



# Offshore Systems International Ltd.

## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

For the six months ended May 31, 2004

## **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 and 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.

## **Overview**

The Company's financial statements are prepared in accordance with Canadian generally accepted accounting principles ("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, results of operations and financial condition of the Company for the six months ended May 31, 2004 in comparison with those for the six months ended May 31, 2003 and for the three months ended May 31, 2004 in comparison with those for the three months ended May 31, 2003. This discussion should be read in conjunction with the Company's unaudited interim consolidated financial statements for the six months ending May 31, 2004, its 2003 Audited Consolidated Financial Statements and the 2003 year end Management's Discussion and Analysis of Financial Condition and Results of Operations.

Founded in 1977, the Company designs, develops and markets the proprietary ECPINS® line of electronic chart navigation systems for commercial and military customers. 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. The Company has developed a strong market position in military navigation, and has ECPINS® systems deployed with the Canadian and United States Coast Guards, the Canadian Navy, the New Zealand Royal Navy, the Royal Danish Navy and the United States Navy. In 2004, the Company is delivering software and system products to the Royal Navy of the United Kingdom and the Royal Australian Navy.

In 2002, the Company expanded the business scope of its wholly-owned subsidiary Offshore Charts Ltd. beyond production of electronic navigation charts to include production of land-based mapping products. The Offshore Charts Ltd. subsidiary was also renamed OSI Geomatics Ltd. to better reflect its business expansion. The Company's U.S. subsidiary – Offshore Systems

International Inc. was renamed OSI Geomatics Inc. and reactivated to enter the U.S. mapping market. Collectively, the two subsidiaries form the Company's new business unit – OSI Geomatics.

In February 2003, the Company announced the launch of a new product, Common Operational Picture - Image Display Server ("COP-IDS®"), a client server application that allows customers to integrate the Company's mapping and imagery display technology into existing Command and Control ("C2") systems rapidly and cost effectively. 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. COP-IDS® is designed to meet the emerging requirements of 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 C2 systems, regardless of which C2 applications systems are in use. COP-IDS® is a C2 product that addresses the needs of not only Navy applications but also Army, Air Force, Special Forces and joint forces operations.

Starting in the Company's 2004 fiscal year, it added a new line of business – OSI Applications, which will develop software applications and tools for situational awareness. OSI Applications is a division of the Company's subsidiary Offshore Systems Ltd. The Applications business unit provides 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 – Image Display Server (COP-IDS®).

The Company plans to grow through internal growth, focused on new and existing customers in the military agencies of Canada, U.S., European NATO and other allies of Canada. In addition, the Company may pursue strategic alliances, investments and acquisitions that are complimentary to its existing lines of business.

## **Overall Performance**

### **Net Earnings**

For the six months ended May 31, 2004, the Company had net earnings of \$850,461 or \$0.03 per share on a basic and diluted basis. For the three months ended May 31, 2004, the Company had net earnings of \$298,670 or \$0.01 per share on a basic and diluted basis.

The Company's results for the three and six months ended May 31, 2004 were largely driven by the Company's successful selection for the major fleet contracts with the Royal Navy, as part of the successful teaming arrangement with Lockheed Martin UK and Kelvin Hughes Ltd. and with the Royal Australian Navy, as part of the successful teaming arrangement with Nautronix Ltd. and Scientific Management Associates. In addition, on April 24, 2004, the Company signed an agreement with Technology Partnerships Canada ("TPC") that provides the Company with financial assistance to fund research and development activities. For a further discussion of these matters, please refer to the "**Results of Operations**" section of this document.

### **Backlog**

Total backlog as at May 31, 2004 is \$22.6 million compared to \$3.3 million at November 30, 2003 and \$5.4 million at May 31, 2003. 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 May 31, 2004 was at \$8.7 million compared to \$0.9 million at November 30, 2003 and \$2.5 million at May 31, 2003. 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 May 31, 2004 was at \$13.9 million compared to \$2.4 million at November 30, 2003 and \$2.9 million at May 31, 2003. There is no guarantee or certainty that the Company's customers will elect to exercise their contract option backlog. Should the Company's customers elect to exercise contract options or place orders against indefinite-quantity contracts, the option backlog converts to firm backlog.

