

Offshore Systems International Ltd.

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

February 29, 2004 and February 28, 2003

(expressed in Canadian dollars)

Offshore Systems International Ltd.

Canadian GAAP

Consolidated Balance Sheets (unaudited)

(expressed in Canadian dollars)

	February 29, 2004 \$	November 30, 2003 \$
Assets		
Current assets		
Cash and cash equivalents	1,716,195	3,837,555
Accounts receivable (note 2)	7,246,510	4,621,836
Inventory (note 3)	635,267	665,503
Prepaid expenses and deposits	345,461	430,419
Future tax assets	594,629	822,523
	<u>10,538,062</u>	<u>10,377,836</u>
Future tax assets	278,904	-
Property, plant, and equipment (note 4)	<u>1,315,010</u>	<u>1,350,421</u>
	<u>12,131,976</u>	<u>11,728,257</u>
Liabilities and Shareholders' Equity		
Current liabilities		
Accounts payable and accrued liabilities (note 5)	2,062,146	2,126,061
Billing in excess of revenues	44,385	45,907
Income taxes payable	4,899	-
Rent payable	133,942	133,942
	<u>2,245,372</u>	<u>2,305,910</u>
Accrued long term royalties	<u>140,539</u>	<u>187,384</u>
	<u>2,385,911</u>	<u>2,493,294</u>
Capital stock		
Authorized		
100,000,000 Class A preference shares with no par value, issuable in series, of which 10,000,000 shares are designated series A voting non-cumulative retractable convertible at a ratio of 1:1, 1% preference shares		
100,000,000 Class B preference shares with a par value of \$50 each, issuable in series of which 10,000,000 are designated series I 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 (2003 – 30,262, note 6(b))	-	-
57,711 Class B preference shares – Series I (2003 – 61,244, note 6(c))	1,946,272	2,065,420
27,016,894 Common shares (2003 - 26,807,475, note 6(a))	<u>18,678,823</u>	<u>18,508,498</u>
	20,625,095	20,573,918
Warrants (note 6(c))	661,575	661,575
Additional Paid in Capital	43,050	43,050
Deficit	<u>(11,583,655)</u>	<u>(12,043,580)</u>
	<u>9,746,065</u>	<u>9,234,963</u>
	<u>12,131,976</u>	<u>11,728,257</u>

See accompanying notes to consolidated financial statements

Offshore Systems International Ltd.

Canadian GAAP

Consolidated Statement of Earnings and Deficit (unaudited)

For the periods ended February 29, 2004 and 2003

(expressed in Canadian dollars)

	February 29 2004	February 28 2003
	\$	\$
Revenue		
Software	2,993,263	205,377
Geomatics	718,733	692,194
Systems and system components	186,894	2,584,517
Other	130,870	81,087
	<hr/> 4,029,760	<hr/> 3,563,175
Cost of sales	<hr/> 1,460,987	<hr/> 1,702,688
Gross profit	<hr/> 2,568,773	<hr/> 1,860,487
Expenses		
General and administrative	730,073	694,444
Research and development	463,224	483,095
Sales and marketing	793,277	501,651
Amortization	52,066	54,614
Interest	268	250
Foreign exchange loss (gain)	(24,741)	136,968
Technology Partnerships Canada royalty	48,926	39,223
Technology Partnerships Canada contribution	-	(298,006)
	<hr/> 2,063,093	<hr/> 1,612,239
Earnings from operations	505,680	248,248
Income tax recovery		
Future income tax recovery	(278,903)	-
Current income tax expense	232,792	-
	<hr/> (46,111)	<hr/> -
Earnings for the period	551,791	248,248
Deficit – Beginning of year	(12,043,580)	(12,188,285)
Class B preference share dividends paid	(91,866)	-
Premium on purchase and cancellation of common shares	-	(16,593)
Deficit – End of year	<hr/> (11,583,655)	<hr/> (11,956,630)
Basic earnings per share	0.02	0.01
Diluted earnings per share	0.02	0.01
Weighted average number of common shares outstanding – basic	26,903,072	26,055,212
Weighted average number of common shares outstanding – diluted	30,190,199	29,792,653

See accompanying notes to consolidated financial statements

Offshore Systems International Ltd.

Canadian GAAP

Consolidated Statements of Cash Flows (unaudited)

For the periods ended February 29, 2004 and February 28, 2003

(expressed in Canadian dollars)

	2004	2003
	\$	\$
Cash flows from operating activities		
Earnings for the period	551,791	248,248
Items not affecting cash		
Amortization	78,045	82,565
Stock based compensation	-	22,050
Future tax assets	(46,111)	-
	<u>583,725</u>	<u>352,863</u>
Changes in non-cash working capital items		
Accounts receivable	(2,624,674)	1,235,580
Inventory	30,236	506,673
Prepaid expenses and deposits	84,958	(48,067)
Accounts payable and accrued liabilities	(63,915)	(108,951)
Billings in excess of revenues	(1,522)	(1,456,964)
Long term royalties	(46,845)	(243,149)
	<u>(2,621,762)</u>	<u>(114,878)</u>
	<u>(2,038,037)</u>	<u>237,985</u>
Cash flows from financing activities		
Issue of Common stock	51,177	9,128
Issue of Class B preference shares - Series 1 and warrants, net of issue costs	-	2,741,535
Class B preference share dividends paid	(91,866)	-
Share repurchases	-	(48,163)
	<u>(40,689)</u>	<u>2,702,500</u>
Cash flows from investing activities		
Additions to property, plant, and equipment	(42,634)	(29,754)
Increase(decrease) in cash and cash equivalents	(2,121,360)	2,910,731
Cash and cash equivalents – Beginning of period	<u>3,837,555</u>	<u>3,244,048</u>
Cash and cash equivalents – End of period	<u>1,716,195</u>	<u>6,154,779</u>

