



## Forward-Looking Statements

Statements in this Management's Discussion And Analysis, 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 Management's Discussion And Analysis 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 fiscal year ended November 30, 2004 in comparison with those for the fiscal year ended November 30, 2003 and for the three months ended November 30, 2004 in comparison with those for the three months ended November 30, 2003. This discussion should be read in conjunction with the Company's 2004 Audited Consolidated Financial Statements.

Founded in 1977, the Company designs, develops and markets the proprietary ECPINS<sup>®</sup> line of electronic chart navigation systems for commercial and military customers. ECPINS<sup>®</sup> 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<sup>®</sup> systems deployed with the Canadian and United States Coast Guards, the Canadian Navy, the Royal New Zealand Navy, the Royal Danish Navy, and the United States Navy. In fiscal 2004, the Company delivered software and system products to the Royal Navy of the United Kingdom, the Royal Australian Navy, the Royal New Zealand Navy and the Portuguese 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 OSI Geomatics business unit.

In February 2003, the Company announced the launch of a new product, Common Operational Picture - Image Display Server ("COP-IDS<sup>™</sup>"), 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<sup>™</sup> facilitates

the integration of information from multiple geospatial 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 coalition forces operations.

To capitalize on the potential of COP-IDS™, the Company added a new line of business, OSI Applications, starting in fiscal 2004. OSI Applications develops software applications and tools for situational awareness. OSI Applications is a division of the Company's subsidiary Offshore Systems Ltd. and provides products and services to military forces, government agencies and systems integrators to enable improved situational awareness.

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 complementary to its existing lines of business.

## Overall Performance

### *Earnings*

For the fiscal year ended November 30, 2004, the Company had earnings of \$114,741 or \$0.00 per share on a basic and diluted basis compared to earnings of \$385,369 or \$0.01 per share for the fiscal year ended November 30, 2003.

The Company's results for fiscal 2004 were largely driven by the Company's revenue growth, increased sales and marketing expenses, the increasing costs of regulatory compliance and financial assistance received from Technology Partnerships Canada.

The Company was selected for major fleet contracts with the Royal Navy of the United Kingdom, as part of a teaming arrangement with Lockheed Martin UK and Kelvin Hughes Ltd., and with the Royal Australian Navy, as part of the teaming arrangement with Nautronix Ltd. and Scientific Management Associates. Also, the Royal New Zealand Navy had exercised contract options with delivery occurring during the third quarter. In addition, on April 26, 2004, the Company signed a second agreement with Technology Partnerships Canada ("TPC") that provides the Company with financial assistance to fund research and development activities. This assistance reduces the operating expenditures of the Company. For a further discussion of these matters, please refer to the "**Results of Operations**" section of this document.

### *Backlog*

Total backlog as at November 30, 2004 was \$21.1 million compared to \$3.3 million at November 30, 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 November 30, 2004 was \$8.4 million compared to \$0.9 million at November 30, 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 November 30, 2004 was at \$12.7 million compared to \$2.4 million at November 30, 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, which then may convert to revenue as contract execution occurs. Total backlog, firm backlog and option backlog are non-GAAP measures that do not have a standardized meaning and are likely not comparable to similar measures presented by other issuers. These measures also do not have a comparable GAAP measure.

The timing of the awarding of major contracts to the Company can significantly impact the Company's total backlog position and revenue for the period. 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 with a lengthy sales cycle and, as a result, there could be large variations in its total backlog

position and revenue from one fiscal quarter to another. The increased firm backlog and option balances at November 30, 2004 as compared to November 30, 2003 were the result of the Company and its partners winning the Royal Navy of the United Kingdom 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 contracts to be terminated by the contracting government agency should future budget funding not be approved. Historically, the termination-for-convenience clause has not been exercised by any Company customer. The Company has included the full value of these government contracts in total backlog.

## 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-for-convenience clause 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 works 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;
- + political developments domestically and abroad; and
- + increased protectionism.

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 international customers. The Company depends on 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 69% of the Company's revenue for fiscal 2004 was from the U.S. Coast Guard, the Royal Navy of the United Kingdom, the Royal Australian Navy, the Royal New Zealand Navy and the Portuguese Navy. For fiscal 2003 approximately 65% of the Company's revenue was from the U.S. Coast Guard, the Canadian Navy and the Royal Danish Navy. Approximately 87% of the Company's revenue for fiscal 2004 was from national and international governments compared to 91% for fiscal 2003. 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 fiscal year ended November 30, 2004, approximately 89% of the Company's revenues were from international customers, including governmental customers: 21% from the U.S. and 68% from other international countries. For the fiscal year ended November 30, 2003, approximately 71% of the Company's revenues were from international customers, including governmental customers: 44% from the U.S. and 27% from other international countries. The Company has focused its expansion efforts for the future on the American, European and Australasian markets. As a result, 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 cooperation 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, the U.S. dollar, the Australian dollar and the Euro.**

Exposure to exchange rate fluctuations exists because a significant portion of the Company's trade receivable and revenue transactions are in U.S. dollars, Australian dollars and Euros. In addition, certain of the Company's subcontract payable and direct cost transactions are in U.S. dollars. For the fiscal year ended November 30, 2004, approximately 25% of the Company's revenue and 10% of its expenses were transacted in U.S. dollars. During the same period, approximately 11% and 5% of the Company's revenue was transacted in Australian dollars and Euros respectively. For the fiscal year ended November 30, 2003, approximately 63% of the Company's revenues and 12% of its expenses were transacted in U.S. dollars. During the same period, the Company did not have material transactions in Australian dollars or Euros. The Company expects that U.S. dollar, Australian dollar and Euro sales will continue to account for a material 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. In order to reduce the impact of U.S. to Canadian dollar, Australian to Canadian dollar and Euro to Canadian dollar exchange rate fluctuations, the Company utilizes its foreign exchange forward contract facility. As at November 30, 2004, the Company has entered into foreign exchange forward contracts in the amount of U.S. \$851,196, Australian \$3,678,061 and €383,310. As at November 30, 2003, the Company had entered into foreign exchange forward contracts in the amount of U.S. \$1,343,705, Australian \$0, and €0.

