

Offshore Systems International Ltd.

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

Six Months Ended May 31, 2004 and 2003

(expressed in Canadian dollars)

Offshore Systems International Ltd.

Canadian GAAP

Consolidated Balance Sheets (unaudited)
(expressed in Canadian dollars)

	As at	
	May 31, 2004	November 30, 2003
	\$	\$
Assets		
Current assets		
Cash and cash equivalents	1,017,005	3,837,555
Accounts receivable (note 2)	8,605,663	4,621,836
Inventory (note 3)	717,147	665,503
Prepaid expenses and deposits	254,432	430,419
Future tax assets	938,003	822,523
	<hr/>	<hr/>
	11,532,250	10,377,836
Property, plant, and equipment (note 4)	<hr/>	<hr/>
	1,432,967	1,350,421
	<hr/>	<hr/>
	12,965,217	11,728,257
Liabilities and Shareholders' Equity		
Current liabilities		
Accounts payable and accrued liabilities (note 5)	2,466,429	2,126,061
Billing in excess of revenues	88,378	45,907
Rent payable	-	133,942
	<hr/>	<hr/>
	2,554,807	2,305,910
Accrued long-term royalties	<hr/>	<hr/>
	93,694	187,384
	<hr/>	<hr/>
	2,648,501	2,493,294
Commitments and contingencies (notes 2 and 6)		
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 (2003 – 30,262, note 6(b))	-	-
57,711 Class B preference shares – Series 1 (2003 – 61,244, note 6(c))	1,926,157	2,065,420
27,378,675 Common shares (2003 - 26,807,475, note 6(a))	18,943,062	18,508,498
	<hr/>	<hr/>
	20,869,219	20,573,918
Warrants (note 6(c))	661,575	661,575
Additional Paid-in Capital	157,474	43,050
Deficit	<hr/>	<hr/>
	(11,371,552)	(12,043,580)
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	10,316,716	9,234,963
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	12,965,217	11,728,257

See accompanying notes to consolidated financial statements

Offshore Systems International Ltd.

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Consolidated Statement of Earnings and Deficit (unaudited)

For the six months ended May 31, 2004 and 2003

(expressed in Canadian dollars)

	Three Months Ended May 31		Six Months Ended May 31	
	2004 \$	2003 \$	2004 \$	2003 \$
Revenue				
Software	1,397,516	42,692	4,390,779	248,069
Geomatics	998,970	914,768	1,717,703	1,606,962
Systems and system components	227,344	1,837,497	414,238	4,422,014
Other	150,005	163,070	280,875	244,157
	2,773,835	2,958,027	6,803,595	6,521,202
Cost of sales	998,832	1,263,781	2,459,819	2,966,469
Gross profit	1,775,003	1,694,246	4,343,776	3,554,733
Expenses				
General and administrative	1,006,462	599,816	1,736,535	1,294,260
Research and development	583,351	400,977	1,046,575	884,072
Sales and marketing	735,541	501,914	1,528,818	1,003,565
Amortization	55,978	58,736	108,044	113,350
Interest	103	39	371	289
Foreign exchange loss (gain)	8,101	46,255	(16,640)	183,223
Technology Partnerships Canada royalty	7,708	13,221	56,634	52,444
Technology Partnerships Canada contribution	(851,542)	(78,874)	(851,542)	(376,880)
	1,545,702	1,542,084	3,608,795	3,154,323
Earnings before income taxes	229,301	152,162	734,981	400,410
Income tax expense/ (recovery)				
Future income tax recovery	(217,363)	-	(496,266)	-
Current income tax expense	147,994	-	380,786	-
	(69,369)	-	(115,480)	-
Net Earnings for the period	298,670	152,162	850,461	400,410
Deficit – Beginning of period	(11,583,655)	(11,956,630)	(12,043,580)	(12,188,284)
Class B preference share dividends	(86,567)	-	(178,433)	-
Premium on purchase and cancellation of common shares	-	(84,762)	-	(101,356)
Deficit – End of period	(11,371,552)	(11,889,230)	(11,371,552)	(11,889,230)
Basic earnings per share (note 6(d))	0.01	0.00	0.03	0.01
Diluted earnings per share (note 6(d))	0.01	0.00	0.03	0.01
Weighted average number of common shares outstanding – basic	27,143,221	26,031,356	27,023,112	26,031,356
Weighted average number of common shares outstanding – diluted	27,807,534	26,922,951	27,802,463	26,922,951

See accompanying notes to consolidated financial statements

Offshore Systems International Ltd.