See accompanying notes to consolidated financial statements

Offshore Systems International Ltd.

Canadian GAAP

Notes to the Consolidated Financial Statements (unaudited)

February 29, 2004 and February 28, 2003

(expressed in Canadian dollars)

1 Basis of preparation

The accompanying interim unaudited consolidated financial statements include the accounts of Offshore Systems International Ltd. and its subsidiaries, collectively referred to as the company. These financial statements have been prepared by the company in Canadian dollars and in accordance with generally accepted accounting principles (“GAAP”) in Canada with respect to interim financial statements, applied on a consistent basis, except as described in Note 7 with respect to the accounting for stock-based compensation. Accordingly, they do not include all the information and footnotes required for compliance with GAAP in Canada for annual financial statements. These interim unaudited consolidated financial statements and notes thereon should be read in conjunction with the audited financial statements and notes included in the company’s Annual Report for the year ended November 30, 2003.

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

2 Accounts receivable

	February 29, 2004	November 30, 2003
	\$	\$
Trade	1,761,206	1,691,685
Unbilled revenue	5,420,395	2,854,942
Other	64,909	75,209
	<hr/>	<hr/>
	7,246,510	4,621,836
	<hr/>	<hr/>

3 Inventory

	February 29, 2004	November 30, 2003
	\$	\$
Materials and components	590,193	620,429
Finished goods	45,074	45,074
	<hr/>	<hr/>
	635,267	665,503
	<hr/>	<hr/>

Offshore Systems International Ltd.

Canadian GAAP

Notes to the Consolidated Financial Statements (unaudited)

February 29, 2004 and February 28, 2003

(expressed in Canadian dollars)

4 Property, plant, and equipment

	February 29, 2004		
	Cost	Accumulated	Net
	\$	Amortization	\$
		\$	\$
Equipment	3,801,723	2,885,612	916,111
Computer software	733,777	427,965	305,812
Furniture and fixtures	126,534	88,386	38,148
Leasehold improvements	222,737	187,526	35,211
Licenses and patents	57,267	37,539	19,728
	<u>4,942,038</u>	<u>3,627,028</u>	<u>1,315,010</u>

	November 30, 2003		
	Cost	Accumulated	Net
	\$	Amortization	\$
		\$	\$
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>

5 Accounts payable and accrued liabilities

	February 29, 2004	November 30, 2003
	\$	\$
Trade	1,093,965	1,171,353
Accrued liabilities	388,143	362,681
Accrued employee costs	484,224	408,592
Accrued royalties	95,814	183,435
	<u>2,062,146</u>	<u>2,126,061</u>

Offshore Systems International Ltd.

Canadian GAAP

Notes to the Consolidated Financial Statements (unaudited)

February 29, 2004 and February 28, 2003

(expressed in Canadian dollars)

6 Capital Stock

(a) Issued and outstanding Common shares

	February 29, 2004		November 30, 2003	
	Number of common shares	Amount \$	Number of Common shares	Amount \$
Balance – Beginning of year	26,807,475	18,508,498	26,043,243	18,220,929
Issued during the year				
Exercise of stock options	48,667	51,177	1,208,198	606,069
Class A preference shares converted	-	-	11,034	-
Class B preference shares converted	160,752	119,148	-	-
Common stock purchased and cancelled	-	-	(455,000)	(318,500)
Balance – End of year	27,016,894	18,678,823	26,807,475	18,508,498

(b) Class A preference shares

The company has 30,262 (November 30, 2003 - 30,262) 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%. During the first quarter of 2004, 3,533 preferred shares were converted into common shares at the ratio listed above.

Offshore Systems International Ltd.

Canadian GAAP

Notes to the Consolidated Financial Statements (unaudited)

February 29, 2004 and February 28, 2003

(expressed in Canadian dollars)

(d) Earnings per share

Basic earnings per share	2004	2003
Net earnings	\$ 551,791	\$ 248,248
Less: Class B preferred share dividends	43,283	-
Net earnings available to common shareholders	<u>\$ 508,508</u>	<u>\$ 248,248</u>
Weighted average number of common shares outstanding	<u>26,903,072</u>	<u>26,055,212</u>
Basic earnings per share	<u>\$ 0.02</u>	<u>\$ 0.01</u>
Diluted earnings per share		
Net earnings	\$ 551,791	\$ 248,248
Less: Class B preferred share dividends	43,283	-
Net earnings available to common shareholders	<u>\$ 508,508</u>	<u>\$ 248,248</u>
Weighted average number of common shares outstanding	26,903,072	26,055,212
Dilutive effect of Class A preference shares – Series A	30,262	30,262
Dilutive effect of Class B preference shares – Series 1	2,625,851	2,786,602
Dilutive effect of stock options	<u>631,014</u>	<u>920,577</u>
Adjusted weighted average number of common shares outstanding	<u>30,190,199</u>	<u>29,792,653</u>
Diluted earnings per share	<u>\$ 0.02</u>	<u>\$ 0.01</u>

(e) Normal course issuer bid

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

During the period January 16, 2003 to January 15, 2004 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.