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 quarter to another. The increased firm backlog and option balances at May 31, 2004 as compared to May 31, 2003 were the result of the Company and its partners winning the Royal Navy tender and additional contract awards from the Royal Australian Navy.

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 be terminated by the contracting government agency should future budget funding not be approved. Historically, the termination-for-convenience clause has not exercised by any Company customer. Therefore, the Company has included the full value of these contracts in total backlog as no evidence exists that the contracts would be terminated.

## **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.

**The Company depends heavily on its 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 the Company's 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. That could have a negative impact on the Company's operations. Also, the Company cannot give assurance that it would be able to procure new government contracts to offset the revenues lost as a result of any termination of its contracts. As the Company's revenues are dependent on its procurement, performance and payment under its contracts, the loss of one or more critical contracts could have a negative impact on the Company's financial condition.

In addition, sales to the governments the Company's work with may be affected by:

- changes in procurement policies;
- changes in the structure and management of government departments;
- budget considerations;
- changing concepts of national defence; and
- political developments domestically and abroad.

The influence of any of these factors, which are largely beyond the Company's control, could also negatively impact its financial condition.

**The Company derives a significant amount of revenue from only a few customers. The Company depends on national and international governments for a significant portion of its sales, and the loss of any of these relationships or a shift in any of these governments' funding could have severe consequences on the Company's financial condition.**

Approximately 75% of the Company's revenue in the six months ended May 31, 2004 was from the U.S. Coast Guard, Royal Navy and Royal Australian Navy. Approximately 91% of the Company's revenue in the six months ended May 31, 2004 was from national and international governments. Therefore, any significant disruption or deterioration of any of the Company's relationships with these entities' governments would significantly reduce its 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 the Company is not involved could have severe consequences for its results of operations.

**The Company's product lines are not broadly diversified.**

The Company derives and expects to derive a substantial majority of its revenue from navigational software, systems and equipment sales. If customers do not purchase the Company's products as a result of competition, technological change, budget constraints or other factors, the Company does not have other product categories that it could rely on to make up any shortfall in sales. As a result, the Company's revenue could decrease and its business and operating results would be adversely affected.

**The Company derives a significant portion of its revenues from international sales and is subject to the risks of doing business in foreign countries.**

In the six months ended May 31, 2004, approximately 91% of the Company's revenues were from international customers, including governmental customers: 25% from the United States and 66% from other international countries. The Company expects that international sales will continue to account for a significant portion of its revenues for the foreseeable future. As a result, the Company is subject to the 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 dealing with 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 the Company's operations in the future.

**The Company's revenues and costs are affected by fluctuations in the rate of exchange between the Canadian dollar, which is its reporting currency, and the U.S. dollar.**

Exposure to exchange rate fluctuations exists because a significant portion of the Company's trade receivable and revenue transactions are in U.S. dollars. In addition, certain of the Company's sub contract payable and direct cost transactions are in U.S. dollars. In fiscal 2003, approximately 63% of the Company's revenue and 12% of its expenses were transacted in U.S. dollars. The Company expects that U.S. dollar sales will continue to account for a significant portion of its revenues for the foreseeable future. As a result, exchange rate fluctuations may affect the Company's revenue and earnings growth materially in the future.

**The Company has established teaming relationships and strategic partnerships with international corporations to pursue major international government procurements, and its reputation and results of operations could be adversely affected by the Company's inability to control their operations.**

The Company relies on agreements with international corporations to assist it in pursuing contracts for major government procurements. These international corporations often assist the Company with systems integration, complimentary products and services, and local domain knowledge necessary to successfully pursue major government procurements. The Company does not have assurance that these third parties will:

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

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

**The Company may lose sales, or sales may be delayed, because of the long sales and implementation cycles for its products and services.**

The company's customers have typically invested substantial time, money and other resources and have many people in the decision to license the Company's software products and purchase its hardware products and services. As a result, the Company may wait up to two or three years after the first contact with a customer for that customer to enter into a purchase agreement while the customer seeks internal approvals for the purchase of our products and/or services. During this long sales cycle, events may occur that affect the size or timing of the purchase or even cause the order to be cancelled.