Canadian GAAP

Consolidated Statements of Cash Flows (unaudited)

For the six months ended May 31, 2004 and 2003

(expressed in Canadian dollars)

	Three Months Ended May 31		Six Months Ended May 31	
	2004 \$	2003 \$	2004 \$	2003 \$
Cash flows used in operating activities				
Net earnings for the period	298,670	152,162	850,461	400,410
Items not affecting cash				
Amortization	83,802	87,371	161,849	169,936
Stock based compensation	114,424	21,000	114,424	43,050
Future tax assets	(64,470)	-	(115,480)	-
	432,426	260,533	1,011,254	613,396
Changes in non-cash working capital items				
Accounts receivable	(1,359,153)	(744,099)	(3,983,827)	491,481
Inventory	(81,880)	114,858	(51,644)	621,531
Prepaid expenses and deposits	91,029	23,523	175,987	(24,544)
Accounts payable and accrued liabilities	312,017	(184,478)	253,801	(293,429)
Billings in excess of revenues	43,993	(62,409)	42,471	(1,519,373)
Rent payable	(133,942)	-	(133,942)	-
Accrued long term royalties	(46,845)	97,085	(93,690)	(146,064)
	(1,174,781)	(755,520)	(3,790,844)	(870,398)
	(742,355)	(494,987)	(2,779,590)	(257,002)
Cash flows from (used in) financing activities				
Issue of Common shares	264,239	56,432	315,416	65,560
Issue of Class B preference shares - Series 1 and warrants, net of issue costs	(20,115)	(14,540)	(20,115)	2,726,995
Class B preference share dividends declared and paid	-	-	(91,866)	-
Share repurchases	-	(223,012)	-	(271,175)
	244,124	(181,120)	203,435	2,521,380
Cash flows used in investing activities				
Additions to property, plant, and equipment	(201,759)	(172,659)	(244,395)	(202,413)
Increase/(decrease) in cash and cash equivalents	(699,190)	(848,766)	(2,820,550)	2,061,965
Cash and cash equivalents – Beginning of period	1,716,195	6,154,779	3,837,555	3,244,048
Cash and cash equivalents – End of period	1,017,005	5,306,013	1,017,005	5,306,013

See accompanying notes to consolidated financial statements

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Notes to the Consolidated Financial Statements (unaudited)

May 31, 2004

(expressed in Canadian dollars)

1 Basis of preparation

The accompanying unaudited interim 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 Canadian generally accepted accounting principles ("GAAP"), applied on a consistent basis with the audited consolidated annual financial statements for the year ended November 30, 2003, except as described in Note 7 with respect to the accounting for stock-based compensation. These unaudited interim financial statements do not include all the disclosures required by Canadian GAAP for annual financial statements. These unaudited interim consolidated financial statements should be read in conjunction with the audited financial statements included in the company's Annual Report for the year ended November 30, 2003.