**The Company has established teaming relationships and strategic partnerships with international corporations to pursue major international government procurements, and the Company's reputation and results of operations could be adversely affected by the Company's inability to control their partners' 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, complementary 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 involved 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 the Company's 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 products can sometimes take several months or even a few years depending on the customer's needs. It may be difficult to deploy the Company's products 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 that 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 ability to procure contracts and gain sales in foreign markets may be negatively impacted by increasing protectionism of foreign governments.**

Some foreign governments have come under increased pressure to protect their domestic economy and national security. Economic and security concerns have resulted in increasing protectionism that excludes foreign market participants from successfully procuring contracts and gaining sales in foreign markets. As a result, the Company's revenue could decrease and its business and operating results would be adversely affected.

**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 significantly 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 dependent upon labour resources located outside North America. While the Company enters into subcontract 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 subcontractor;
- + the cultural compatibility between Canada and the home country of each subcontractor;
- + 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 subcontractor's home country and the subcontractor.

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 Navigation 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 non-disclosure 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 be required 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. 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 operations, 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 Annual Information**

*Statement of Earnings Information*

	<b>For the years ended November 30</b>		
	<b>2004</b>	2003	2002
	<b>\$</b>	\$	\$
Revenue	<b>13,451,303</b>	11,520,793	13,868,779
Gross profit	<b>7,781,979</b>	6,361,725	6,771,387
Gross profit percentage	<b>57.9%</b>	55.2%	48.8%
Net earnings for the year	<b>114,741</b>	385,369	1,635,031
Basic earnings per share	<b>0.00</b>	0.01	0.06
Diluted earnings per share	<b>0.00</b>	0.01	0.06

*Balance Sheet Information*

	<b>As at November 30</b>		
	<b>2004</b>	2003	2002
	<b>\$</b>	\$	\$
Cash and cash equivalents	<b>251,037</b>	3,837,555	3,244,048
Working capital *	<b>8,287,798</b>	8,071,926	4,449,492
Current assets	<b>10,964,025</b>	10,377,836	8,810,568
Total assets	<b>12,310,738</b>	11,728,257	10,766,438
Current liabilities	<b>2,676,227</b>	2,305,910	4,361,076
Long term liabilities	—	187,384	372,717
Total liabilities	<b>2,676,227</b>	2,493,294	4,733,793
Shareholders' equity	<b>9,634,511</b>	9,234,963	6,032,645
Dividends declared per share:			
Common shares	—	—	—
Class A preference shares	—	—	—
Class B preference shares	<b>3.00</b>	2.37	—

\* Working capital is a non-GAAP measure that does not have a standardized meaning and may not be comparable to similar measures presented by other issuers. This measure does not have a comparable GAAP measure. Working capital is defined as current assets less current liabilities.

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 69% of the Company's revenue for the fiscal year ended November 30, 2004 was from the U.S. Coast Guard, the Royal Navy of the United Kingdom, the Royal Australian Navy, the Royal New Zealand Navy and the Portuguese Navy. Approximately 65% of the Company's revenue for the fiscal year ended November 30, 2003 was from the U.S. Coast Guard, the Danish Navy and the Canadian Navy. Approximately 84% of the Company's revenue for the fiscal year ended November 30, 2002 was from the U.S. Coast Guard, the Danish Navy and the Canadian Navy. Approximately 87% of the Company's revenue for the fiscal year ended November 30, 2004 was from national and international governments compared to 91% and 98% for the fiscal years 2003 and 2002 respectively.

The lower revenue in fiscal 2003 as compared to fiscal 2002 was largely attributable to the substantial completion in fiscal 2002 of the Canadian Department of National Defence contract awarded to the Company in fiscal 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 fiscal 2003. The increase in revenue in fiscal 2004 over fiscal 2003 was the result of contracts from the Royal Navy of the United Kingdom and the Royal Australian Navy that were awarded to the Company in late fiscal 2003 and early fiscal 2004.

The fluctuations in gross profit year over year are impacted negatively by projects that include a large proportion of third-party systems or labour resulting in higher cost of sales. 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. In addition, the product mix of Software, Geomatics, Systems and systems components in any given period may impact the gross profit for the period.

During the first six months of fiscal 2004, the Company's gross profit percentage increased because of an increase in software revenue. During the last six months of fiscal 2004, the Company's gross profit percentage was lower when compared to the first six months as the Software revenue decreased and Systems and systems components revenue increased.

## Results of Operations

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

	For the years ended November 30			
	2004 \$	2004 %	2003 \$	2003 %
<b>Revenue</b>				
Software	5,576,540	41.5	1,036,417	9.0
Systems and system components	4,328,740	32.2	6,208,464	53.9
Geomatics	2,979,728	22.2	3,560,440	30.9
Other	566,295	4.1	715,472	6.2
	<b>13,451,303</b>	<b>100.0</b>	11,520,793	100.0
<b>Cost of sales</b>	<b>5,669,324</b>	<b>42.1</b>	5,159,068	44.8
<b>Gross profit</b>	<b>7,781,979</b>	<b>57.9</b>	6,361,725	55.2
<b>Expenses</b>				
General and administrative	3,435,688	25.5	2,498,021	21.8
Research and development	2,104,806	15.7	1,548,523	13.4
Sales and marketing	3,160,359	23.5	2,000,238	17.4
Amortization	231,033	1.8	241,295	2.1
Interest	2,045	0.0	2,824	0.0
Foreign exchange loss	38,338	0.3	151,961	1.3
Technology Partnerships Canada royalty	124,425	0.9	50,473	0.4
Technology Partnerships Canada contribution	(1,471,414)	(10.9)	(376,880)	(3.3)
	<b>7,625,280</b>	<b>56.8</b>	6,116,455	53.1
<b>Earnings before income taxes</b>	<b>156,699</b>	<b>1.1</b>	245,270	2.1
<b>Income tax expense (recovery)</b>	<b>41,958</b>	<b>0.3</b>	(140,099)	(1.2)
<b>Earnings for the year</b>	<b>114,741</b>	<b>0.8</b>	385,369	3.3

## **Revenues**

The Company's core revenue stream is derived from four sources: Software, Systems and system components, 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<sup>®</sup>"), delivers the majority of the revenue. The Company also derives revenue from the delivery of the ECPINS<sup>®</sup> software component of its system product.