Even if a purchase agreement is signed, the time period required to deploy the Company's products varies significantly from one customer to the next. Implementing the Company's product can sometimes take several months or even a few years depending on the customer's needs. It may be difficult to deploy our product if the customer has complicated deployment requirements. If a customer utilizes a third party to deploy the Company's products, we cannot guarantee that the Company's products will be deployed successfully.

As a result, the Company's revenue could decrease and its business and operating results would be adversely affected.

**Competition within the Company's markets may reduce its procurement of future contracts and its sales.**

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

**The Company's future success will depend on its ability to develop new technologies that achieve market acceptance.**

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

- identify emerging technological trends in the Company's market;

- develop and maintain competitive products;
- enhance the Company's products by adding innovative features that differentiate its products from those of its competitors; and
- manufacture and bring products to market quickly at cost-effective prices.

The Company believes that, in order to remain competitive in the future, it 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 the Company's products will develop or continue to expand as the Company currently anticipates. The failure of the Company's technology to gain market acceptance could significantly reduce its revenues and harm its business. Furthermore, the Company cannot be sure that its competitors will not develop competing technology, which gains market acceptance in advance of the Company's products. The possibility that the Company's competitors might develop new technology or products might cause the Company's existing technology and products to become obsolete. If the Company fails in its new product development efforts or its products fail to achieve market acceptance more rapidly than the Company's competitors, its revenues will decline and its business, financial condition and results of operations will be negatively affected.

**The Company depends on the recruitment and retention of qualified personnel, and its failure to attract and retain such personnel could seriously harm its business.**

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

**The Company does not have fixed-term employment agreements with its officers and key employees and the loss of any officer or key employee could seriously harm the Company's business.**

The Company has not entered into fixed-term employment agreements with its officers and key employees. The Company's success depends upon the abilities and experience of its officers and key employees. Competition for highly skilled management, engineering, technical and other key employees is intense. The loss of officers and key employees could seriously disrupt the Company's operations and impair its ability to compete.

**The Company depends on offshore sub-contract labour in its geomatics and navigation systems operations to maintain a competitive position in the geomatics and navigation systems marketplaces.**

The Company's geomatics and navigation systems operations are highly dependent upon labour resources located outside North America. While the Company enters into sub-contract agreements with these suppliers, it cannot be sure that the labour resources will be available when required and at the levels required. Accordingly, maintaining the Company's competitiveness will depend upon 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 the Company;
- 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 the Company's geomatics and systems operations in the future.

**The Company may be unable to adequately protect its intellectual property rights, which could affect its ability to compete.**

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

**The Company's operations depend on component availability and its key suppliers to manufacture and deliver its products and services.**

The Company's operations are highly dependent on the timely delivery of materials by outside suppliers. While the Company enters into purchase agreements with a few of its suppliers, the Company cannot be sure that materials, components, and subsystems will be available in the quantities required, if at all. If any of the suppliers fail to meet the Company's needs, it may not have readily available alternatives. The Company's inability to fill its supply needs would jeopardize its ability to satisfactorily complete the Company's obligations under its 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 the Company's reputation and relationships with its customers. All of these events could have a negative effect on the Company's financial condition.

**The unpredictability of the Company's results may harm or contribute to the volatility of the trading price of its common stock.**

The Company's operating results may vary significantly over time for a variety of reasons, many of which are outside its control and any of which may harm its business. The value of the Company's common stock 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 and corporate spending patterns;
- the timing of contract receipt and funding;
- the Company's ability and the ability of its key suppliers to respond to changes in customer orders;
- the timing of the Company's new product introductions and its 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.

**The Company may pursue strategic relationships, investments and acquisitions. The Company may not be able to successfully manage its operations if it fails to successfully integrate the acquired technologies and/or businesses.**

As part of the Company's business strategy, it may expand its product offerings to include application software products that are complementary to the Company's 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 its 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 the Company. 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 the Company's ongoing business;
- undisclosed liabilities;
- failure to realize anticipated benefits (such as synergies and cost savings);
- the difficulty of integrating previously distinct businesses into one business unit; and
- technological uncertainty regarding the current and future functionality of the product.

