

# **Offshore Systems International Ltd.**

Interim Consolidated Financial Statements (Unaudited)  
(Prepared in accordance with United States Generally  
Accepted Accounting Principles)

**February 28, 2005 and February 29, 2004**

(expressed in Canadian dollars)

# Offshore Systems International

U.S. GAAP

(Incorporated under the laws of the Province of British Columbia, Canada)

## Consolidated Balance Sheets (unaudited)

(expressed in Canadian dollars)

	As at	
	February 28, 2005 \$	November 30, 2004 \$
<b>Assets (note 8)</b>		
<b>Current assets</b>		
Cash	-	251,037
Accounts receivable (note 3)	8,160,192	9,140,478
Inventory (note 4)	862,554	649,427
Prepaid expenses and deposits	440,073	142,752
Deferred income taxes	899,135	780,331
	<hr/>	<hr/>
	10,361,954	10,964,025
<b>Deferred income taxes</b>	119,561	-
<b>Plant and equipment</b> (note 5)	915,603	938,102
<b>Intangible and other assets</b> (note 6)	387,447	408,611
	<hr/>	<hr/>
	11,784,565	12,310,738
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<b>Liabilities</b>		
<b>Current liabilities</b>		
Bank overdraft (note 8)	548,394	-
Accounts payable and accrued liabilities (note 7)	1,744,382	2,596,362
Unearned revenue	74,345	79,865
	<hr/>	<hr/>
	2,367,121	2,676,227
	<hr/>	<hr/>
<b>Commitments and contingencies</b> (note 11)		
<b>Shareholders' Equity</b>		
<b>Capital stock</b>		
Authorized (note 9(a))		
100,000,000 Class A preference shares with no par value, issuable in series, of which 10,000,000 shares are designated Series A voting non-cumulative retractable convertible at a ratio of 1:1, 1% preference shares		
100,000,000 Class B preference shares with a par value of \$50 each, issuable in series of which 10,000,000 are designated Series 1 voting cumulative convertible shares at a ratio of 1:45.5, 6% preference shares		
100,000,000 common shares without par value		
Issued and outstanding		
30,262 Class A preference shares – Series A (2004 – 30,262) (note 9(b))	30,262	30,262
57,711 Class B preference shares – Series 1 (2004 – 57,711) (note 9(c))	2,197,061	2,163,622
27,488,074 Common shares (2004 - 27,488,074)	20,033,931	20,033,931
	<hr/>	<hr/>
	22,261,254	22,227,815
<b>Warrants</b> (note 9(c))	661,575	661,575
<b>Additional Paid in Capital</b>	944,492	941,968
<b>Accumulated Deficit</b>	(14,449,877)	(14,196,847)
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	9,417,444	9,634,511
	<hr/>	<hr/>
	11,784,565	12,310,738
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The accompanying notes are an integral part of these unaudited interim consolidated financial statements.

# Offshore Systems International Ltd.

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## Consolidated Statement of Earnings (Loss) and Accumulated Deficit (unaudited) (expressed in Canadian dollars)

	For the three months ended	
	February 28, 2005 \$	February 29, 2004 \$
<b>Revenue</b>		
Software	1,491,168	2,993,263
Systems and system components	405,735	186,894
Geomatics	307,581	718,733
Other	55,379	130,870
	<hr/>	<hr/>
	2,259,863	4,029,760
<b>Cost of sales</b>	<hr/>	<hr/>
	1,027,755	1,460,987
<b>Gross profit</b>	<hr/>	<hr/>
	1,232,108	2,568,773
<b>Expenses</b>		
General and administrative	1,036,084	730,073
Research and development	319,232	463,224
Sales and marketing	552,256	793,277
Depreciation and amortization	53,746	52,066
Interest	12,716	268
Foreign exchange gain	(73,144)	(24,741)
Technology Partnerships Canada royalty (note 10)	54,691	48,926
Technology Partnerships Canada contribution (note 10)	(265,517)	-
	<hr/>	<hr/>
	1,690,064	2,063,093
<b>Earnings (loss) before income taxes</b>	<hr/>	<hr/>
	(457,956)	505,680
<b>Income tax expense (recovery)</b> (note 12)		
Deferred income tax recovery	(238,365)	(278,903)
Current income tax expense	-	232,792
	<hr/>	<hr/>
	(238,365)	(46,111)
<b>Earnings (loss) for the period</b>	<hr/>	<hr/>
	(219,591)	551,791
<b>Accumulated Deficit – Beginning of period</b>	(14,196,847)	(14,046,108)
<b>Class B preference share dividend declared</b>	-	(91,866)
<b>Class B preference share dividend accreted</b>	(33,439)	(33,439)
	<hr/>	<hr/>
<b>Accumulated Deficit – End of period</b>	(14,449,877)	(13,619,622)
<b>Basic earnings (loss) per share</b> (note 9(e))	(0.01)	0.02
<b>Diluted earnings (loss) per share</b> (note 9(e))	(0.01)	0.02
<b>Weighted average number of common shares outstanding – basic</b> (note 9(e))	27,488,074	26,903,072
<b>Weighted average number of common shares outstanding – diluted</b> (note 9(e))	27,488,074	30,190,199

The accompanying notes are an integral part of these unaudited interim consolidated financial statements.