Consolidated revenue for the fiscal year ended November 30, 2004 was \$13,451,303, compared with \$11,520,793 for the fiscal year ended November 30, 2003, resulting in an increase of 16.8%. 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 the fiscal year ended November 30, 2004, 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 this period because of the long sales cycles, but may yield orders in the future.

The main customers for the Company's products and services were the Royal Navy of the United Kingdom through Lockheed Martin UK, the Royal Australian Navy through Nautronix Ltd., the U.S. Coast Guard, the Royal New Zealand Navy and the Portuguese Navy through SICOM (Sistemas de Comunicações, Lda) of Lisbon, Portugal. Revenue from these customers accounted for 61% of the consolidated revenue for the three months ended November 30, 2004 and for 69% of the consolidated revenue for the fiscal year ended November 30, 2004. For fiscal 2003, the main customers for the Company's products and services were the U.S. Coast Guard, Canadian Coast Guard, Canadian Department of National Defence, Royal Danish Navy and the U.S. Navy. Revenue from these customers accounted for 50% of the consolidated revenue for the three months ended November 30, 2003 and for 70% of the consolidated revenue for the fiscal year ended November 30, 2003.

A significant change in the Company's revenue mix occurred during the last fiscal quarter of 2003 and the six months ended May 31, 2004. Revenues during this period shifted to Software from Systems and system components. The revenue shift was 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 quarters of 2004 where, in order to ensure its success in pursuing certain contracts, the Company elected to sell off-the-shelf or customized versions of its ECPINS<sup>®</sup> software. Prior to this, the Company focused on the delivery of ECPINS<sup>®</sup> electronic chart navigation systems which included both its ECPINS<sup>®</sup> software and specialized hardware.

During the third and fourth fiscal quarters of 2004 the Company's revenue mix returned to its historical makeup where the Company's contracts focused on the delivery of ECPINS<sup>®</sup> electronic chart navigation systems which are reported as Systems and systems component revenue.

### *Segment Results*

Revenue from the Navigation Systems business unit for fiscal 2004 was \$10,232,671 compared to \$7,927,166 for fiscal 2003, an increase of \$2,305,505 or 29.1%. The increase in revenue in fiscal 2004 over fiscal 2003 is attributable to contracts from the Royal Navy of the United Kingdom and the Royal Australian Navy that were awarded to the Company in late fiscal 2003 and early fiscal 2004.

Revenue from the Geomatics business unit for fiscal 2004 was \$3,027,353 compared to \$3,593,627 for the same period last year, a decrease of \$566,274 or 15.8%. The business unit revenue levels decreased in the current fiscal year compared with that of the previous fiscal year as the result of supplier delays experienced by the Company in receiving the contracted services to satisfy customer needs and increased difficulty in penetrating the U.S. geomatics market.

Revenue from the Applications business unit was \$191,279 for fiscal 2004 (2003-\$0). 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 sales cycle with government customers for Applications products can be upwards of three years. The business unit's initial product is Common Operational Picture – Image Display Server (COP-IDS<sup>™</sup>).

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***

For fiscal 2004, the Company's gross profit increased \$1,420,254 to \$7,781,979 from \$6,361,725 for fiscal 2003. Gross profit percentage increased to 57.9% from 55.2% when comparing fiscal 2004 over fiscal 2003.

A significant change in the Company's revenue mix occurred during the last fiscal quarter of 2003 and the six months ended May 31, 2004. Revenues during this period shifted to Software from Systems and system components and resulted in the Company reporting higher gross profit percentage. The revenue shift was 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 quarters of 2004. These contracts required the Company to deliver off-the-shelf or customized versions of its ECPINS<sup>®</sup> software.

During the third and fourth fiscal quarters of 2004 the Company's revenue mix returned to its historical makeup where the Company's contracts focused on the delivery of ECPINS<sup>®</sup> electronic chart navigation systems.

### ***Segment Results***

Gross profit from the Navigation Systems business unit for fiscal 2004 was \$6,561,870 compared to \$4,797,613 for fiscal 2003, an increase of \$1,764,257 or 36.8%. Gross profit percentage increased to 64.1% from 60.5% period over period. The increase was attributable to the increased software revenue for the six months ended May 31, 2004 and resulted in the Navigation Systems business unit reporting gross margin percentages that were higher than those reported historically. During the third and fourth fiscal quarters of 2004 the Company's revenue mix returned to its historical makeup which has the Company's contracts focused on the delivery of ECPINS<sup>®</sup> electronic chart navigation systems.

Gross profit from the Geomatics business unit for fiscal 2004 was \$1,048,591 compared to \$1,564,112 for fiscal 2003, a decrease of \$515,521 or 33.0%. Gross profit percentage decreased to 34.6% from 43.5% period over period. The decrease is the result of the competitive nature of the geomatics market where customers are very price sensitive and the increasing protectionism the Geomatics business unit has encountered entering the U.S. geomatics market. The Company plans to implement changes in its strategies to improve its market position in the U.S.

Gross profit for the Company's new business unit, Applications, was \$171,518 for fiscal 2004 compared to \$0 for fiscal 2003. Gross profit percentage for fiscal 2004 was 89.7% and reflected the contract mix that included more applications software contracts than applications systems contracts.

### ***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. For fiscal 2004, G&A increased \$937,667 to \$3,435,688 from \$2,498,021 for fiscal 2003. As a percentage of revenue, G&A increased to 25.5% from 21.8% period over period. The increase is the result of increased professional fees, directors' fees and directors' and officers' insurance, as well as charges for stock-based compensation, increased salaries and decreased interest income that resulted from lower cash reserves during the period. The Company anticipates that as a result of recently introduced regulations in Canada and the U.S., the Company will continue to experience increases in costs primarily relating to professional fees.

