies, complete and introduce products under development in a timely manner, continue to upgrade and commercialize its technologies, attract, retain and motivate qualified personnel, manage rapid growth and establish strategic alliances with large multi-national corporations. There can be no assurance that the Company will successfully address all of these challenges.

The Company's annual and quarterly operating results are primarily affected by the level, timing and duration of customer orders, relative mix of value added products and services and fluctuations in materials costs. The Company's operating results are also affected by, among other factors, price competition, manufacturing effectiveness and efficiency, the ability to manage inventory and capital assets effectively, foreign exchange fluctuations, the timing of expenditures in anticipation of increased sales, customer product delivery requirements and shortages of components or labour.

The Company has incurred losses from continuing operations, which has resulted in an accumulated deficit in shareholders' equity of \$12,043,580. For the past four fiscal years, the Company has established moderately profitable operations. In 2003, the Company recorded \$11,520,793 in revenue, driven by contracts executed by the Company during the year with the United States Coast Guard, the Royal Danish Navy and the Canadian Navy. Earnings for fiscal 2003 were \$385,369. In addition, cash and cash equivalents strengthened to \$3,837,555, with positive cash flow from operations for the past four years.

As at November 30, 2003, the Company has 26,807,475 common shares, 30,262 Class A preference shares - Series A and 61,244 Class B preference shares - Series 1 outstanding.

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Critical Accounting Policies

The Company prepares its consolidated financial statements in accordance with accounting principles generally accepted in Canada, and makes estimates and assumptions that affect its reported amounts of assets, liabilities, revenue and expenses, and the related disclosure of contingent liabilities. The Company bases its estimates on historical experience and other assumptions that it believes are reasonable in the circumstances. Actual results may differ from these estimates.

The following critical accounting policies affect the Company's more significant estimates and assumptions used in preparing its consolidated financial statements:

Revenue

The Company is required to estimate the costs to complete certain systems and geomatics services contracts. Revenues from these contracts are recognized on the percentage-of-completion method measured by the percentage of costs incurred to total estimated costs to complete for each contract. When it has been determined that a contract will generate a loss for the Company, the Company estimates that loss and books a reserve for the total expected loss on the contract. In the event that actual results differ from these estimates, or the Company adjusts these estimates in future periods, the Company may need to adjust the revenues for these projects.

Future Income Taxes

The Company is required to estimate its income taxes in each of the jurisdictions in which it operates. This process involves estimating the Company's actual current tax exposure, together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in future tax assets and liabilities that may be included on the Company's consolidated balance sheet. The Company recognizes future income taxes to the extent that their realizations are considered more likely than not and provides a valuation allowance against any remaining balance. The valuation allowance is based on the Company's estimates of taxable income by jurisdiction in which it operates and the period over which its future tax assets will be recoverable. In the event that actual results differ from these estimates, or the Company adjusts these estimates in future periods, the Company may need to adjust the valuation allowance.

Stock-based Compensation

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 Company does not recognize a compensation expense when stock options are granted under stock option plans to employees and directors with no cash settlement features. However, direct awards of stock to employees, stock option and stock awards granted to non-employees are accounted for in accordance with the fair value method of accounting for stock-based compensation.

Inventory

The Company values its inventory at the lower of cost, determined on an average first in first

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out basis, and net realizable value. The Company assesses the need for inventory write-downs based on its assessment of estimated net realizable value using assumptions about future demand and market conditions. If market conditions differ from those originally estimated by the Company, an additional inventory write-down may be required.

Accounts Receivable

The Company maintains an allowance for doubtful accounts for estimated losses that may arise if any of its customers is unable to make required payments. Management specifically analyzes the age of outstanding customer balances, historical bad debts, customer credit-worthiness and changes in customer payment terms when making estimates of the uncollectability of the Company's accounts receivable. If the Company determines that the financial condition of any of its customers deteriorates, increases in the allowance may be made.

Results of Operations

For the fiscal year ended November 30, 2003, the Company had net earnings of \$385,369, or \$0.01 per share on a basic and diluted basis.