# Offshore Systems International Ltd.

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Consolidated Statement of Shareholders' Equity (unaudited)

For the three months ended February 28, 2005

(expressed in Canadian dollars)

	Class A preference shares – Series A		Class B preference shares – Series 1		Common Shares		Warrants		Additional paid-in capital \$	Accumulated Deficit \$	Total \$
	Number	Amount \$	Number	Amount \$	Number	Amount \$	Number	Amount \$			
<b>Balance - November 30, 2004</b>	30,262	30,262	57,711	2,163,622	27,488,074	20,033,931	1,393,301	661,575	941,968	(14,196,847)	9,634,511
Accretion of discount on Class B preference shares - Series 1	-	-	-	33,439	-	-	-	-	-	(33,439)	-
Stock-based compensation	-	-	-	-	-	-	-	-	2,524	-	2,524
	30,262	30,262	57,711	2,197,061	27,488,074	20,033,931	1,393,301	661,575	944,492	(14,230,286)	9,637,035
Net loss for the period	-	-	-	-	-	-	-	-	-	(219,591)	(219,591)
<b>Balance - February 28, 2005</b>	30,262	30,262	57,711	2,197,061	27,488,074	20,033,931	1,393,301	661,575	944,492	(14,449,877)	9,417,444

The accompanying notes are an integral part of these unaudited interim consolidated financial statements.

**Offshore Systems International Ltd.**  
Consolidated Statements of Cash Flows (unaudited)  
(expresses in Canadian dollars)

U.S. GAAP

	<b>For the three months ended</b>	
	<b>February 28, 2005</b>	<b>February 29, 2004</b>
	<b>\$</b>	<b>\$</b>
<b>Cash flows used in operating activities</b>		
Earnings (loss) for the period	(219,591)	551,791
Items not affecting cash		
Depreciation and amortization	84,670	78,045
Stock based compensation	2,524	-
Deferred income taxes	(238,365)	(46,111)
Changes in non-cash working capital items		
Accounts receivable	980,286	(2,624,674)
Inventory	(213,127)	30,236
Prepaid expenses and deposits	(297,321)	84,958
Accounts payable and accrued liabilities	(765,414)	(63,915)
Unearned revenue	(5,520)	(1,522)
Accrued royalties	-	(46,845)
	<u>(671,858)</u>	<u>(2,038,037)</u>
<b>Cash flows provided by (used in) financing activities</b>		
Proceeds from operating line of credit	548,394	-
Issue of common shares	-	51,177
Class B preference share dividend paid	(86,566)	(91,866)
	<u>461,828</u>	<u>(40,689)</u>
<b>Cash flows used in investing activities</b>		
Additions to plant and equipment	(27,424)	(29,697)
Additions to intangible and other assets	(13,583)	(12,937)
	<u>(41,007)</u>	<u>(42,634)</u>
<b>Decrease in cash</b>	(251,037)	(2,121,360)
<b>Cash – Beginning of period</b>	<u>251,037</u>	<u>3,837,555</u>
<b>Cash – End of period</b>	<u>-</u>	<u>1,716,195</u>
<b>Supplemental disclosure of cash flow information</b>		
Cash paid during the period for interest	5,816	268

See accompanying notes to unaudited interim consolidated financial statements

# Offshore Systems International Ltd.

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Notes to the Consolidated Financial Statements (unaudited)

February 28, 2005 and February 29, 2004

(expressed in Canadian dollars)

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## 1 Basis of presentation

These unaudited interim consolidated financial statements have been prepared by management and include the accounts of Offshore Systems International Ltd. and its subsidiaries, collectively referred to as the Company. These unaudited interim consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") and all amounts herein have been expressed in Canadian dollars unless otherwise noted. These unaudited interim consolidated financial statements do not include all the information and footnote disclosures required for compliance with U.S. GAAP for annual financial statements applied on a consistent basis. These unaudited interim consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and notes thereto. These unaudited interim consolidated financial statements conform in all material respects with Canadian generally accepted accounting principles ("Canadian GAAP"), except as disclosed in note 16.