### ***Research and Development Expenses***

Research and development ("R&D") expenses consist mainly of salaries and benefits of software and hardware engineering personnel, subcontractor costs, facilities expenses and related expenses. The Company expenses R&D costs in the period incurred unless, in the opinion of management, certain development costs meet the deferral criteria under Cdn 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 fiscal 2004 or for fiscal 2003.

The Company continued 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. For fiscal 2004, R&D costs increased \$556,283 to \$2,104,806 or 15.7% of revenue, compared to \$1,548,523 or 13.4% of revenue for fiscal 2003. 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 fiscal 2004 does not reflect approximately \$282,000 that was charged to cost of sales to support the software customization required to meet the needs of specific customers. For fiscal 2003, R&D costs charged to cost of sales to support the software customization required to meet the needs of specific customers was approximately \$114,000.

In November 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 had 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. Up to November 30, 2004, the Company had accrued for future payment or paid royalties of \$1,241,154. 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 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. Up to November 30, 2004, the Company had claimed for \$1,471,414 of eligible assistance under the TPC program. The Company will receive the remaining contributions over the remaining term. 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 fiscal 2004.

Although the Company believes that its submissions for TPC funding meet the terms and conditions of the TPC agreements, the final determination is subject to audit by government authorities in the ordinary course of business. During the year ended November 30, 2004, the Company was subject to an audit by government authorities. The results of the audit have not been communicated to the Company, however, the Company has no reason to believe that the audit will have a material impact on the Company's financial results.

### ***Sales and Marketing Expenses***

Sales and marketing ("S&M") expenses consist primarily of compensation of sales and marketing personnel, as well as expenses associated with advertising, trade shows, facilities and other expenses related to the sales and marketing of the Company's products and services. For fiscal 2004, S&M expenses increased \$1,160,121 or 58.0%, to \$3,160,359 (23.5% of revenue) from \$2,000,238 (17.4% of revenue) for fiscal 2003. The increase in expenses was the result of the Company's additional S&M staff hired to pursue new business. The Company has increased its level of business development activity relating to its expansion efforts into American, European and Australasian markets. The expansion effort targets new and existing customers in the military agencies of Canada, U.S., European NATO and other allies of Canada to increase the profile of the Company and its products through the establishment of marketing agreements with companies local to the targeted regions, and to broaden the Company's customer base thereby reducing its dependence on the current few international customers. Some of these activities may not result in closing orders during the current year but may yield orders in subsequent fiscal years. The Company expects a continued increase in S&M expenditures for the ongoing pursuit of these opportunities.

### ***Amortization***

Total amortization increased \$2,585 to \$362,564 for fiscal 2004 from \$359,979 for fiscal 2003. The increase reflects the acquisitions in the period and mix of property, plant and equipment in the Company at November 30, 2004.

### ***Interest***

Interest expense decreased to \$2,045 for fiscal 2004 from \$2,824 for fiscal 2003. The Company did not utilize its operating line credit facility of \$1,000,000 during fiscal 2004.

### **Foreign Exchange**

Foreign exchange loss for fiscal 2004 decreased \$113,623 to \$38,338 from \$151,961 for fiscal 2003. The decrease in fiscal 2004 was the result of the Company having established a policy during the first quarter of fiscal 2003 to hedge against foreign exchange exposure.

### **Income Taxes**

Based on the information available at the time of the issue of the audited consolidated financial statements for fiscal 2004, the Company estimated that it will have sufficient taxable earnings in future years to utilize a portion of the Company's \$3,079,232 Canadian and \$315,342 U.S. non-capital losses carried forward and other tax balances. As a result of this assessment, the Company has recognized a future tax recovery of \$479,446 for fiscal 2004 compared to a future tax recovery of \$363,484 for fiscal 2003. In accordance with Cdn GAAP, the Company provided a valuation allowance of \$3,842,899 against the total future tax asset as it is not considered "more likely than not" that the remaining future tax asset will be recovered. The Company continues to evaluate its taxable position quarterly and considers factors such as estimated taxable income, the history of losses for tax purposes and the growth of the Company, among others.

For fiscal 2004, the Company recorded current tax expense of \$521,404, which is the tax expense that the Company would have incurred had the Company not had available losses carried forward from prior years. This compares to a current tax expense for the prior fiscal year of \$223,385.

### **Earnings/Loss**

As a result of the above factors, earnings for fiscal 2004 were \$114,741 or 0.8% of revenue, compared to earnings of \$385,369 for fiscal 2003, or 3.3% of revenue.

## **Summary of Quarterly Results**

<b>For the three months ended</b>	<b>Revenue \$</b>	<b>Gross Profit \$</b>	<b>Net Earnings/ (Loss) \$</b>	<b>Basic Earn- ings/(Loss) per Share \$</b>	<b>Diluted Earn- ings/(Loss) per Share \$</b>
November 30, 2004	3,696,137	1,968,649	(251,851)	(0.01)	(0.01)
August 31, 2004	2,951,571	1,469,554	(483,869)	(0.02)	(0.02)
May 31, 2004	2,773,835	1,775,003	298,670	0.01	0.01
February 29, 2004	4,029,760	2,568,773	551,791	0.02	0.02
November 30, 2003	2,724,438	1,630,781	323,756	0.01	0.01
August 31, 2003	2,275,153	1,176,211	(338,797)	(0.01)	(0.01)
May 31, 2003	2,958,027	1,694,246	152,162	0.00	0.00
February 28, 2003	3,563,175	1,860,487	248,248	0.01	0.01

For a discussion on the factors that affect the quarterly results, please refer to the section **Selected Annual Information**.