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

2 Accounts receivable

	May 31, 2004	November 30, 2003
	\$	\$
Trade receivables	3,194,769	1,691,685
Unbilled revenue	4,512,165	2,854,942
Technology Partnerships Canada receivable (note 8)	851,542	-
Other	47,187	75,209
	<hr/>	<hr/>
	8,605,663	4,621,836
	<hr/>	<hr/>

3 Inventory

	May 31, 2004	November 30, 2003
	\$	\$
Materials and components	672,073	620,429
Finished goods	45,074	45,074
	<hr/>	<hr/>
	717,147	665,503
	<hr/>	<hr/>

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Notes to the Consolidated Financial Statements (unaudited)

May 31, 2004

(expressed in Canadian dollars)

4 Property, plant, and equipment

	May 31, 2004		
	Cost	Accumulated	Net
	\$	Amortization	\$
		\$	\$
Equipment	3,837,390	2,935,588	901,802
Computer software	900,281	457,836	442,445
Furniture and fixtures	126,534	90,394	36,140
Leasehold improvements	222,737	189,379	33,358
Licenses and patents	57,267	38,045	19,222
	<u>5,144,209</u>	<u>3,711,242</u>	<u>1,432,967</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

	May 31, 2004	November 30, 2003
	\$	\$
Trade payables	1,242,450	1,171,353
Accrued liabilities	481,236	362,681
Accrued employee costs	505,809	408,592
Accrued royalties	150,367	183,435
Dividends	86,567	-
	<u>2,466,429</u>	<u>2,126,061</u>

Offshore Systems International Ltd.

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Notes to the Consolidated Financial Statements (unaudited)

May 31, 2004

(expressed in Canadian dollars)

6 Capital Stock

(a) Issued and outstanding Common shares

	May 31, 2004		November 30, 2003	
	Number of common shares	Amount \$	Number of Common shares	Amount \$
Balance – Beginning of period	26,807,475	18,508,498	26,043,243	18,220,929
Issued during the period:				
Exercise of stock options	410,448	315,416	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 period	27,378,675	18,943,062	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

	May 31, 2004		November 30, 2003	
	Number of Class B preference shares	Amount \$	Number of Class B preference shares	Amount \$
Balance – Beginning of period	61,244	2,065,420	-	-
Issued during the period:				
Class B preference shares issued	-	-	61,244	2,342,625
Share issue costs	-	(20,115)	-	(277,205)
Class B preference shares Converted	(3,533)	(119,148)	-	-
Balance – End of period	57,711	1,926,157	61,244	2,065,420

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Notes to the Consolidated Financial Statements (unaudited)

May 31, 2004

(expressed in Canadian dollars)

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 \$297,320. 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 interest rate of 2.7%, (ii) expected volatility of 66%, (iii) an estimated life of 5 years and (iv) an expected dividend rate of 0%.

Dividends payable amount to \$86,567 for the six months ended May 31, 2004 and have been recorded in the accompanying financial statements as they have been declared.

(d) Earnings per share

	Three Months Ended		Six Months Ended	
	May 31 2004	2003	May 31 2004	2003
Basic earnings per share				
Net earnings	\$ 298,670	\$ 152,162	\$ 850,461	\$ 400,410
Less: Class B preferred share dividends	43,283	45,933	86,567	45,933
Net earnings available to common shareholders	<u>\$ 255,387</u>	<u>\$ 106,229</u>	<u>\$ 763,894</u>	<u>\$ 354,477</u>
Weighted average number of common shares outstanding	<u>27,023,112</u>	<u>26,031,356</u>	<u>27,023,112</u>	<u>26,031,356</u>
Basic earnings per share	<u>\$ 0.01</u>	<u>\$ 0.00</u>	<u>\$ 0.03</u>	<u>\$ 0.01</u>
Diluted earnings per share				
Net earnings	\$ 298,670	\$ 152,162	\$ 850,461	\$ 400,410
Less: Class B preferred share dividends	43,283	45,933	86,567	45,933
Net earnings available to common shareholders	<u>\$ 255,387</u>	<u>\$ 106,229</u>	<u>\$ 763,894</u>	<u>\$ 354,477</u>
Weighted average number of common shares outstanding	27,023,112	26,031,356	27,023,112	26,031,356
Dilutive effect of Class A preference shares – Series A	30,262	30,262	30,262	30,262
Dilutive effect of Class B preference shares – Series 1 (*1)	-	-	-	-
Dilutive effect of warrants	92,624	-	92,624	-
Dilutive effect of stock options	656,465	861,333	656,465	861,333
Adjusted weighted average number of common shares outstanding	<u>27,802,463</u>	<u>26,922,951</u>	<u>27,802,463</u>	<u>26,922,951</u>
Diluted earnings per share	<u>\$ 0.01</u>	<u>\$ 0.00</u>	<u>\$ 0.03</u>	<u>\$ 0.01</u>