**The Company may require additional capital, in which case it may need to raise additional funds from lenders and equity markets in the future.**

If the Company's expenditures exceed its incoming cashflows, the Company may choose to raise additional capital. In addition, the Company may choose to pursue additional financing in order to capitalize on potential opportunities in the marketplace that may accelerate its growth objectives. The Company's ability to arrange such financing in the future will depend in part on the prevailing capital market conditions as well as on its business performance. There can be no assurance that the Company will be successful in its efforts to raise additional funds, if needed, on terms satisfactory to it. If additional capital is raised by the issuance of shares, shareholders may experience dilution to their equity interest in the Company.

**The Company's business could be adversely affected if it fails to manage its growth effectively.**

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

- improve its financial and management controls, reporting systems and procedures;
- add and integrate new senior management personnel;
- improve its licensing models and procedures;
- hire, train and retain qualified employees;

- control expenses;
- diversify channel sales strategies; and
- invest in its internal networking infrastructure and facilities.

The Company has committed funds to obtaining additional systems and facilities to accommodate its current and future anticipated growth. To the extent that this anticipated growth does not occur or occurs more slowly than the Company anticipates, it may not be able to reduce expenses to the same degree. If the Company incurs operating expenses out of proportion to revenue in any given quarter, its operating results may be adversely impacted.

**Third parties may claim that the Company infringes their proprietary rights.**

The Company potentially may receive claims that it has 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, the Company may become increasingly subject to infringement claims, including patent, trademark and copyright infringement claims. In addition, former employers of the Company's former, current or future employees may assert claims that such employees have improperly disclosed to the Company 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 the Company's core business, require it to stop selling or delay shipping, or cause the redesign of its product or products. In addition, the Company may be required to pay monetary amounts as damages, for royalty or licensing arrangements, or to satisfy indemnification obligations that it has with some of its customers.

The Company licenses and uses software from third parties in its business. These third party software licenses may not continue to be available to the Company on acceptable terms. Also, these third parties may from time to time receive claims that they have infringed the intellectual property rights of others, including patent and copyright infringement claims, which may affect the Company's ability to continue licensing this software. The Company's inability to use any of this third party software could result in shipment delays or other disruptions in its business, which could materially and adversely affect the Company's operating results.

**The Company may not be able to protect its proprietary information.**

The Company relies on a combination of copyright, trademark and trade secret laws, confidentiality procedures, contractual provisions and other measures to protect its proprietary information. All of these measures afford only limited protection. These measures may be invalidated, circumvented or challenged, and others may develop technologies or processes that are similar or superior to the Company's technology. Despite the Company's efforts to protect its proprietary rights, unauthorized parties may attempt to copy the Company's products or to obtain or use information that the Company regards as proprietary.

**The Company's products may contain significant defects, which may result in liability and/or decreased sales.**

Software products frequently contain bugs, errors or failures, especially when first introduced or when new versions are released. Despite the Company's efforts to test its products, the Company might experience significant errors or failures in its products, or they might not work with other hardware or software as expected. This could delay the development or release of new products or new versions of products, or could adversely affect market acceptance of the Company's products. Customers use the Company's products for applications that are critical to their businesses, and they have a greater sensitivity to product defects than the market for other software products generally. The Company's customers may claim that the Company is responsible for damages to the extent they are harmed by the failure of any of the Company's products. If the Company were to experience significant delays in the release of new products or new versions of products, or if customers were dissatisfied with product functionality or

performance, the Company could lose revenue or be subject to liability for service or warranty costs. Should this occur, the Company's business and operating results could be adversely affected.

**The Company's products depend on third party software products and its reputation and results of operations could be adversely affected by the Company's inability to control their operations.**

The Company's products incorporate and use software products developed by other entities. The Company does not have assurance that such third parties will:

- remain in business;
- support the Company's product lines;
- maintain viable and functional product lines; and
- make their product lines available to the Company on commercially acceptable terms.

Any significant interruption in the supply of such third-party technology could have a materially adverse effect on the Company's business, results of operation, cash flows and financial condition.