## **Liquidity and Capital Resources**

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

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

At November 30, 2004, the Company had current assets of \$10,964,025, current liabilities of \$2,676,227 and a cash position of \$251,037. Working capital increased \$215,872 to \$8,287,798 at November 30, 2004 from \$8,071,926 at November 30, 2003 primarily due to a combination of an increase in accounts receivable and a decrease in cash and cash equivalents.

The Company has credit facilities consisting of an operating line, standby letters of credit and forward exchange contract facilities. The credit facilities permit the Company to borrow funds directly for general corporate purposes (including acquisitions) at floating rates. No borrowings against the operating line were outstanding as at November 30, 2004. The Company has a \$1,000,000 operating line available with a Canadian chartered bank collateralized by accounts receivable and inventory. The Company has issued standby letters of credit totalling U.S. \$127,000 and Australian \$283,886. The Company has utilized the standby letters of credit to support certain performance obligations to our customers. The Company has entered into foreign exchange forward contracts in the amount of U.S. \$851,196, Australian \$3,678,061 and €383,310. The Company utilizes its forward exchange contract facility to reduce its exposure to exchange rate movements.

Cash flows from operating activities before changes in non-cash working capital items for fiscal 2004 were \$690,939, compared with \$619,591 for fiscal 2003, an increase of \$71,348. The increase in cash flow for fiscal 2004 was the result of the Company's decreased earnings for fiscal 2004 being offset by the effect of increases to cash flow provided by the non-cash items stock-based compensation and future tax assets, as compared to fiscal 2003.

Changes in non-cash working capital items for fiscal 2004 were a usage of cash of \$4,118,532 compared to usage of cash of \$2,490,597 for fiscal 2003. Changes occurred in most non-cash working capital items between these two periods, all within the normal business activities of the Company. The largest change was an increase in accounts receivable, which is the result of milestone terms that exist in certain contracts.

Cash used in investing activities totalled \$358,856 for fiscal 2004 compared with \$309,386 for fiscal 2003. The increase is reflective of the acquisitions of property, plant and equipment commensurate with the Company's plans to obtain additional systems and facilities to accommodate its current and future anticipated growth.

Net cash provided by financing activities for fiscal 2004 amounted to \$199,931 compared to net cash provided of \$2,773,899 for fiscal 2003. The issuance of common shares provided funds of \$398,479 for fiscal 2004 compared to having provided \$606,069 for fiscal 2003. Preferred share issue costs used funds of \$20,115 for fiscal 2004 compared to the issuance of warrants and preferred shares net of issue costs having provided funds of \$2,726,995 for fiscal 2003. The payment of dividends on the Class B preference shares used funds of \$178,433 for fiscal 2004 compared to a usage of funds of \$53,484 for fiscal 2003. During the period January 16, 2003 to January 15, 2004, the Company purchased 455,000 of its common shares under a 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 charged to the deficit.

As a result of the above mentioned changes, the net decrease in cash amounted to \$3,586,518 for fiscal 2004 compared to an increase of \$593,507 for fiscal 2003. The Company has been focused on accounts receivable collections activities and has reduced accounts receivable by \$2,400,000 as of January 25, 2005.

As at November 30, 2004, the Company estimates that a U.S. \$0.01 increase in the exchange rate of the U.S. dollar relative to the Canadian dollar would have an annualized impact of reducing earnings before income taxes by approximately \$25,000. As at November 30, 2004, the Company estimates that an Australian \$0.01 increase in the exchange rate of the Australian dollar relative to the Canadian dollar would have an annualized impact of reducing earnings before income taxes by approximately \$12,000. As at November 30, 2004, the Company estimates that an €0.01 increase in the exchange rate of the Euro relative to the Canadian dollar would have an annualized impact of reducing earnings before income taxes by approximately \$10,000.

In order to reduce the impact of U.S. to Canadian dollar, Australian to Canadian dollar and Euro to Canadian Dollar exchange rate fluctuations, the Company has used the forward exchange contract facility described above. The Company used the forward exchange contract facility to set the exchange rate between the U.S. and Canadian dollar, the Australian to Canadian dollar and the Euro to Canadian dollar for specific transactions at a specific agreed upon rate, thereby mitigating any foreign exchange gain or loss that might occur on those transactions. The Company uses the forward exchange contract facility only for known or reasonably certain future U.S., Australian dollar and Euro transactions.

## Contractual Obligations

	Payments due by period				
	Total \$	Less than 1 year \$	1 to 3 years \$	4 to 5 years \$	After 5 years \$
Facility leases	687,203	259,361	427,842	–	–
Equipment leases	37,937	16,680	17,592	3,665	–
Total contractual obligations	725,140	276,041	445,434	3,665	–

## Off-Balance Sheet Arrangements

### Derivatives

The Company uses foreign exchange contracts to hedge transactions denominated in U.S. dollars, Australian dollars and Euros. The fair value of these derivative instruments at November 30, 2004 is an unrecorded liability of \$42,303. For a discussion on these contracts, please see Note 14 of the Company's audited consolidated financial statements for fiscal 2004.

### Guarantees

The Company has issued standby letters of credit totalling U.S. \$127,000 and Australian \$283,886. The Company has utilized the standby letters of credit to support certain performance obligations to its customers.

### Transactions with Related Parties

During the last two years, the Company did not enter into any transactions with its management, members of its Board of Directors or major shareholders.

### Proposed Transactions

The Company has not proposed any asset or business acquisition or disposition.

## Fourth Quarter

### Overall Performance

#### Earnings/Loss

For the three months ended November 30, 2004, the Company had a loss of \$251,851 or loss of \$0.01 per share on a basic and diluted basis compared to earnings of \$323,756 or earnings of \$0.01 per share for the three months ended November 30, 2003.

The Company's results for the three months ended November 30, 2004 were largely driven by the Company's revenue growth and financial assistance received from Technology Partnerships Canada and increased G&A, R&D and S&M expenses.

Revenue growth for the three months ended November 30, 2004 was largely attributable to revenues earned from the Royal Australian Navy, the Portuguese Navy and the Royal Navy of the United Kingdom.