(*1) The Class B preference shares are anti-dilutive for the purposes of calculating diluted earnings per share for both the three and six months ended May 31, 2004 and 2003.

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May 31, 2004

(expressed in Canadian dollars)

(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 premium on the purchase and cancellation of the common shares under the normal course issuer bid was \$187,181 and was charged to the deficit. The premium on the purchase and cancellation of 242,600 common shares for the six months ended May 31, 2003 was \$101,356.

7 Stock-based compensation

Effective December 1, 2002 the Company adopted CICA Handbook Section 3870 Stock-based Compensation and Other Stock-based Payments ("CICA 3870"). 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 based on the fair value method, starting in the current fiscal year. As permitted by the standard, the company has applied this change prospectively for new awards granted on or after December 1, 2003. The Company continues to provide pro forma disclosures with respect to options granted in the year ended November 30, 2003. Direct awards of stock to employees, stock options 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 in accordance with the provisions of CICA 3870, the Company's net earnings and earnings per basic and diluted share would have been adjusted to the pro forma amounts indicated below:

	Six Months Ended May 31	
	2004	2003
	\$	\$
Net earnings for the period	850,461	400,410
Additional compensation expense	12,600	399,713
Pro forma net earnings for the period	837,861	697
Pro forma basic earnings per share	0.03	0.00
Pro forma diluted earnings per share	0.03	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 six months ended May 31, 2004 was \$0.46 per option.

In addition, the net earnings for the six months ended May 31, 2004 includes a charge for stock-based compensation of \$114,421 (2003 - \$21,000)

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May 31, 2004

(expressed in Canadian dollars)

8 Technology Partnerships Canada

On April 26, 2004, the Company entered into an agreement with Technology Partnerships Canada ("TPC") whereby TPC granted financial assistance to the Company for the purpose of funding research and development activities to be completed on or before March 31, 2007. The maximum eligible contribution by TPC is \$3,768,391. As at May 31, 2004, the Company has claimed for \$851,542 of assistance under the agreement. In addition, the Company is required to pay a royalty of 1.4% on annual gross Navigation Systems and Applications revenue for the period January 1, 2006 to December 31, 2008 and a royalty of 2.5% on annual gross Navigation Systems and Applications revenue for the period January 1, 2009 to December 31, 2013. Royalty payments will continue until the cumulative royalties paid or payable to December 31, 2013 are at least \$6,079,176 or until December 31, 2017. No amounts for royalty payments, in connection with this agreement have been recorded in the financial statements.

On November 15, 1999, the company entered into an agreement with TPC whereby 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. Under the agreement with TPC, the company was 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. In addition, the company is required to pay a royalty of 3% on annual gross Navigation Systems and Applications revenue for the period December 1, 1999 to November 30, 2008. 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.

9 Segmented information

The company's reportable segments are as outlined below.

	Three Months Ended May 31, 2004			
	Navigation Systems \$	Applications \$	Geomatics \$	Total \$
Revenue	1,691,056	39,986	1,042,793	2,773,835
Gross profit	1,252,341	29,699	492,963	1,775,003
Technology Partnerships Canada - net	(782,654)	(61,180)	-	(843,834)
Interest expense	37	-	66	103
Income tax recovery	(69,369)	-	-	(69,369)
Net earnings (loss)	365,567	(214,047)	147,150	298,670
Property, plant and equipment expenditures	34,006	11,929	155,824	201,759
Amortization	55,811	538	27,453	83,802