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

## 2 Accounting changes

### a) Changes in accounting policies relating to the adoption of U.S. GAAP

Effective December 1, 2004, the Company elected to report its consolidated financial statements in conformity with U.S. GAAP. The Company continues to report all amounts in Canadian dollars as the functional currency of the Company is Canadian dollars. All accounting policies are the same as described in note 2 to the Company's audited financial statements for the year ended November 30, 2004, which were prepared in accordance with Canadian GAAP, filed with the appropriate securities commissions except for the following which have been retroactively adopted to comply with U.S. GAAP:

#### *Stock Based Compensation*

The Company grants stock options to employees, officers, directors, and persons providing management or consulting services to the Company pursuant to the stock option plans described in note 9(d). As allowed by Statement of Financial Accounting Standard 123 Accounting for Stock Based Compensation, ("SFAS 123") as amended by Statement of Financial Accounting Standard 148, the Company followed the Accounting Principles Board Opinion 25, Accounting for Stock Issued to Employees, ("APB 25") and presented pro forma information that is required by SFAS 123. APB 25 requires compensation cost for stock-based employee compensation plans to be recognized over the vesting period based on the difference, if any, between the quoted market price of the Company's stock as of the grant date and the amount an employee must pay to acquire the stock.

For stock options granted to non-employees, the Company follows the requirements of SFAS 123 and related interpretations. Costs are measured at the estimated fair value of the consideration received or the estimated fair value of the options issued, whichever is more reliably measurable. The value of the options issued for consideration other than employee services is determined on the earlier of a performance commitment or completion of performance by the provider of goods or services.

#### *Beneficial conversion feature and accretion of discount on preference shares issued with attached warrants*

Under Canadian GAAP, there is no requirement to record the beneficial conversion feature and accretion of discount when preference shares are issued with attached warrants. For U.S. GAAP purposes, during the fiscal year 2003, the Company recorded a beneficial conversion feature of \$668,785 as dividends calculated on the effective conversion price of the preference shares to common shares based on the proceeds allocated to the preference shares. The conversion feature of the preference shares vested immediately and the Company recorded the accretion of the full amount of the beneficial conversion feature. The preference shares discount that resulted from the allocation of the gross proceeds is accreted over the five-year

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February 28, 2005 and February 29, 2004

(expressed in Canadian dollars)

life of the warrants. This resulted in an accretion of \$33,439 to Accumulated Deficit for the three months ended February 28, 2005 (\$33,439 for the three months ended February 29, 2004).

## *Derivative Financial Instruments*

Under Canadian GAAP, there is a requirement for derivatives outside of hedging relationships to be recognized on the balance sheet at fair market value, however for derivatives in hedging relationships, Canadian GAAP does not specify how such derivatives should be recorded. As a result, under Canadian GAAP in some instances derivatives may not be recorded on the balance sheet. Under U.S. GAAP it is required that all derivatives be recorded as assets or liabilities, measured at fair value. Derivatives that are not hedges are adjusted to fair value through income. If the derivative is a hedge, depending upon the nature of the hedge, changes in the fair value of the derivative are either offset against the fair value of assets, liabilities or firm commitments through income, or recognized in other comprehensive income until the hedged item is recognized in income. The ineffective portion of a derivative's change in fair value is immediately recognized into income. The requirement to record derivatives at their fair market value has not had a material impact on the Company's financial statements.

## **b) Recent pronouncements**

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard 123R, Share-Based Payment, ("SFAS 123R") a revision to SFAS 123. SFAS 123R requires all share-based payments to be recognized in the financial statements based on their values using either a modified-prospective or modified-retrospective transition method. The standard no longer permits pro-forma disclosure or prospective recognition. Accordingly, from the date of adoption, September 1, 2005, of the revised standard, the Company will be required to recognize compensation expense for all share-based payments based on grant-date fair value, including those granted, modified or settled prior to September 1, 2005, that were previously disclosed on a pro-forma basis. The Company is currently evaluating the impact of SFAS 123R on its consolidated financial statements.

## **3 Accounts receivable**

	<b>February 28, 2005</b>	<b>November 30, 2004</b>
	\$	\$
Trade	3,503,314	4,655,150
Unbilled revenue	4,189,348	4,116,828
Technology Partnerships Canada contribution (note 10)	378,158	257,266
Other	89,372	111,234
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	8,160,192	9,140,478
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The Company has collateralized its accounts receivable as security against its operating line facility.

## **4 Inventory**

	<b>February 28, 2005</b>	<b>November 30, 2004</b>
	\$	\$
Materials and components	851,254	638,127
Finished goods	11,300	11,300
	<hr/>	<hr/>
	862,554	649,427
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Notes to the Consolidated Financial Statements (unaudited)

February 28, 2005 and February 29, 2004

(expressed in Canadian dollars)

## 5 Plant and equipment

	February 28, 2005		
	Cost \$	Accumulated Depreciation \$	Net \$
Equipment	3,926,965	3,084,270	842,695
Furniture and fixtures	131,095	96,601	34,494
Leasehold improvements	234,175	195,761	38,414
	<u>4,292,235</u>	<u>3,376,632</u>	<u>915,603</u>

  

	November 30, 2004		
	Cost \$	Accumulated Depreciation \$	Net \$
Equipment	3,910,980	3,038,921	872,059
Furniture and fixtures	131,095	94,705	36,390
Leasehold improvements	222,737	193,084	29,653
	<u>4,264,812</u>	<u>3,326,710</u>	<u>938,102</u>