### Selected Information

Statement of Earnings Information	For the three months ended November 30	
	2004 \$	2003 \$
Revenue	<b>3,696,137</b>	2,724,438
Gross profit	<b>1,968,649</b>	1,630,781
Gross profit percentage	<b>53.3%</b>	59.9%
Earnings (loss) for the period	<b>(251,851)</b>	323,756
Basic earnings (loss) per share	<b>(0.01)</b>	0.01
Diluted earnings (loss) per share	<b>(0.01)</b>	0.01

### Results of Operations

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

	Three months ended November 30			
	2004 \$	2004 %	2003 \$	2003 %
<b>Revenue</b>				
Software	906,701	24.5	607,326	22.3
Systems and system components	1,927,201	52.1	902,640	33.1
Geomatics	754,829	20.4	962,021	35.3
Other	107,406	3.0	252,452	9.3
	<b>3,696,137</b>	<b>100.0</b>	2,724,439	100.0
<b>Cost of sales</b>	<b>1,727,488</b>	<b>46.7</b>	1,093,658	40.1
<b>Gross profit</b>	<b>1,968,649</b>	<b>53.3</b>	1,630,781	59.9
<b>Expenses</b>				
General and administrative	857,004	23.3	669,575	24.6
Research and development	496,207	13.4	267,790	9.8
Sales and marketing	870,230	23.5	490,659	18.0
Amortization	64,376	1.7	64,222	2.4
Interest	812	0.0	2,531	0.1
Foreign exchange loss (gain)	6,647	0.2	(31,581)	(1.2)
Technology Partnerships Canada royalty	42,665	1.2	(16,072)	(0.6)
Technology Partnerships Canada contribution	(245,875)	(6.7)	—	0.0
	<b>2,092,066</b>	<b>56.6</b>	1,447,124	53.1
<b>Earnings (loss) before income taxes</b>	<b>(123,417)</b>	<b>(3.3)</b>	183,657	6.8
<b>Income tax (recovery)</b>	<b>128,434</b>	<b>3.5</b>	(140,099)	(5.1)
<b>Earnings (loss) for the year</b>	<b>(251,851)</b>	<b>(6.8)</b>	323,756	11.9

### Revenues

Consolidated revenue for the three months ended November 30, 2004 was \$3,696,137 compared with \$2,724,439 for the three months ended November 30, 2003, resulting in an increase of 35.7%. 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 the three months ended November 30, 2004, 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 this period because of the long sales cycles, but may yield orders in the future. The main customers for the Company's products and services during the three months ended November 30, 2004 were the Royal Navy of the United Kingdom through Lockheed Martin UK, the Royal Australian Navy through Nautronix Ltd. and the Portuguese Navy through SICOM (Sistemas de Comunicações, Lda) of Lisbon, Portugal. Revenue from these customers accounted for 61% of the consolidated revenue for the three months ended November 30, 2004. The main customers for the Company's products and services during the three months ended November 30, 2003 were the U.S. Coast Guard, the Canadian Navy and the Royal Australian Navy. Revenue from these customers accounted for 89% of the consolidated revenue for the three months ended November 30, 2003.

A significant change in the Company's revenue mix occurred during the last fiscal quarter of 2003. Revenues during this period shifted to Software from Systems and system components. The revenue shift was the result of a change in the nature of contracts the Company entered into during the last fiscal quarter of 2003 where, in order to ensure its success in pursuing certain contracts, the Company elected to sell off-the-shelf or customized versions of its ECPINS<sup>®</sup> software.

Prior to this, the Company focused on the delivery of ECPINS® electronic chart navigation systems which included both its ECPINS® software and specialized hardware. During the fourth fiscal quarter of 2004, the Company's revenue mix returned to its historical makeup where the Company's contracts focused on the delivery of ECPINS® electronic chart navigation systems, which are reported as Systems and systems component revenue.

#### *Segment Results*

Revenue from the Navigation Systems business unit for the three months ended November 30, 2004 was \$2,832,204 compared to \$1,773,814 for the same period last year, an increase of \$1,058,390 or 59.7%. The increase is attributable to recognition of revenue during the fourth quarter of fiscal 2004 on the Royal Navy of the United Kingdom, Royal Australian Navy, and Portuguese Navy contracts.

Revenue from the Geomatics business unit for the three months ended November 30, 2004 was \$740,958 compared to \$950,625 for the three months ended November 30, 2003, a decrease of \$209,667 or 22.1%. The business unit revenue levels decreased in the current fiscal year compared with that of the previous fiscal year as the result of supplier delays experienced by the Company in receiving the contracted services to satisfy customer needs and increased difficulty in penetrating the U.S. geomatics market.

Revenue for the Company's new business unit, Applications, was \$122,975 for the three months ended November 30, 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 sales cycle with government customers for Applications products can be upwards of three years. The business unit's initial product is Common Operational Picture – Image Display Server (COP-IDS™).

#### *Gross Profit*

The Company's gross profit increased \$337,868 to \$1,968,649 for the three months ended November 30, 2004 compared to gross profit of \$1,630,781 for the same period last year. Gross profit percentage decreased to 53.3% for the three months ended November 30, 2004 from 59.9% for the three months ended November 30, 2003. The decrease in the Company's gross profit percentage for the three months ended November 30, 2004 as compared to the three months ended November 30, 2003 is attributable to the mix of contracts having shifted to Systems and system components from Software. A significant change in the Company's revenue mix occurred in the three months ended November 30, 2003. Revenues during this period shifted to Software from Systems and system components and resulted in the Company reporting higher gross margin.

#### *Segment Results*

Gross profit from the Navigation Systems business unit for the three months ended November 30, 2004 was \$1,591,268 compared to \$1,160,137 for the same period last year, an increase of \$431,131. Gross profit percentage decreased to 56.2% from 65.4% period over period. The decrease was attributable to the decrease in software revenue for the three months ended November 30, 2004 when compared to the three months ended November 30, 2003, and resulted in the Company reporting gross margin percentages that were in line with those reported historically. For the fourth fiscal quarter of 2004 the Company's revenue mix had returned to its historical makeup which has the Company's contracts focused on the delivery of ECPINS® electronic chart navigation systems.