The table below presents, for the periods indicated, selected financial data of the Company expressed as a percentage of total revenues:

	Year ended November 30	
	2003	2002
Revenue		
Systems and system components	53.9%	70.4%
Geomatics	30.9%	16.9%
Software	9.0%	7.0%
Other	6.2%	5.7%
	100%	100%
Cost of sales	44.8%	51.2%
Gross profit	55.2%	48.8%
Expenses		
General and administrative	21.7%	18.7%
Research and development	13.4%	10.9%
Sales and marketing	17.4%	12.7%
Amortization	2.1%	1.8%
Interest	0.0%	0.0%
Foreign exchange loss	1.3%	0.4%
Technology Partnerships Canada royalty	0.4%	3.4%
Technology Partnerships Canada contribution	(3.3%)	(6.2%)
	53.1%	41.7%

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Earnings from operations	2.1%	7.1%
Proceeds on settlement of claim	0.0%	1.6%
Earnings before tax recovery	2.1%	8.7%
Income tax recovery		
Income tax recovery	1.2%	3.1%
Earnings for the year	3.3%	11.8%

Revenues

The Company's core revenue stream is derived from four sources: Systems and System Components, Software, Geomatics, and Other which includes System Repairs and Servicing, Training and Consulting. The Company's principal developed and manufactured product, the Electronic Chart Precise Integrated Navigation System ("ECPINS®"), delivers the majority of the revenue.

The Company recognizes revenue from each source when earned in compliance with CDN GAAP. Certain revenues from projects for navigation systems are 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. When it has been determined that a project or a project segment will generate a loss, the Company estimates that loss and books a reserve for the total expected loss on the project or project segment. Certain other systems revenues and revenues from navigation software are 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 revenues under bill-and-hold arrangements, whereby revenues were recognized but goods have not been shipped, are recognized when the customer has 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 are not complete. Revenues from the sale of geomatics products are recognized when the products are delivered. Revenues from projects for geomatics services are 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. Revenues from systems components and other revenues are recorded at the time of delivery or as the services are provided.

The Company's revenue and margins can vary from period to period as a result of the level of business volumes, seasonality of demand, mix of contracts, accuracy of estimates used in revenue recognition and component supply availability. Actual production volumes are based on orders for the delivery of products.

Consolidated revenue for the year was \$11,520,793, compared with \$13,868,779 for fiscal 2002, a decrease of 17%. The Company's revenues are primarily affected by the level, timing and duration of customer orders and customer product delivery requirements. The Company depends heavily on government contracts and derives a significant amount of revenue from a few customers, which may result in varying revenue and margins. During fiscal 2003, the Company

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continued and expanded its business development initiatives with prospective and existing customers. Some of these activities did not result in closing orders during the year but may yield orders in subsequent fiscal years. The main customers for the Company's products and services were the U.S. Coast Guard, Canadian Coast Guard, Canadian Department of National Defence, Royal Danish Navy and the U.S. Navy. Revenue from these customers accounted for 70% of the consolidated revenue for fiscal 2003 compared to 90% of the consolidated revenue for 2002.

Segment Results

Revenue from the systems segment for fiscal 2003 was \$7,927,166, compared to \$11,521,314 for fiscal 2002, a decrease of \$3,594,148 or 31%. This decrease was largely attributable to the substantial completion in fiscal year 2002 of the Canadian Department of National Defence contract awarded to the Company in fiscal year 2001, the Marinette Marine Corp. contracts to provide ECDIS systems for the U.S. Coast Guard Juniper class buoy tenders, and the substantial completion of the Danish Navy contract during fiscal 2003.

Revenue from the geomatics segment for fiscal 2003 was \$3,593,627 compared to \$2,347,465 fiscal 2002, an increase of \$1,246,162 or 53%. In fiscal 2003, most of the increased revenue resulted from the Company's expansion into the land mapping market in the fourth quarter of fiscal 2002, although some increases in revenues stemmed from the existing customer base in the nautical chart market.

In both operating segments, the Company continues to invest significant corporate, sales and marketing resources in identifying and pursuing new opportunities and contracts, both in its existing customer base and with new prospective customers.

Gross Profit

The Company's gross profit decreased \$409,662 to \$6,361,725 in fiscal 2003 from \$6,771,387 in fiscal 2002. Gross profit percentage increased to 55.2% in fiscal 2003 from 48.8% in fiscal 2002. The increase was attributable to a major project that included a large proportion of third-party systems at low gross profit margins in fiscal 2002.

General and Administrative Expenses

General and administrative ("G&A") expenses consist mainly of salaries and benefits of management and administrative personnel, professional fees, public company expenses, related facility costs and general administrative expenses, net of interest and other income. G&A decreased \$98,873 in fiscal 2003 to \$2,498,021 from \$2,596,895 in fiscal 2002. As a percentage of revenue, G&A increased to 21.7% in fiscal 2003 from 18.7% in fiscal 2002. The Company continues to protect its Intellectual Property and its ability to conduct its businesses in an unrestricted manner through the appropriate avenues. These activities may result in increased G&A expenses in future periods.