**The Company's products may not be compatible with various operating systems and therefore the Company may not be able to sell its products to potential customers.**

The Company's products are used in combination with various operating systems. The Company's future success depends on our ability to continue to support widely-used operating systems. The Company's applications run on Microsoft operating systems. Therefore, the Company's ability to increase sales depends on the continued acceptance of Microsoft operating system products. If the Company is unable to develop and market products that support Microsoft's operating platforms or develop and market products that support other operating systems on a timely and cost effective basis, its business and operating results could be adversely affected.

## Selected Information

### Statement of Earnings Information

	For the six months ended May 31		For the years ended November 30		
	2004	2003	2003	2002	2001
	\$	\$	\$	\$	\$
Revenue	6,803,595	6,521,202	11,520,793	13,868,779	7,919,632
Gross profit	4,343,776	3,554,733	6,361,725	6,771,387	4,585,372
Gross profit percentage	63.8%	54.5%	55.2%	48.8%	57.9%
Net earnings for the period	850,461,400,	410	385,369	1,635,031	496,409
Basic earnings per share	0.03	0.01	0.01	0.06	0.02
Diluted earnings per share	0.03	0.01	0.01	0.06	0.02

**Balance Sheet Information**

	As at May 31		As at November 30		
	2004 \$	2003 \$	2003 \$	2002 \$	2001 \$
Cash and cash equivalents	1,017,005	5,306,013	3,837,555	3,244,048	2,037,625
Working capital	8,977,443	7,235,791	8,071,926	4,449,492	2,848,151
Current assets	11,532,250	9,784,065	10,377,836	8,810,568	6,022,312
Total assets	12,965,217	11,772,411	11,728,257	10,766,438	7,375,007
Current liabilities	2,554,807	2,548,274	2,305,910	4,361,076	3,174,161
Long term debt	93,694	226,653	187,384	372,717	371,484
Total liabilities	2,648,501	2,774,927	2,493,294	4,733,793	3,545,645
Shareholders' equity	10,316,716	8,997,484	9,234,963	6,032,645	3,829,362

The Company's annual and quarterly results 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, gross profit and earnings. Approximately 75% of the Company's revenue in the six months ended May 31, 2004 was from the U.S. Coast Guard, Royal Navy and Royal Australian Navy. Approximately 91% of the Company's revenue in the six months ended May 31, 2004 was from national and international governments.

The increase in revenue in the fiscal year 2002 as compared to the fiscal years 2003 and 2001 were 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 in early FY2003. The fluctuations in revenue quarter over quarter are largely attributable to the level, timing and duration of customer orders, relative mix of contracts and customer product delivery requirements.

The fluctuations in gross profit year over year are largely attributable to projects that include a large proportion of third-party systems or labour resulting in lower gross profit margins. Certain contracts awarded to the Company may require the Company to include third-party systems or labour. In order to maintain competitiveness on these contracts, the Company may elect to reduce its usual margins on the third party components.

**Results of Operations**

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

	Three months ended May 31		Six months ended May 31	
	2004 %	2003 %	2004 %	2003 %
<b>Revenue</b>				
Software	50.4%	1.4%	64.6%	3.8%
Geomatics	36.0%	30.9%	25.2%	24.6%
Systems and system components	8.2%	62.2%	6.1%	67.9%
Other	5.4%	5.5%	4.1%	3.7%
	100.0%	100.0%	100.0%	100.0%
<b>Direct costs</b>	36.0%	42.7%	36.2%	45.5%
<b>Gross profit</b>	64.0%	57.3%	63.8%	54.5%
<b>Expenses</b>				
General and administrative	36.3%	20.3%	25.5%	19.8%
Research and development	21.0%	13.6%	15.4%	13.6%
Sales and marketing	26.5%	17.0%	22.5%	15.4%
Amortization	2.0%	2.0%	1.6%	1.7%
Interest	0.0%	0.0%	0.0%	0.0%
Foreign exchange loss (gain)	0.3%	1.6%	(0.2%)	2.8%
Technology Partnerships Canada royalty	0.3%	0.4%	0.8%	0.8%
Technology Partnerships Canada contribution	(30.7%)	(2.7%)	(12.5%)	(5.8%)
	55.7%	52.2%	53.1%	48.3%
<b>Earnings before income taxes</b>	8.3%	5.1%	10.7%	6.2%
<b>Income tax (recovery)</b>	(2.5%)	0.0%	(1.7%)	0.0%
<b>Net earnings for the period</b>	10.8%	5.1%	12.4%	6.2%

## 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 also derives revenue from the delivery of the ECPINS® software component of its system product.