Gross profit from the Geomatics business unit for the three months ended November 30, 2004 was \$254,530 compared to \$470,644 for the same period last year, a decrease of \$216,114 or 45.9%. Gross profit percentage decreased to 34.4% from 49.5% period over period. The decrease is the result of the competitive nature of the geomatics market where customers are very price sensitive and the increasing protectionism the Company has encountered entering the U.S. geomatics market.

Gross profit for the Company's new business unit, Applications, was \$122,851 (99.9% of revenue) for the three months ended November 30, 2004.

#### *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 \$187,429 for the three months ended November 30, 2004 to \$857,004

compared to G&A of \$669,575 in the same period last year. As a percentage of revenue, G&A decreased from 24.6% to 23.3% period over period. The increased cost is the result of increased directors' fees and directors' and officers' insurance, as well as charges for stock-based compensation, increased salaries and decreased interest income that resulted from lower cash reserves during the periods. The Company anticipates G&A costs will continue to increase as a 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, facilities expenses and related 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 Cdn 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 months ended November 30, 2004 and had not capitalized any development costs for the three months ended November 30, 2003.

R&D costs increased \$228,417 to \$496,207 or 13.4% of revenue for the three months ended November 30, 2004, compared to R&D costs of \$267,790 or 9.8% of revenue in the same period last year. 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 TPC contribution for the three months ended November 30, 2004 was \$245,875 compared to \$0 for the same period last year, an increase of \$245,875. The increase is due to the Company not having a contract in place with TPC during the last quarter of fiscal 2003. A contract was signed on April 26, 2004.

The TPC royalty for the three months ended November 30, 2004 was an expense of \$42,665 compared to a recovery of \$16,072 for the same period last year, an increase of \$58,737. The increase is due to the amount of the royalty being based on the revenue of the Company which was higher for the three months ended fiscal 2004 as compared to the same period last year.

### ***Sales and Marketing Expenses***

Sales and marketing ("S&M") expenses consist primarily of compensation of sales and marketing personnel, as well as expenses associated with advertising, trade shows, facilities and other expenses related to the sales and marketing of the Company's products and services. S&M expenses increased \$379,571 or 77.4%, for the three months ended November 30, 2004 to \$870,230 (23.5% of revenue) from \$490,659 (18% of revenue) for the same period last year. The increase in expenses was the result of the Company's additional S&M staff hired to pursue new business. The Company has increased its level of business development activity relating to its expansion efforts into American, European and Australasia markets. The expansion effort targets new and existing customers in the military agencies of Canada, U.S., European NATO and other allies of Canada to increase the profile of the Company and its products through the establishment of marketing agreements with companies local to the targeted regions. The Company expects a continued increase in S&M expenditures for the ongoing pursuit of these opportunities.

### ***Amortization***

Total amortization increased to \$105,085 for the three months ended November 30, 2004 from \$96,808 for the three months ended November 30, 2003. The increase reflects the acquisitions in the period and mix of property, plant and equipment in the Company at November 30, 2004.

### ***Interest***

Interest expense decreased to \$812 for the three months ended November 30, 2004 compared to interest expense of \$2,531 for the three months ended November 30, 2003. The Company did not utilize its credit facility during fiscal 2004.

### ***Foreign Exchange***

Foreign exchange loss for the three months ended November 30, 2004 was \$6,647 and was the net foreign exchange amount for unhedged foreign currency transactions. For the same period last year the Company had a foreign exchange

gain of \$31,581, which was as a result of certain U.S. dollar transactions that were hedged during the fourth quarter of fiscal 2003, having been hedged at forward exchange rates that were more favourable than the average rate for the fourth quarter of fiscal 2003.

### ***Income Taxes***

The Company has recognized an increase of \$98,340 in the future tax recovery for the three months ended November 30, 2004 compared to an increase of \$363,484 for the same period last fiscal year. The recovery is the result of the change in the valuation allowance against the total future tax asset. The Company has provided the valuation allowance against the total future tax asset as it is not considered "more likely than not" that the remaining future tax asset will be recovered. The Company continues to evaluate its taxable position quarterly and considers factors such as estimated taxable income, the history of losses for tax purposes and the growth of the Company, among others.

For the three months ended November 30, 2004, the Company recorded current tax expense of \$226,774 which is the tax expense that the Company would have incurred had the Company not had available losses carried forward from prior years. This compares to a current tax expense for the same period for the prior fiscal year of \$223,385.

### ***Earnings/Loss***

Based on the factors discussed above, loss for the three months ended November 30, 2004 was \$251,851 or 6.8% of revenue, compared to earnings of \$323,756 or 11.9% of revenue, for the three months ended November 30, 2003.

## **Liquidity and Capital Resources**

Cash flows provided by operating activities before changes in non-cash working capital items for the three months ended November 30, 2004, amounted to \$9,036 compared with a source of \$251,757 for the three months ended November 30, 2003, a decrease of \$242,721. The decrease was the result of the Company's decreased earnings for the three months ended November 30, 2004 partially offset by an increase to cash flow for the same period provided by the non-cash item future tax assets.

Changes in non-cash working capital items for the three months ended November 30, 2004 were a usage of cash of \$1,553,506 compared to cash usage of \$1,774,522 for the same period in 2003. Changes occurred in most non-cash working capital items between these two periods, all within the normal business activities of the Company. The largest change was an increase in accounts receivable, which is the result of milestone terms that exist in certain contracts.

Cash used in investing activities totalled \$75,392 for the three months ended November 30, 2004 compared with \$73,224 for the same period in 2003. The increase is reflective of the acquisitions of property, plant and equipment commensurate with the Company's plans to obtain additional systems and facilities to accommodate its current and future anticipated growth.