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Research and Development Expenses

Research and development (“R&D”) expenses consist mainly of salaries and benefits of software and hardware engineering personnel, sub-contractor costs and related overhead and facilities expenses. The Company expenses research and development costs in the period incurred unless, in the opinion of management, certain development costs meet the deferral criteria under Canadian GAAP, in which case development expenditures are capitalized and amortized over the estimated life of the related products. To date, the Company has not capitalized any development costs.

The Company continued to invest in new product development in 2003. The Company believes that in order to maintain its technological capabilities, it must continue to fine-tune existing products and introduce new high quality products that challenge and redefine the industry standards. As a result, fiscal 2003 spending on R&D increased \$31,995 to \$1,548,523 or 13.4% of revenue, compared to \$1,516,528 or 10.9% of revenue in fiscal 2002. The increased spending is the result of additional salaries and benefits for new staff to support the additional R&D activities related to the development of the recently released COP-IDS® product and the continuing development of the ECPINS® product.

In November of 1999, the Company announced an agreement with Technology Partnerships Canada (“TPC”) whereby TPC granted financial assistance to the Company to fund research and development activities. The maximum eligible repayable contribution is \$4,000,177 over the period to March 31, 2003. During the year, the Company incurred costs of \$376,880 and has claimed the full amount. To November 30, 2003, the Company has claimed the full amount eligible under the TPC program. Also, under the terms of the agreement, the Company is required to pay TPC a royalty based on the revenue of its subsidiary Offshore Systems Ltd. To November 30, 2003, the Company has accrued for future payment or paid royalties of \$1,116,730. 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.

Sales and Marketing Expenses

Sales and marketing (“S&M”) expenses consist primarily of compensation of sales and marketing personnel, as well as expenses associated with advertising, trade shows, facilities and other expenses related to the sales and marketing of the Company’s products and services. S&M expenses increased \$238,569, or 14%, in fiscal 2003 to \$2,000,238 (17.4% of revenue) from \$1,761,669 (12.7% of revenue) in fiscal 2002. The increase in expenses was the result of the Company’s increased level of business development activity relating to its expansion efforts into American, European and Asia-Pacific markets. These expansion efforts required the Company to hire additional S&M staff to pursue specific opportunities in these regions. The expansion effort targets the military agencies of Canada, NATO and other allies of Canada to increase the profile of the Company and its products through the establishment of marketing agreements with companies local to the targeted regions. Some of these activities did not result in closing orders during the year but may yield orders in subsequent fiscal years.

Amortization

Total amortization decreased slightly to \$241,295 from \$243,786 in fiscal 2002. The decrease

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reflects the dollar value and mix of fixed assets in the Company for fiscal 2003.

Interest

Interest expense decreased to \$2,824 from \$3,582 in fiscal 2002 because the Company did not utilize its credit facility during fiscal 2003.

Income Taxes

Based on the information available at the time of the issue of the annual audited financial statements, the Company estimated that it will have sufficient taxable earnings in future years to utilize a portion of the Company's \$4,502,648 Canadian and \$451,030 U.S. non-capital losses carried forward. As a result of this assessment, the Company recognized a future tax asset of \$168,807 for the year ended November 30, 2003. In accordance with Canadian GAAP, the Company provided a valuation allowance of \$3,758,072 against the total future tax asset as it is not considered more likely than not that the remaining future tax asset will be recovered. The Company continues to evaluate its taxable position quarterly and considers factors such as estimated taxable income, the history of losses for tax purposes and the growth of the Company, among others.

Net Earnings

Consolidated net earnings for the year were \$385,369, or 3.3% of revenue, compared to \$1,635,031 for fiscal 2002, or 11.8% of revenue.

Backlog

Total backlog as at November 30, 2003 was \$3.3 million compared to \$6.1 million at November 30, 2002. Total backlog is the total of the firm and option backlogs. Firm backlog consists of firm, fixed, signed orders issued to the Company and executable by the Company subsequent to the balance sheet date. Firm backlog as at November 30, 2003 was at \$0.9 million compared to \$3.7 million as at November 30, 2002. Option backlog consists of unexercised contract options at the balance sheet date and indefinite-quantity contracts executable by the Company subsequent to the balance sheet date. Option backlog as at November 30, 2003 was \$2.4 million compared to \$2.4 million at November 30, 2002. Subsequent to November 30, 2003, the Company booked an additional \$4.0 million in firm, fixed, signed orders that will be executed in fiscal 2004 and an additional \$14.5 million of option backlog to be executed during and after fiscal 2004.