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. If the Company anticipates that a project or a project segment will generate a loss, the Company estimates that loss and records 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. Revenues generated from contracts with multiple deliverables are allocated to various elements of the arrangement based upon the relative fair value of each component. 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 process is 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.

Consolidated revenue for the three months ended May 31, 2004 was \$2,773,835, compared with \$2,958,027 for the three months ended May 31, 2003, resulting in a decrease of 6%. Consolidated revenue for the six months ended May 31, 2004 was \$6,803,595, compared with \$6,521,202 for the six months ended May 31, 2003, resulting in an increase of 4%. The Company's revenues are primarily affected by the level, timing and duration of customer orders, relative mix of contracts 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 year 2003 ("FY2003"), the Company continued and expanded its business development initiatives with prospective and existing customers. Some of the activities did not result in closing orders during FY2003 but may yield orders in subsequent fiscal years. The selection of the Company for the fleet-wide contract with the Royal Navy as part of a teaming arrangement with Lockheed Martin UK and Kelvin Hughes Ltd. is one example of this situation. The main customers for the Company's products and services were the Royal Navy through Lockheed-Martin UK, the U.S. Coast Guard and the Royal Australian Navy through Nautronix Ltd. Revenue from these customers accounted for 60% of the consolidated revenue for the three months ended May 31, 2004 and for 75% of the consolidated revenue for the six months ended May 31, 2004.

A significant change in the Company's revenue mix occurred in the three and six months ended May 31, 2004. Revenues during this period shifted to Software from Systems and system components. The revenue shift is the result of a change in the nature of contracts the Company entered into during the last fiscal quarter of 2003 and the first two fiscal quarter of 2004. These contracts require the Company to deliver off-the-shelf or customized versions of its ECPINS® software. Should this trend continue, the Company's major revenue source will become ECPINS® software. Historically, the Company's contracts focused on the delivery of ECPINS® electronic chart navigation systems and the Company continues to develop and market its ECPINS® navigation systems.

### Segment Results

Revenue from the Navigation Systems business unit for the three months ended May 31, 2004 was \$1,691,056, compared to \$2,045,284 for the same period last year, a decrease of \$354,228 or 17%. Revenue for the six months ended May 31, 2004 was \$4,971,154, compared to \$4,914,240 for the six months ended May 31, 2003, an increase of \$56,914 or 1%. The changes are the net of two factors - a decrease attributable to the substantial completion of two contracts, the Canadian Department of National Defence contract awarded to the Company in fiscal year 2001 and the Marinette Marine Corp. contracts to provide ECPINS® systems for the U.S. Coast Guard Juniper class buoy tenders, and an increase attributable to the Royal Navy and Royal Australian Navy contracts.

Revenue from the Geomatics business unit for the three months ended May 31, 2004 was \$1,042,793 compared to \$912,743 for the three months ended May 31, 2003, an increase of \$130,050 or 14%. Revenue for the six months ended May 31, 2004 was \$1,764,137 compared to \$1,606,962 for the same period last year, an increase of \$157,175 or 10%. The business unit increased revenue levels in the current fiscal year compared with that of the previous fiscal year primarily as the result of an increase in the number of contracts awarded to the Company.

The Company's new business unit – Applications generated \$39,986 in revenue for the three months ended May 31, 2004 and \$68,304 for the six months ended May 31, 2004. The Applications business unit develops software applications and tools for situational awareness and provides 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 – Image Display Server (COP-IDS®).