## 6 Intangible and other assets

	February 28, 2005		
	Cost \$	Accumulated Amortization \$	Net \$
Computer software	950,174	580,465	369,709
Licenses and patents	57,267	39,529	17,738
	<u>1,007,441</u>	<u>619,994</u>	<u>387,447</u>

  

	November 30, 2004		
	Cost \$	Accumulated Amortization \$	Net \$
Computer software	936,591	546,190	390,401
Licenses and patents	57,267	39,057	18,210
	<u>993,858</u>	<u>585,247</u>	<u>408,611</u>

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Notes to the Consolidated Financial Statements (unaudited)

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## 7 Accounts payable and accrued liabilities

	February 28, 2005 \$	November 30, 2004 \$
Trade	865,021	1,343,129
Accrued employee costs	619,585	572,589
Accrued liabilities	205,953	282,227
Accrued royalties (note 10)	53,823	311,851
Class B preference shares dividends declared and unpaid	-	86,566
	<u>1,744,382</u>	<u>2,596,362</u>

## 8 Credit Facilities

In February 2005, the Company renewed certain credit facilities with a Canadian chartered bank, which consist of an operating line, a foreign exchange forward contract facility and standby letters of credit. The operating line bears interest at the chartered bank's prime lending rate plus 0.5% with interest payable monthly. The prime lending rate at February 28, 2005 was 4.25% (2004 – 4.25%). The standby letters of credit are denominated in U.S. dollars and bear interest at the rate of 1.25% per annum. Funds drawn on the operating line and the standby letters of credit are repayable on demand. As of February 28, 2005, letters of credit, relating principally to customer contracts, amounting to U.S. \$nil (2004 – U.S. \$127,000) and Australian \$283,886 (2004 – \$nil) have been issued. The Company utilizes letters of credit to back certain performance obligations with its customers.

The maximum amount(s) available to the Company under the operating line is \$2,000,000 and under the foreign exchange forward contract facility are U.S. \$2,000,000 and Australian \$2,750,000. The credit facilities are collateralized by an assignment of accounts receivable, a general security agreement from the Company and its subsidiaries Offshore Systems Ltd., OSI Geomatics Ltd and OSI Geomatics Inc. In addition, the Company is required to meet certain covenants as outlined in the credit facilities agreement. As at February 28, 2005, the Company had drawn on its foreign exchange contract facility in the amount of U.S. \$nil (2004 – U.S. \$1,186,836) and Australian \$2,750,000 (2004 – \$nil). As at February 28, 2005, the Company had drawn on the operating line facility in the amount of \$548,394 (November 30, 2004 - \$nil).

## 9 Capital Stock

### (a) Authorized

100,000,000 common shares without par value

100,000,000 Class A preference shares without par value, issuable in series, with rights as set by the Company's board of directors, of which 10,000,000 shares are designated Series A preference shares, voting, convertible into common shares at a 1:1 ratio, with a non-cumulative dividend rate of 1%

100,000,000 Class B preference shares, issuable in series, with rights as set by the Company's board of directors, with a par value of \$50 each, of which 10,000,000 shares are designated Series 1 preference shares, voting, convertible into common shares at a 1:45.5 ratio, with a cumulative dividend rate of 6%

### (b) Class A preference shares

The Company has 30,262 (November 30, 2004 - 30,262) Class A preference shares outstanding that have a value of \$30,262 for financial statement purposes. These Class A preference shares are being held in escrow but are no longer subject to any escrow restrictions and may be converted at any time into common shares of the Company, by notice in writing from the holders.

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Notes to the Consolidated Financial Statements (unaudited)

February 28, 2005 and February 29, 2004

(expressed in Canadian dollars)

## (c) Class B preference shares

The Company completed a private placement on February 13, 2003 consisting of 61,244 units for total gross proceeds of \$3,004,200. Each unit consists of one Class B Series 1 preference share and 22.75 common share purchase warrants exercisable at \$1.10. The preference shares are voting convertible shares at a ratio of 1:45.5 and have a cumulative dividend of 6% per annum. The Company has the right to redeem the preference shares after five years. The share purchase warrants are convertible to common shares at a ratio of 1:1 and expire five years after issue. The private placement incurred share issue costs of \$297,320. The gross proceeds of \$3,004,200 were allocated between the preference shares and warrants based on their relative fair value at the date of issuance. The \$2,342,625 fair value of the preference shares has been estimated based on the fair value of the underlying common shares. The \$661,575 fair value of the warrants has been estimated using the Black-Scholes option pricing model. Assumptions used in the pricing model included: (i) risk free interest rate of 2.7%, (ii) expected volatility of 66%, (iii) an estimated life of 5 years and (iv) an expected dividend rate of 0%. During the fiscal year 2003, the Company has recorded a beneficial conversion feature of \$668,785 in dividends calculated on the effective conversion price of the preference shares to common shares based on the proceeds allocated to the preference shares. The conversion feature of the preference shares vested immediately and the Company recorded the accretion of the full amount of the beneficial conversion feature. The preference share discount that resulted from the allocation of the gross proceeds is accreted over the five-year life of the warrants. This resulted in an accretion of \$33,439 to accumulated deficit for the three months ended February 28, 2005 (\$33,439 for the three months ended February 29, 2004).