The timing of the awarding of major contracts to the Company can significantly impact the Company's total backlog position. Historically, major contracts that have been awarded to the Company have taken up to three years to finalize, with the contracting process involving lengthy discussions and negotiations with several groups of people within the prospective customer's organization. The Company has continually pursued and will continue to pursue major contracts and, as a result, there could be large variations in its total backlog position from one fiscal year to another.

Because governments approve budget expenditures on an annual basis, multi-year contracts with government agencies have a termination-for-convenience clause that allows the contract to

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be terminated should future budget funding not be approved. The Company has included the full value of these contracts in backlog as no evidence exists that the contracts would be terminated.

Liquidity and Capital Resources

The Company concluded the fiscal year with a positive cash position. At November 30, 2003, the Company had current assets of \$10,377,836, current liabilities of \$2,305,910 and a cash position of \$3,837,555. Working capital increased \$3,622,434 to \$8,071,926 at November 30, 2003 from \$4,449,492 a year earlier, primarily through an increase in accounts receivable and a decrease in billings in excess of revenues.

The Company has credit facilities consisting of an operating line, standby letters of credit, and forward exchange contract facilities. The credit facilities permit the Company to borrow funds directly for general corporate purposes (including acquisitions) at floating rates. No borrowings against the operating line were outstanding as at November 30, 2003. The Company has issued standby letters of credit totalling US\$127,000. The Company has utilized the standby letters of credit to back certain performance obligations with its customers. The Company has entered into forward exchange contracts in the amount of US\$1,343,705. The Company utilizes its forward exchange contract facility to reduce the level of exposure to currency exchange rate movements.

Fiscal year ended November 30, 2003 operating cash flow, before changes in non-cash working capital items, was \$619,591, compared with \$1,568,937 in the fiscal year ended November 30, 2002, a decrease of \$949,346. The reduction reflected the decreased profitability of the Company for the fiscal year 2003. Changes in non-cash working capital items were a usage of cash of \$2,490,597 for fiscal 2003 compared to \$306,525 for the previous year. Changes occurred in most non-cash working capital items between the two fiscal years, all within the normal business activities of the Company. The two largest changes in non-cash working capital were to Accounts payable and accrued liabilities and Billing in excess of revenues. Both of these decreases reflect the regular business activities of the Company.

Net cash provided by financing activities amounted to \$2,773,899 in fiscal 2003, compared to \$568,252 in fiscal 2002. The improvement of \$2,205,647 was largely the result of the issue of Class B Series 1 preference shares and share purchase warrants.

Cash used in investing activities in fiscal 2003 totalled \$309,386, compared with \$624,241 in fiscal 2002. The decrease is reflective of the decrease in property, plant and equipment acquisitions.

The net increase in cash and cash equivalents amounted to \$593,507 in fiscal 2003, compared with a net cash position increase of \$1,206,423 in fiscal 2002.

The Company believes that cash flow from operating activities, together with cash on hand and borrowings available under its revolving credit facilities, will be sufficient to fund currently anticipated working capital, planned capital spending and debt service requirements for the next 12 months. There can be no assurance that these resources will be adequate or that additional financing will be available to the Company.

Transactions with Directors, Officers and Major Shareholders

The Company did not enter into any transactions with directors, officers or major shareholders

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during the current and prior fiscal years.

Special Purpose Entities

There are no special purpose entities of the Company. The Company consolidates all of its subsidiaries and the Company does not have any other equity investments.

THE YEAR IN REVIEW

This section summarizes the Company's events as published periodically through press releases.

In January 2003, the Company proceeded with a normal course issuer bid whereby it purchased its own common shares out of the market through the facilities of the TSX. All shares repurchased by the Company will be cancelled. The bid commenced on January 16, 2003 and terminated January 15, 2004.

In February 2003, the Company:

- Announced that it has completed a private placement of US\$2,000,000 (CDN\$3,100,000) with four New York based institutional funds.
- Announced the launch of COP-IDS[®], a client server application that allows customers to integrate OSI's mapping and imagery display technology into existing command and control systems rapidly and cost effectively. COP-IDS[®] stands for Common Operational Picture – Image Display Server. It is designed to meet the emerging requirements for our customers' international fleets to be able to operate from and share common tactical data in the field. COP-IDS[®] allows the Company's customers to share data across command and control systems, regardless of the systems in use.