Net cash provided by financing activities for the three months ended November 30, 2004 amounted to \$28,625 compared to net cash provided of \$377,182 for the same period in 2003. The issuance of common shares provided funds of \$28,625 for the three months ended November 30, 2004 compared to the issuance of common shares having provided funds of \$500,946 for the same period in fiscal 2003. There was no use of funds for share repurchases under a normal course issuer for the three months ended November 30, 2004 compared to a use of funds of \$70,280 for the same period in fiscal 2003. The payment of dividends on the Class B preference shares used funds of \$0 for the three months ended November 30, 2004 compared to a usage of funds of \$53,484 for the three months ended November 30, 2003.

As a result of the above mentioned changes, the net decrease in cash amounted to \$1,591,237 for the three months ended November 30, 2004 compared to a decrease of \$1,218,807 for the three months ended November 30, 2003.

## **Critical Accounting Estimates**

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

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

### ***Revenue***

The Company is required to estimate the costs to complete certain systems and geomatics services contracts. Revenues from these contracts are recognized on the percentage-of-completion method measured by the percentage of costs incurred to total estimated costs to complete each contract. The Company may need to adjust the estimated costs to complete for these projects if the actual results differ from the Company's estimates. If the Company anticipates that a contract or a contract segment will generate a loss, the Company estimates that loss and records the total expected loss on the contract or contract segment. When revenues exceed amounts invoiced under a contract, the difference is recorded as unbilled revenue. The Company believes that unbilled revenue will be invoiced and collected. Billings in excess of revenues are amounts that have been billed to the customer but have not been recognized in revenue.

### ***Income Taxes***

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

### ***Stock-based Compensation and Other Stock-based Payments***

The Company has established three stock option plans under which options to purchase common shares may be granted to directors, officers and employees of the Company and to any other person or company permitted by the applicable regulatory authorities to purchase unissued common shares. The Company recognizes compensation for stock options which have been granted and vested to employees and directors, under stock option plans with no cash settlement feature based on the fair value method. The fair value of the stock options was estimated using the Black-Scholes option pricing model, using weighted-average assumptions for the following: dividend yield, volatility rate, risk-free interest rate and expected average life. Direct awards of stock to employees, stock option and stock awards granted to non-employees are also accounted for in accordance with the fair value method of accounting for stock-based compensation.

### ***Accounts Receivable***

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

### ***Inventory***

Materials and components are stated at the lower of cost and replacement value as determined by the first-in first-out method. Work-in-process and manufactured parts are stated at the cost of materials and direct labour applied to the product and the applicable share of overhead. Finished goods are stated at the lower of cost and net realizable value. The Company assesses the need for inventory write-downs based on its assessment of estimated net realizable value using assumptions about future demand and market conditions. If market conditions differ from those originally estimated by the Company, an additional inventory write-down may be required.

## **Changes in Accounting Policies Including Initial Adoption**

Effective December 1, 2003, the Company adopted the new recommendations of the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3870 – Stock-Based Compensation and Other Stock-Based Payments ("CICA 3870") requiring the use of the fair value method of accounting for stock-based compensation transactions. The new recommendations have been adopted prospectively. Prior to the adoption of this standard, the settlement method was used whereby any consideration received on the exercise of stock options or the purchase of stock was credited to share capital. As required by the new recommendations, the Company discloses the pro forma effects of awards granted, modified or settled prior to December 1, 2003 to the income for the period as if the fair value method had been in use at the date of grant.

## **Financial Instruments and Other Instruments**

### ***Foreign Exchange Forward Contracts***

The Company uses foreign exchange forward contracts to hedge transactions denominated in U.S. dollars, Australian dollars and Euros. The purpose of the Company's hedging activities is to reduce the level of exposure to exchange rate movements. At November 30, 2004, the Company had foreign exchange forward contracts to sell U.S. \$851,196, Australian \$3,678,061 and €383,310. The exchange rates set in the foreign exchange forward contracts ranged between \$1.1870 to \$1.1942 for U.S. \$1.00, between \$0.9005 to \$0.9576 for Australian \$1.00 and \$1.5777 for €1.00. The contracts mature between December 2004 and May 2005.

Derivative financial instruments are utilized by the Company in the management of its foreign currency exposure to reduce its exposure to fluctuations in foreign exchange on certain committed and anticipated transactions. The Company formally documents the relationships between derivative financial instruments and hedged items, as well as the risk management objective and strategy. The Company assesses, on an ongoing basis, whether the derivative financial instruments continue to be effective in offsetting changes in fair values or cash flows of the hedged transactions.

Foreign exchange translation gains and losses on foreign currency denominated derivative financial instruments used to hedge anticipated or committed foreign currency exposures are recognized as an adjustment to the related operating costs, revenue or capital expenditures when the hedged transaction is recorded. Derivatives that are not subject to hedge accounting are recorded on the balance sheet with the changes in fair value being recorded in the statement of earnings each period. For the fiscal year 2004, all derivative financial instruments met the criteria for hedge accounting.

## **Disclosure of Outstanding Share Data**

As at December 31, 2004, the Company had issued and outstanding 27,488,074 common shares, and 1,695,112 outstanding stock options. As at December 31, 2004, the Company also had 30,262 issued and outstanding Class A preference shares and 57,711 issued and outstanding Class B preference shares convertible into common shares at conversion ratios of 1:1 and 1:45.5 respectively, which represents 2,656,112 common shares. Also at December 31, 2004 the Company had outstanding 1,393,301 common share purchase warrants convertible to common shares at a conversion ratio of 1:1, representing 1,393,301 common shares.

## **Other MD&A Requirements**

Additional information is also contained in the Company's other securities filings for the financial year ended November 30, 2004 and in the Company's Annual Information Form dated March 17, 2004. The information contained in those documents is hereby incorporated by reference. This and other additional information relating to the Company may be found on SEDAR at [www.sedar.com](http://www.sedar.com). Also, copies of these documents will be provided to any person, on request to the Secretary of the Corporation at 107-930 West 1st Street, North Vancouver, British Columbia, Canada, V7P 3N4, telephone (604) 904-4600, fax (604) 986-4454.