## (d) Stock option plans

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 number of common shares authorized for grant under the Company's stock option plans is 10,930,732, of which 4,375,494 are available for granting. The exercise price of options granted pursuant to the plans may not be less than the market price of the common shares at the time of grant. The plans provide that options may be granted with vesting periods and expiry dates at the discretion of the board of directors. Options granted to directors and executives vest over periods ranging from immediately to three years and options granted to employees vest one year after the date granted.

A summary of the Company's stock options outstanding and exercisable at February 28, 2005 is as follows:

Range of exercise prices \$	Options outstanding			Options exercisable	
	Number outstanding at February 28, 2005	Weighted average remaining contractual life (years)	Weighted average exercise price \$	Number exercisable at February 28, 2005	Weighted average exercise price \$
1.01 – 1.35	1,622,135	1.25	1.06	1,330,135	1.05
1.36 – 1.41	60,000	0.31	1.41	60,000	1.41
1.01 – 1.41	1,682,135	1.22	1.08	1,390,135	1.06

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(expressed in Canadian dollars)

## *Stock-based compensation*

For the three months ended February 28, 2005, the Company incurred non-cash stock-based compensation expense of \$2,524 related to stock options granted to third parties (three month period ended February 29, 2004 - \$nil). The expense was included in general and administrative costs and was recorded in additional paid-in capital. The fair value of the stock options was estimated using the Black-Scholes option pricing model, using the following assumptions: dividend yield of 0%; a volatility rate of 58%; risk-free interest rate of 2.2%; and an expected average life of 3 years.

There were no stock options granted for the three months ended February 28, 2005 (February 28, 2004 - \$nil).

## *Pro forma disclosure*

The Company applies the intrinsic value method for employee stock options granted as prescribed in APB 25. Had compensation cost been determined using the fair value approach set forth in SFAS 123, the Company's earnings (loss) for the three month period and earnings (loss) per share would have been in accordance with the pro forma amounts indicated below:

	<b>For the three months ended February 28, 2005</b>	<b>For the three months ended February 29, 2004</b>
	\$	\$
Earnings as reported	(219,591)	551,791
Add: Stock-based compensation cost	2,524	-
Less: Pro forma stock-based compensation cost	(32,469)	(6,300)
Pro forma income (loss)	<u>(249,536)</u>	<u>545,491</u>
Pro forma basic and diluted earnings (loss) per share	<u>(0.01)</u>	<u>0.02</u>
Weighted average number of common shares outstanding - basic	<u>27,488,074</u>	<u>26,903,072</u>
Weighted average number of common shares outstanding - diluted	<u>27,488,074</u>	<u>30,190,199</u>

The fair value of the stock options was estimated using the Black-Scholes option pricing model using the following weighted average assumptions by grant year:

	<b>2004</b>	<b>2003</b>
Risk-Free interest rate	2.24%	2.65%
Expected dividend yield	0.0%	0.0%
Expected volatility factor	57.7%	102.0%
Expected option term (in years)	3	3

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February 28, 2005 and February 29, 2004

(expressed in Canadian dollars)

## (e) Earnings per share

	February 28, 2005	February 29, 2004
<b>Basic earnings per share</b>		
Earnings (loss) for the period	\$ (219,591)	\$ 551,791
Less: Class B preference share dividends	76,722	76,722
Earnings (loss) available to common shareholders	\$ (296,313)	\$ 475,069
Weighted average number of common shares outstanding	27,488,074	26,903,072
Basic earnings (loss) per share	\$ (0.01)	\$ 0.02
<b>Diluted earnings per share</b>		
Earnings (loss) for the period	\$ (219,591)	\$ 551,791
Less: Class B preference share dividends	76,722	76,722
Earnings (loss) available to common shareholders	\$ (296,313)	\$ 475,069
Weighted average number of common shares outstanding	27,488,074	26,903,072
Dilutive effect of Class A preference shares – Series A (*1)	-	30,262
Dilutive effect of Class B preference shares – Series 1 (*1)	-	2,625,851
Dilutive effect of warrants (*2)	-	-
Dilutive effect of stock options (*1)	-	631,014
Adjusted weighted average number of common shares outstanding	27,488,074	30,190,199
Diluted earnings (loss) per share	\$ (0.01)	\$ 0.02

(\*1) The Class B preference shares – Series 1 and the Class A preference shares- Series A and stock options were anti-dilutive for the purposes of calculating diluted earnings per share for the three months ended February 28, 2005.

(\*2) The outstanding 1,393,301 warrants were not included in the diluted earnings per share for the three months ended February 28, 2005 and February 29, 2004 because the warrant exercise prices were greater than the average market price of the common shares and, therefore, the effect would be antidilutive.