In March 2003, the Company:

- Announced that it has won a contract with the City of Ottawa, through its nautical charting and land mapping division, OSI Geomatics, to produce land mapping data critical to the planning and management of city infrastructure.
- Confirmed that it and its teaming partners have been short-listed as potential contractors to supply its ECPINS[®] navigation display system to two international customers in the military defence industry. The award of formal contracts is subject to further technical evaluation and preparation of formal agreements. In May 2003, the Company announced the signing of a contract by one of the two international customers – the Royal New Zealand Navy.

In April 2003, the Company:

- Received a contract from the Canadian Navy to develop submarine navigation systems for deployment on the Canadian Navy's Victoria Class Navy submarines.
- Announced that its nautical charting and land mapping division, OSI Geomatics, has received new sales contracts worth over CDN\$950,000.

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- Announced that its systems division, Offshore Systems Ltd. (“OSL”), has received follow-on orders from the Canadian and the Danish navies worth CDN \$1,430,000. The orders are for additional services, equipment, and upgrades related to the navies’ fleet-wide deployment of Offshore’s proprietary ECPINS-M™ (Electronic Chart Precise Integrated Navigation System - Military).
- Announced that its systems division, OSL, has entered into an agreement with Kelvin Hughes Limited, part of Smith Marine Systems, to jointly pursue opportunities to supply electronic navigation systems to military customers. With an initial focus on the U.K. the companies will offer navigation systems compliant to the NATO Warship Electronic Chart Display and Information System standard (“WECDIS”). In June 2003, OSL and Kelvin Hughes were joined by Lockheed Martin U.K. to pursue the contract opportunity with the Royal Navy.

In May 2003, the Company announced that its systems division, OSL, has signed a contract with the Royal New Zealand Navy. The contract, valued at over CDN\$1,000,000 with all options exercised, will see Offshore’s proprietary ECPINS-M™ deployed across the navy’s entire fleet.

In June 2003, the Company:

- Announced that its nautical charting and land-mapping division, OSI Geomatics, has been awarded a contract by a large US mapping company valued at over CDN\$1,000,000. Under the contract, OSI Geomatics will provide data production services in support of a state-wide mapping project.
- Announced that Lockheed Martin UK has teamed with Kelvin Hughes Ltd and OSL to bid into the initial competitive stage of the United Kingdom’s Ministry of Defence’s requirement for WECDIS, which is being considered for installation into all Royal Navy ships. The team includes Babcock Design and Technology Ltd who would manage the task of ship-fitting design and the installation of the systems into the fleet.

In July 2003, the Company:

- Announced that Standard & Poor’s had initiated research coverage of OSI.
- Announced that its systems division, OSL, had joined negotiations with the Royal Australian Navy. OSL, together with its industrial team-mates Nautronix Ltd. of Fremantle, Australia, and Scientific Management Associates of Lane Cove NSW, Australia, had been selected as the “Preferred Tenderer” by the Royal Australian Navy for its SEA1430 Phase 2A fleet-wide electronic chart navigation systems procurement.

In September 2003, the Company:

- Announced the appointment of Mr. Peter W. Roberts, the Chief Financial Officer of Sierra Wireless, Inc., to the Company’s Board of Directors and its Audit Committee.
- Announced that OSI Geomatics, had received new orders worth more than \$1,500,000. The group of orders span the end of the Company’s third quarter and the beginning of the fourth quarter.

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Also, in September 2003, Taglich Brothers, Inc. commenced research coverage of the Company. The Initial Research Report is available on Taglich Brothers' website and on the Company's website.

In November 2003 the Company announced that Alan Vlemmiks has joined the Company as Director of Sales and Marketing, Navigation Systems. Mr. Vlemmiks is a 28-year veteran of tactical sales and strategic business development.

In December 2003, the Company:

- Announced that the Canadian Navy has awarded a new contract for navigation systems to OSI's Navigation Systems unit. The navigation systems will be deployed on new Canadian Navy training vessels with deliveries to commence in April 2004. This is the latest order following the Canadian Navy's fleet purchase of OSI's ECPINS-M™ navigation systems. The committed contract value is \$800,000, and totals \$1.1 million inclusive of options.
- Announced that its new OSI Applications unit has begun to deliver developer tool kits and support for its COP-IDS® server platform that extends the capabilities of third-party application developers and increases the availability of additional products for potential COP-IDS® customers. The OSI Applications unit is led by Andrew Carniel, Vice President of Business Development for the Company. His leadership of the Navigation Systems unit established the Company as a leading supplier of military navigation systems. He will now focus upon expanding the Company's existing Navy relationships into the broader and larger global command and control marketplace for all forces - land-based, air and marine.