In all three business units, 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 increased \$80,757 to \$1,775,003 for the three months ended May 31, 2004 from \$1,694,246 for the same period last year. Gross profit percentage increased to 64.0% for the three months ended May 31, 2004 from 57.3% for the three months ended May 31, 2003. For the six months ended May 31, 2004, the Company's gross profit increased \$789,043 to \$4,343,776 from \$3,554,733 for the six months ended May 31, 2003. Gross profit percentage increased to 63.8% from 54.5% period over period. The increases were attributable to the significant software revenue by the Navigation System business unit for the three and six months ended May 31, 2004. The increase is the result of the shift to delivering off-the-shelf or customized versions of its ECPINS® software from the delivery of ECPINS® electronic chart navigation systems. Should this change in revenue mix continue, the Company will continue to report gross margin percentages that are higher than those reported historically.

### Segment Results

Gross profit from the Navigation Systems business unit for the three months ended May 31, 2004 was \$1,252,341, compared to \$1,256,884 for the same period last year, a slight decrease of \$4,543. Gross profit percentage increased to 74.1% from 61.5% period over period. Gross profit from the Navigation Systems business unit for the six months ended May 31, 2004 was \$3,648,387, compared to \$2,866,295 for the same period last year, an increase of \$782,092 or 27%. Gross profit percentage increased to 73.4% from 58.3% period over period. The increase was attributable to the significant software revenue for the three and six months ended May 31, 2004.

Gross profit from the Geomatics business unit for the three months ended May 31, 2004 was \$492,963 compared to \$437,362 for the same period last year, an increase of \$55,601 or 13%. Gross profit percentage decreased to 47.3% from 47.9% period over period. Gross profit from the Geomatics business unit for the six months ended May 31, 2004 was \$646,722 compared to \$688,438 for the six months ended May 31, 2003, a decrease of \$41,716 or 6%. Gross profit percentage decreased to 36.7% from 42.8% period over period. The decrease is the result of the competitive nature of the geomatics market where customers are very price sensitive.

### **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 other general administrative expenses, net of interest and other income. G&A

increased \$406,646 for the three months ended May 31, 2004 to \$1,006,462 from \$599,816 in same period last year. As a percentage of revenue, G&A increased to 36.3% from 20.3% period over period. For the six months ended May 31, 2004, G&A increased \$442,275 to \$1,736,535 from \$1,294,260 for the six months ended May 31, 2003. As a percentage of revenue, G&A increased to 25.5% from 19.8% period over period. The increase is the result of increased public company costs in investor relations, professional fees, directors fees and directors and officers insurance, as well as charges for stock-based compensation and increased salaries, and decreased interest income that resulted from lower cash reserves during the periods. The Company anticipates G&A will continue to be higher in the current fiscal year when compared with the previous fiscal year as the result of increasing costs associated with regulatory compliance.

## **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. The Company has not capitalized any development costs for the three and six months ended May 31, 2004 and the prior year comparable periods.

The Company continues to invest in new product development in 2004. The Company believes that in order to maintain its technological capabilities, it must continue to develop existing products and introduce new high quality products that challenge and redefine the industry standards. R&D costs increased \$182,374 to \$583,351 or 21.0% of revenue for the three months ended May 31, 2004, compared to \$400,977 or 13.6% of revenue in the same period last year. For the six months ended May 31, 2004, R&D costs increased \$162,503 to \$1,046,575 or 15.4% of revenue, compared to \$884,072 or 13.6% of revenue for the six months ended May 31, 2004. The increase in 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. The increase in R&D costs for the six months ended May 31, 2004 does not reflect approximately \$268,000 that was charged to cost of sales to support the software customization required to meet the needs of specific customers.

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 to March 31, 2003. As at November 30, 2003, the Company has received the maximum eligible contribution of \$4,000,177. 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 May 31, 2004, the Company has accrued for future payment or paid royalties of \$1,173,364. 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.

In April of 2004, TPC announced an agreement with the Company whereby TPC granted financial assistance to the Company to fund research and development activities to March 31, 2007. The maximum eligible contribution is \$3,768,391. As at May 31, 2004, the Company has claimed for \$851,542 of eligible assistance 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. commencing January 2006. 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. There were no royalties paid or payable in connection with this agreement for the three and six months ended May 31, 2004.