## 10 Technology Partnerships Canada

On April 26, 2004, the Company entered into an agreement with Technology Partnerships Canada (“TPC”) whereby TPC granted financial assistance to the Company for the purpose of funding research and development activities to be completed on or before March 31, 2007. The maximum eligible contribution by TPC is \$3,768,391. As at February 28, 2005, the Company has claimed \$1,736,931 of assistance under the agreement. Accounts receivable at February 28, 2005 includes \$378,158 of amounts receivable from TPC in connection with these claims (November 30, 2004 – \$257,266).

In addition, under the April 26, 2004 agreement, the Company is required to pay a royalty of 1.4% on annual gross Navigation Systems and Applications revenue for the period January 1, 2006 to December 31, 2008 and a royalty of 2.5% on annual gross Navigation Systems and Applications revenue for the period January 1, 2009 to December 31, 2013. Royalty payments will continue until the cumulative royalties paid or payable to December 31, 2013 are at least \$6,079,176 or until December 31, 2017. No amounts for royalty payments in connection with this agreement have been recorded in the financial statements.

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(expressed in Canadian dollars)

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On November 15, 1999, the Company entered into an agreement with TPC whereby TPC granted financial assistance to the Company for the purpose of funding research and development activities to be completed on or before March 31, 2003. Under the agreement with TPC, the Company was eligible to receive contributions to a maximum of \$4,000,177 over the period from December 23, 1998 to March 31, 2003. As of March 31, 2003, the Company had received the maximum allowed under the agreement. There are no amounts recorded in accounts receivable with respect to these claims.

In addition, under the November 15, 1999 agreement, the Company is required to pay a royalty of 3% on annual gross Navigation Systems and Applications business unit revenue for the period December 1, 1999 to November 30, 2008. The Company has paid royalties of \$1,242,022 to date (November 30, 2004 – \$929,303) and has accrued royalties of \$53,823 at February 28, 2005 (November 30, 2004 - \$311,851). 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.

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

If the Company causes an event of default, as defined in the agreement, TPC can suspend or terminate any obligation to contribute to the costs of the project or require the Company to repay all or part of the contributions made, together with interest, from the date of demand.

## 11 Commitments and contingencies

In July 2002, two of the Company's subsidiaries, Offshore Systems Ltd. and OSI Geomatics Ltd., and four employees became subject to a lawsuit for an undisclosed amount by Triathlon Ltd., a subsidiary of MacDonald, Dettwiler and Associates Ltd., related to use of confidential information and breach of fiduciary duty. No amount has been accrued at February 28, 2005 in respect of these claims because the potential liability for the claims and the amount of damages, if any, cannot be reasonably estimated. Management believe that the claims are without merit.

## 12 Income taxes

The Company is subject to income taxes in Canada and the United States and the use of estimates is required in determining the Company's provision for income taxes. Although the Company believes its tax estimates are reasonable, the ultimate tax determination involves significant judgement that could become subject to audit by tax authorities in the ordinary course of business.

The effective rate used to record income tax expense for the three months ended February 28, 2005 differed from the Canadian federal and provincial combined statutory tax rate primarily due to the change in valuation allowance to reflect those future tax benefits that were more likely than not to be realized and, also, items not deductible for income tax purposes. The change in effective tax rate from 2004 to 2005 was due primarily to the effect of the change in valuation allowance.

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At February 28, 2005, the Company adjusted its valuation allowance against deferred tax assets to reflect the amount of the future tax benefit that was more likely than not to be realized. A valuation allowance continues to be provided against those deferred tax assets for which there is uncertainty of future realization.

	For the three months ended February 28, 2005	For the three months ended February 28, 2004
	\$	\$
Deferred income tax (recovery)	(238,365)	(278,903)
Current income tax expense	-	232,792
Income tax (recovery)	(238,365)	(46,111)
Effective tax rate	52.0%	(9.1)%

## 13 Segmented information

The Company's reportable segments are as outlined below. Accounting policies used by these segments are the same as those described in the significant accounting policies as disclosed in note 2 of the Company's audited consolidated annual financial statements for the year ended November 30, 2004 prepared in accordance with Canadian GAAP. The Company defines reportable segments as components of the Company about which separate financial information is available and which is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance.