In January 2004, the Company announced that its Navigation Systems unit has been selected for a major fleet-wide contract with the Royal Navy. OSI, 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.

Recent Accounting Developments

In fiscal 2003, the Company was required to adopt certain provisions of the recently issued accounting standards for financial reporting purposes from CICA Handbook Section 3870 – Stock-Based Compensation and Other Stock-Based Payments. The Company was required to expense, in its consolidated financial statements, the fair value of stock options granted to third parties. The impact of adopting these new standards on the Consolidated Statements of Earnings and Deficit has been reported in its annual Audited Consolidated Financial Statements for year ended November 30, 2003.

By fiscal 2005, the Company will be required to adopt the remaining provisions of the recently issued accounting standards for financial reporting purposes from CICA Handbook Section 3870

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– Stock-Based Compensation and Other Stock-Based Payments. The Company will be required to expense, in its consolidated financial statements, the fair value of stock options granted to employees and directors. The impact of adopting these new standards on the Consolidated Statements of Earnings and Deficit has not been determined.

RISKS AND UNCERTAINTIES

Certain statements made in this report by the Company constitute forward-looking statements, and are subject to risks and uncertainties that may cause future results to differ materially from those expected. Factors that may cause such differences include, but are not limited to, the factors discussed below. If any of these events actually occur, they could have a materially adverse effect on the Company, its financial condition or results of operations.

We depend heavily on our government contracts, which are only partially funded, subject to termination, heavily regulated and audited. The termination of one or more of these contracts could have a negative impact on our operations. The contract termination clauses are generally in favour of the Government Agencies. Typically the termination clause for convenience is 30 days or less with the condition that all costs to that date are paid by the Government Agencies.

The termination of funding for a government program would result in a loss of anticipated future revenues attributable to that program, which could have a negative impact on our operations. Also, we can give no assurance that we would be able to procure new government contracts to offset the revenues lost as a result of any termination of our contracts. As our revenues are dependent on our procurement, performance and payment under our contracts, the loss of one or more critical contracts could have a negative impact on our financial condition.

In addition, sales to the governments we work with may be affected by:

- changes in procurement policies;
- budget considerations;
- changing concepts of national defence; and
- political developments abroad.

The influence of any of these factors, which are largely beyond our control, could also negatively impact our financial condition.

We derive a significant amount of revenue from only a few customers. We depend on the United States, Canadian and Danish governments for a significant portion of our sales, and the loss of any of these relationships or a shift in any of these governments' funding could have severe consequences on our financial condition.

Approximately 27%, 20% and 18% of our revenue in the year ended November 30, 2003 were from the U.S. Coast Guard, Canadian Navy and Royal Danish Navy, respectively. Therefore, any significant disruption or deterioration of any of our relationships with these entities' governments would significantly reduce our revenues. These governments may choose to use other competing corporations for their navigational equipment. In addition, a shift in government spending to other programs in which we are not involved could have severe consequences for our results of operations.

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Our product lines are not broadly diversified.

We derive and expect to derive a substantial majority of our revenue from navigational equipment sales. If customers do not purchase our products as a result of competition, technological change, budget constraints or other factors, we do not have other product categories that we could rely on to make up any shortfall in sales. As a result, our revenue could decrease and our business and operating results would be adversely affected.

We derive a significant portion of our revenues from international sales and are subject to the risks of doing business in foreign countries.

In the financial year ended November 30, 2003, approximately 71%, of our revenues were from international customers, including governmental customers: 44% from the United States and 27% from other international countries. We expect that international sales will continue to account for a significant portion of our revenues for the foreseeable future. As a result, we are subject to risks of doing business internationally, including those risks related to:

- changes in regulatory requirements;
- domestic and foreign government policies, including requirements to expend a portion of program funds locally and governmental industrial co-operation requirements;
- fluctuations in foreign currency exchange rates;
- the complexity and necessity of using foreign representatives and consultants;
- imposition of tariffs or embargoes, export controls and other trade restrictions; and
- compliance with a variety of foreign laws.

While the presence of these factors and the impact of these factors are difficult to predict, any one or more of them could adversely affect our operations in the future.