	Six Months Ended May 31, 2004			
	Navigation Systems \$	Applications \$	Geomatics \$	Total \$
Revenue	4,971,154	68,304	1,764,137	6,803,595
Gross profit	3,648,387	48,667	646,722	4,343,776
Technology Partnerships Canada - net	(733,728)	(61,180)	-	(794,908)
Interest expense	228	-	143	371
Income tax recovery	(115,480)	-	-	(115,480)
Net earnings (loss)	1,335,857	(525,346)	39,950	850,461
Property, plant and equipment expenditures	71,016	14,409	158,968	244,393
Amortization	110,612	615	50,620	161,847

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May 31, 2004

(expressed in Canadian dollars)

	Three Months Ended May 31, 2003			
	Navigation	Applications	Geomatics	Total
	Systems			
	\$	\$	\$	\$
Revenue	2,045,284	-	912,743	2,958,027
Gross profit	1,256,884	-	437,362	1,694,246
Technology Partnerships Canada - net	(65,653)	-	-	(65,653)
Interest expense	-	-	39	39
Net earnings	62,185	-	89,977	152,162
Property, plant and equipment expenditures	145,361	-	27,298	172,659
Amortization	62,249	-	25,122	87,371

	Six Months Ended May 31, 2003			
	Navigation	Applications	Geomatics	Total
	Systems			
	\$	\$	\$	\$
Revenue	4,914,240	-	1,606,962	6,521,202
Gross profit	2,866,295	-	688,438	3,554,733
Technology Partnerships Canada - net	(324,436)	-	-	(324,436)
Interest expense	-	-	289	289
Net earnings	292,674	-	107,736	400,410
Property, plant and equipment expenditures	164,428	-	37,985	202,413
Amortization	120,948	-	48,988	169,936

	May 31, 2004			
	Navigation	Applications	Geomatics	Total
	Systems			
	\$	\$	\$	\$
Total assets employed	10,835,898	13,794	2,115,525	12,965,217

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

The Applications business unit began operations effective fiscal year 2004.

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May 31, 2004

(expressed in Canadian dollars)

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

	Three Months Ended May 31		Six Months Ended May 31	
	2004 \$	2003 \$	2004 \$	2003 \$
Europe	415,953	872,094	2,480,974	1,983,514
Australia/New Zealand	1,019,610	-	1,967,873	-
United States	832,518	995,649	1,728,111	2,600,443
Canada	505,754	1,090,284	626,637	1,937,245
Total	2,773,835	2,958,027	6,803,595	6,521,202

Geographically, property, plant and equipment are reported based on location. At May 31, 2004 and November 30, 2003, all of the Company's property, plant and equipment was located in Canada.

10 Financial instruments

Fluctuations in foreign currency exchange rates

The company enters into transactions denominated in United States and Australian dollars and as such its revenue, expenses, monetary assets and liabilities will be affected by fluctuations in the United States and Australian dollar relative to its functional currency, the Canadian dollar.

The company uses foreign exchange forward contracts to hedge transactions denominated in United States and Australian 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 and Australia. At May 31, 2004, the Company had forward exchange contracts maturing in the current period to sell United States dollars in the amount of US\$818,398. The exchange rates set in the forward exchange contracts ranged between \$1.3601 to \$1.3906 for US\$1.00. The contracts mature between June and October 2004. The Company also entered into forward exchange contracts in the current period to sell Australian dollars in the amount of AUD\$2,750,000. The exchange rates set in the forward exchange contracts ranged between \$0.9473 to \$0.9674 for AUD\$1.00. The contracts mature between November 2004 and May 2005.

The fair value of derivative instruments generally reflects the estimated amounts that the company would receive or pay to settle the contracts at May 31, 2004. The fair value of the above derivative financial instruments was an unrecorded benefit of \$24,166 at May 31, 2004.

11 Reclassifications

Certain balances for the three and six months ended May 31, 2003 have been reclassified to conform to the presentation adopted for the current period.