	February 28, 2005			
	Navigation Systems	Applications	Geomatics	Total
	\$	\$	\$	\$
Revenue	1,940,783	11,500	307,580	2,259,863
Gross profit	1,198,088	10,012	24,008	1,232,108
Technology Partnerships Canada – net recovery	210,826	-	-	210,826
Interest expense	11,231	-	1,485	12,716
Income tax recovery	(214,110)	-	(24,255)	(238,365)
Net earnings (loss)	189,730	(172,826)	(236,495)	(219,591)
Plant and equipment expenditures	27,424	-	-	27,424
Intangible and other asset expenditures	10,348	1,213	2,022	13,583
Depreciation and amortization	52,894	1,074	30,702	84,670
	February 29, 2004			
	Navigation Systems	Applications	Geomatics	Total
	\$	\$	\$	\$
Revenue	3,280,098	28,318	721,344	4,029,760
Gross profit	2,396,046	18,968	153,759	2,568,773
Technology Partnerships Canada – net expense	48,926	-	-	48,926
Interest expense	191	-	77	268
Income tax recovery	(46,111)	-	-	(46,111)
Net earnings (loss)	970,291	(311,300)	(107,200)	551,791
Plant and equipment expenditures	27,215	2,482	-	29,697
Intangible and other asset expenditures	9,793	-	3,144	12,937
Depreciation and amortization	54,800	77	23,168	78,045

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Total assets employed	Navigation Systems \$	Applications \$	Geomatics \$	Total \$
As at February 28, 2005	10,729,400	17,496	1,037,669	11,784,565
As at November 30, 2004	10,562,064	17,357	1,731,317	12,310,738

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

	February 28, 2005 \$	February 29, 2004 \$
Europe	1,627,000	2,065,021
Australia/New Zealand	311,894	948,263
United States	200,713	895,593
Canada	120,256	120,883
Total	2,259,863	4,029,760

Geographically, plant and equipment and intangible and other assets are reported based on location. At February 28, 2005 and November 30, 2004, all of the Company's plant and equipment and intangible and other assets were located in Canada.

## 14 Financial instruments

### Fluctuations in foreign currency exchange rates

The Company enters into transactions denominated in U.S. dollars, Australian dollars and Euros and as such its revenue, expenses, monetary assets and liabilities will be affected by fluctuations in the various currencies relative to its functional currency, the Canadian dollar.

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 February 28, 2005, the Company had foreign exchange forward contracts maturing in the following periods to sell Australian \$2,750,000 (February 29, 2004 – nil). As at February 28, 2005, the Company had drawn on its foreign exchange contract facility in the amount of U.S. \$nil (2004 – U.S. \$1,186,836) and Australian \$2,750,000 (2004 – \$nil). The exchange rates set in the forward exchange contracts ranged between 0.9473 to 0.9562 for Australian \$1.00. The contracts mature between May and June 2005.

## 15 Financial guarantees

The Company utilizes letters of credit to back certain performance obligations with its customers. The standby letters of credit are repayable on demand after certain conditions have been met. As of February 28, 2005, one letter of credit, relating principally to a customer contract, had been issued for Australian \$283,886 (November 30, 2004 – Australian \$283,886).

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## 16 Reconciliation of generally accepted accounting principles

The Company prepares its unaudited interim consolidated financial statements in accordance with U.S. generally accepted accounting principles which, as applied in these unaudited interim consolidated financial statements, conform in all material respects to Canadian GAAP, except for the differences below as follows:

(a) Under Canadian GAAP, for stock option awards granted by the Company after December 1, 2003, the Company is required to recognize compensation when stock options are granted to employees and directors under stock option plans with no cash settlement feature based on the fair value method. As permitted by the standard, the Company had applied this change prospectively for new awards granted on or after December 1, 2003.

(b) Under Canadian GAAP, there is no requirement to record the beneficial conversion feature and accretion of discount when preference shares are issued. During the fiscal year 2003, the Company has recorded a beneficial conversion feature of \$668,785 as dividends calculated on the effective conversion price of the preference shares to common shares based on the proceeds allocated to the preference shares. The conversion feature of the preference shares vested immediately and the Company recorded the accretion of the full amount of the beneficial conversion feature. The preference shares discount that resulted from the allocation of the gross proceeds is accreted over the five-year life of the warrants. This resulted in an accretion of \$33,439 to accumulated deficit for the three months ended February 28, 2005 (\$33,439 for the three months ended February 29, 2004).

(c) Under Canadian GAAP, there is a requirement for derivatives outside of hedging relationships to be recognized on the balance sheet at fair market value, however for derivatives in hedging relationships, Canadian GAAP does not specify how such derivatives should be recorded. As a result, under Canadian GAAP in some instances derivatives may not be recorded on the balance sheet. Under U.S. GAAP it is required that all derivatives be recorded as assets or liabilities, measured at fair value. Derivatives that are not hedges are adjusted to fair value through income. If the derivative is a hedge, depending upon the nature of the hedge, changes in the fair value of the derivative are either offset against the fair value of assets, liabilities or firm commitments through income, or recognized in other comprehensive income until the hedged item is recognized in income. The ineffective portion of a derivative's change in fair value is immediately recognized into income. The requirement to record derivatives at their fair market value has not had a material impact on the Company's financial statements.

(d) Under Canadian GAAP, the Company was not required to record stock based compensation for options granted to third parties prior to fiscal 2004. Under U.S. GAAP, the Company is required to record stock based compensation based on fair value as required by SFAS 123 retroactive for prior periods. As a result of these stock based compensation transactions, differences as compared to the same balances as previously reported under Canadian GAAP have occurred.