We have established teaming relationships and strategic partnerships with international corporations to pursue major international government procurements, and our reputation and results of operations could be adversely affected by our inability to control their operations.

We rely on agreements with international corporations to assist us in pursuing contracts for major government procurements. We do not have assurance that these third parties will:

- remain in business;
- maintain the financial stability required to fulfill the requirements of these international procurements;
- continue to consider the Company's products in their business priorities.

There can be no assurance that we would be able to pursue and secure major international government procurements without these third parties.

Competition within our markets may reduce our procurement of future contracts and our sales.

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The defence industry in which we operate is highly competitive. Our competitors range from smaller companies, which are primarily targeting the pleasure boat market, to large diversified corporations in the radar/marine equipment segment of the industry. Some of our competitors may have more extensive or more specialized engineering, manufacturing and marketing capabilities than we have. There can be no assurance that we can continue to compete effectively with these companies.

Our future success will depend on our ability to develop new technologies that achieve market acceptance.

The defence market is characterized by rapidly changing technologies and evolving industry standards. Accordingly, our future performance depends on a number of factors, including our ability to:

- identify emerging technological trends in our market;
- develop and maintain competitive products;
- enhance our products by adding innovative features that differentiate our products from those of our competitors; and
- manufacture and bring products to market quickly at cost-effective prices.

We believe that, in order to remain competitive in the future, we will need to continue to develop new products, which will require the investment of significant financial resources in new product development. In addition, there can be no assurance that the market for our products will develop or continue to expand as we currently anticipate. The failure of our technology to gain market acceptance could significantly reduce our revenues and harm our business. Furthermore, we cannot be sure that our competitors will not develop competing technology, which gains market acceptance in advance of our products. The possibility that our competitors might develop new technology or products might cause our existing technology and products to become obsolete. If we fail in our new product development efforts or our products fail to achieve market acceptance more rapidly than our competitors, our revenues will decline and our business, financial condition and results of operations will be negatively affected.

We depend on the recruitment and retention of qualified personnel, and our failure to attract and retain such personnel could seriously harm our business.

Due to the specialized nature of our business, our future performance is highly dependent upon the continued services of our key engineering personnel and executive officers. Our prospects depend upon our ability to attract and retain qualified engineering, manufacturing, marketing, sales and management personnel for our operations. Competition for personnel is intense, and we may not be successful in attracting or retaining qualified personnel. Our failure to compete for these personnel could seriously harm our business, results of operations and financial condition.

We depend on offshore sub-contract labour in our geomatics and systems operations to maintain a competitive position in the geomatics and systems marketplaces.

Our geomatics and systems operations are highly dependent upon labour resources located outside North America. While we enter into sub-contract agreements with these suppliers, we cannot be sure that the labour resources will be available when we require them and at the levels

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we require them. Accordingly, maintaining our competitiveness will depend on a number of factors, including:

- the geopolitical uncertainties specific to the home country of each sub-contractor;
- the cultural compatibility between Canada and the home country of each sub-contractor;
- the English language proficiency of the labour resources made available to us,
- labour pool characteristics such as work ethic, education, skill level and attrition; and
- the infrastructure of both the sub-contractor's home country and the sub-contractor.

While the presence of these factors and the impact of these factors are difficult to predict, any one or more of them could adversely affect our geomatics operations in the future.

We may be unable to adequately protect our intellectual property rights, which could affect our ability to compete.

Protecting our intellectual property rights is critical to our ability to compete and succeed as a company. We have trademark and copyright registrations, which are necessary and contribute significantly to the preservation of our competitive position in the market. There can be no assurance that any of these patents and other intellectual property will not be challenged, invalidated or circumvented by third parties. In the future, we may not be able to obtain necessary licenses on commercially reasonable terms. We enter into confidentiality and invention assignment agreements with our employees, and enter into non-disclosure agreements with our suppliers and customers, as appropriate, so as to limit access to and disclosure of our proprietary information. These measures may not suffice to deter misappropriation or independent third party development of similar technologies.

We depend on component availability and our key suppliers to manufacture and deliver our products and services.

Our operations are highly dependent on the timely delivery of materials by outside suppliers. While we enter into purchase agreements with a few of our suppliers, we cannot be sure that materials, components, and subsystems will be available in the quantities we require, if at all. If any of the suppliers fail to meet our needs, we may not have readily available alternatives. Our inability to fill our supply needs would jeopardize our ability to satisfactorily complete our obligations under our contracts on a timely basis. This might result in reduced sales, contractually imposed penalties for delay in delivery, termination of one or more of these contracts or damage to our reputation and relationships with our customers. All of these events could have a negative effect on our financial condition.