7 Stock based compensation

Effective December 1, 2002 the Company adopted CICA 3870 Stock-based Compensation and Other Stock-based payments. As permitted by CICA 3870 the Company has applied this change prospectively for new awards granted on or after December 1, 2003. The Company has chosen to recognize compensation when stock options are granted to employees and directors under stock option plans with no cash settlement feature starting in the current fiscal year. For the three months ended February 29, 2004, the company did not grant options to its employees and directors. 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 expense for the 2003 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:

Offshore Systems International Ltd.

Canadian GAAP

Notes to the Consolidated Financial Statements (unaudited)

February 29, 2004 and February 28, 2003

(expressed in Canadian dollars)

	February 29, 2004 \$	February 28, 2003 \$
Earnings for the year	551,791	248,248
Additional compensation expense	6,300	359,224
Pro forma net earnings (loss)	545,491	(110,976)
Pro forma basic earnings (loss) per share	0.02	0.00
Pro forma diluted earnings (loss) per share	0.02	0.00

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%; (ii) expected volatility between 45% and 114%; (iii) an estimated average life of 1 to 5 years; and (iv) an expected dividend yield of 0%.

The weighted average fair value of the options granted during the period ended February 28, 2003 was \$0.52 per option.

8 Segmented information

The company's reportable segments are as outlined below. Accounting policies used by these segments are the same as those described in the significant accounting policies as disclosed in note 2 of the company's audited financial statements for the year ended November 30, 2003

	February 29, 2004			
	Navigation Systems \$	Applications \$	Geomatics \$	Total \$
Revenue	3,280,098	28,318	721,344	4,029,760
Gross profit	2,396,046	18,968	153,759	2,568,773
Technology Partnerships Canada - net	-	-	-	-
Interest expense	191	-	77	268
Income tax recovery	(46,111)	-	-	(46,111)
Net earnings	970,291	(311,300)	(107,200)	551,791
Property, plant and equipment expenditures	37,010	2,480	3,144	42,634
Amortization	54,800	77	23,168	78,045

Offshore Systems International Ltd.

Canadian GAAP

Notes to the Consolidated Financial Statements (unaudited)

February 29, 2004 and February 28, 2003

(expressed in Canadian dollars)

	February 28, 2003		
	Systems \$	Geomatics \$	Total \$
Revenue	2,868,956	694,219	3,563,175
Gross Profit	1,609,411	251,076	1,860,487
Technology Partnerships Canada - net	(258,783)	-	(258,783)
Interest expense	-	250	250
Income tax recovery	-	-	-
Net earnings	230,489	17,759	248,248
Property, plant and equipment expenditures	19,067	10,687	29,754
Amortization	58,699	23,866	82,565

	February 29, 2004		
	Systems \$	Geomatics \$	Total \$
Total assets employed	10,286,904	1,840,394	12,127,298

	November 30, 2003		
	Systems \$	Geomatics \$	Total \$
Total assets employed	10,103,117	1,625,140	11,728,257

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

	February 29, 2004	February 28, 2003
	\$	\$
Europe	2,065,021	1,111,420
Australia/New Zealand	948,263	-
United States	895,593	1,604,794
Canada	120,883	846,961
Total	4,029,760	3,563,175

Geographically, property, plant and equipment are reported based on location. At February 29, 2004 and November 30, 2003, all of the company's property, plant and equipment was located in Canada.

Offshore Systems International Ltd.

Canadian GAAP

Notes to the Consolidated Financial Statements (unaudited)

February 29, 2004 and February 28, 2003

(expressed in Canadian dollars)

9 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 February 29, 2004, the Company had forward exchange contracts maturing in the following year to sell United States dollars in the amount of US\$1,186,836. The exchange rates set in the forward exchange contracts ranged between \$1.3047 to \$1.4029 for US\$1.00. The contracts mature between March 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 February 28, 2004. The fair value of the above derivative financial instruments was a liability of \$41,237.

10 Reclassifications

Certain balances for the three months ended February 28, 2003 have been reclassified to conform to the presentation adopted for the current period.

11 Subsequent Events

On March 4, 2004, the company announced that its teaming partner, Nautronix Ltd, has signed the final prime contract to supply the Royal Australian Navy with a fleet installation of the Company's ECPINS®-M electronic chart navigation system. Delivery of software licenses and some hardware installations begins in September 2004. The total contract value, including delivery of further hardware, training and the support services necessary for additional installations, is approximately CDN \$8 million.