The unpredictability of our results may harm or contribute to the volatility of the trading price of our securities.

Our operating results may vary significantly over time for a variety of reasons, many of which

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are outside our control and any of which may harm our business. The value of our securities may fluctuate as a result of considerations that are difficult to forecast, such as:

- the volume and timing of product orders received and delivered;
- levels of product demand;
- government spending patterns;
- the timing of contract receipt and funding;
- our ability and the ability of our key suppliers to respond to changes in customer orders;
- the timing of our new product introductions and our competitors' new product introductions;
- the cost and availability of components and subsystems;
- price erosion;
- the adoption of new technologies and industry standards;
- competitive factors, including pricing, availability and demand for competing products;
- fluctuations in foreign currency exchange rates; and
- regulatory developments.

We may pursue strategic relationships, investments and acquisitions. We may not be able to successfully manage our operations if we fail to successfully integrate the acquired technologies and/or businesses.

As part of our business strategy, we may expand our product offerings to include application software products that are complementary to our existing products. This strategy may involve technology licensing agreements, joint development agreements, investments or acquisitions of other businesses that offer complementary products. The risks that the Company may encounter in acquiring or licensing technology from third parties include the following:

- difficulty in integrating the third-party product with our products;
- undiscovered software errors in the third-party product;
- difficulties in selling the third-party product;
- difficulties in providing satisfactory support for the third-party product;
- potential infringement claims from the use of the third-party product; and
- discontinuation of third-party product lines.

The risks commonly encountered in the investment in or acquisition of businesses would accompany any future investments or acquisitions by us. Such risks may include the following:

- issues related to product transition (such as development, distribution and customer support);
- the substantial management time devoted to such activities;
- the potential disruption of our ongoing business;
- undisclosed liabilities;
- failure to realize anticipated benefits (such as synergies and cost savings); and
- the difficulty of integrating previously distinct businesses into one business unit.

We may require additional capital, in which case we may need to raise additional funds from lenders and equity markets in the future.

If our expenses exceed our revenues, we may choose to raise additional financing. In addition, we may choose to raise additional financing in order to capitalize on potential opportunities in the marketplace that may accelerate our growth objectives. Our ability to arrange such financing in

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the future will depend in part on the prevailing capital market conditions as well as on our business performance. There can be no assurance that we will be successful in our efforts to arrange additional financing, if needed, on terms satisfactory to us. If additional financing is raised by the issuance of shares, shareholders may experience dilution to their equity interest in us.

Our business could be adversely affected if we fail to manage our growth effectively.

If we fail to manage our growth effectively, our business and operating results could be adversely affected, which could cause the market price of our stock to fall. We expect to continue to grow our operations domestically and internationally, and to hire additional employees. The growth in our operations and staff has placed, and will continue to place, a significant strain on our management systems and resources. If we fail to manage our future anticipated growth, we may experience higher operating expenses, and we may be unable to meet the expectations of investors with respect to future operating results. To manage this growth we must, among other things, continue to:

- improve our financial and management controls, reporting systems and procedures;
- add and integrate new senior management personnel;
- improve our licensing models and procedures;
- hire, train and retain qualified employees;
- control expenses;
- diversify channel sales strategies; and
- invest in our internal networking infrastructure and facilities.

We have committed funds to obtaining additional systems and facilities to accommodate our current and future anticipated growth. To the extent that this anticipated growth does not occur or occurs more slowly than we anticipate, we may not be able to reduce expenses to the same degree. If we incur operating expenses out of proportion to revenue in any given quarter, our operating results may be adversely impacted.

Third parties may claim that we infringe their proprietary rights.

We potentially may receive claims that we have infringed the intellectual property rights of others. As the number of products in the software industry increases and the functionality of these products further overlap, we may become increasingly subject to infringement claims, including patent, trademark and copyright infringement claims. In addition, former employers of our former, current or future employees may assert claims that such employees have improperly disclosed to us the confidential or proprietary information of these former employers. Any such claim, with or without merit, could be time consuming to defend, result in costly litigation, divert management's attention from our core business, require us to stop selling or delay shipping, or cause the redesign of our product. In addition, we may be required to pay monetary amounts as damages, for royalty or licensing arrangements, or to satisfy indemnification obligations that we have with some of our customers.