(e) For Canadian GAAP financial statement purposes, the Company's 30,262 (November 30, 2004 - 30,262) Class A preference shares have been presented at a nominal value. For U.S. GAAP financial statement purposes, these shares have been presented at a value of \$30,362.

(f) If Canadian GAAP were followed:

i) the effect on the Consolidated Statements of Earnings (Loss) and Accumulated Deficit would be:

	<b>February 28, 2005</b>	<b>February 29, 2004</b>
	\$	\$
Earnings (loss) for the period, U.S. GAAP	(219,591)	551,791
Adjustment for stock based compensation (a),(d)	(23,645)	-
Earnings (loss) for the period, Canadian GAAP	<u>(243,236)</u>	<u>551,791</u>
Basic and diluted earnings (loss) per common share, Canadian GAAP	(0.01)	0.02
Weighted average number of common shares - basic, Canadian GAAP	<u>27,488,074</u>	<u>26,903,072</u>
Weighted average number of common shares - diluted, Canadian GAAP	<u>27,488,074</u>	<u>30,190,199</u>

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ii) Balance Sheet items which would differ under Canadian GAAP are as follows:

	<b>February 28, 2005</b>	<b>November 30, 2004</b>
	\$	\$
Common shares (d)	19,026,125	19,026,125
Class A preference shares – Series A (e)	-	-
Class B preference shares – Series 1 (b)	1,926,157	1,926,157
Additional paid in capital (a), (d)	240,661	214,492
Accumulated Deficit (a), (b), (d)	(12,437,044)	(12,193,838)

(g) Pro forma information – Stock based compensation

The following pro forma financial information as required by The Canadian Institute of Chartered Accountants (“CICA”) Handbook section 3870, Stock-Based Compensation and Other Stock – based Payments, presents the earnings (loss) had the Company recognized stock-based compensation using a fair value method for all stock awards granted, modified or settled prior to December 1, 2003:

	<b>Three Months Ended February 28, 2005</b>	<b>Three Months Ended February 29, 2004</b>
	\$	\$
Earnings as reported	(243,236)	551,791
Add: Stock-based compensation cost	26,169	-
Less: Pro forma stock-based compensation cost	(32,469)	(6,300)
Pro forma income (loss)	<u>(249,536)</u>	<u>545,491</u>
Pro forma basic and diluted earnings (loss) per share	<u>(0.01)</u>	<u>0.02</u>
Weighted average number of common shares – basic	<u>27,488,074</u>	<u>26,903,072</u>
Weighted average number of common shares – diluted	<u>27,488,074</u>	<u>30,190,199</u>

The fair value of the stock options was estimated using the Black-Scholes option pricing model using the following weighted average assumptions by grant year:

	<b>2004</b>	<b>2003</b>
Risk-Free interest rate	2.24%	2.65%
Expected dividend yield	0.0%	0.0%
Expected volatility factor	57.7%	102.0%
Expected option term (in years)	3	3

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## 17 Other Information

The following presents the conversion of the Company's comparative financial information from Canadian GAAP to U.S. GAAP and presents a comparison for amounts which differ between Canadian GAAP and U.S. GAAP:

(a) Balance sheet at November 30, 2004

	As previously reported under Canadian GAAP \$	As currently reported under U.S. GAAP \$
<b>Shareholders' Equity</b>		
<b>Capital stock</b>		
Issued and outstanding		
30,262 Class A preference shares – Series A	-	30,262
57,711 Class B preference shares – Series I	1,926,157	2,163,622
27,488,074 common shares	19,026,125	20,033,931
	20,952,282	22,227,815
<b>Additional Paid in Capital</b>	214,492	941,968
<b>Accumulated Deficit</b>	(12,193,838)	(14,196,847)

(b) Statement of Earnings and Accumulated Deficit for the three months ended February 29, 2004

	As previously reported under Canadian GAAP \$	As currently reported under U.S. GAAP \$
<b>Accumulated Deficit – Beginning of period</b>	(12,043,580)	(14,046,108)
<b>Class B preference share dividend paid</b>	(91,866)	(91,866)
<b>Class B preference share dividend accreted</b>	-	(33,439)
<b>Accumulated Deficit – End of period</b>	(11,583,655)	(13,619,622)

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## 18 Subsequent events

### (a) Agreement to acquire Mapcon Mapping Consultants Inc.

On February 28, 2005, the Company entered into an agreement to purchase all of the issued and outstanding shares of Mapcon Mapping Consultants Inc. ("Mapcon") of Salt Lake City, Utah. Mapcon is a land mapping company in the U.S. geomatics (digital map and electronic chart data production) market.

Under the terms of the agreement, the Company will purchase all of the shares of Mapcon from its shareholders for cash of US\$1,000,000. The purchase is subject to a number of conditions, including the execution of a definitive agreement. The definitive agreement was executed April 8, 2005 and the transaction was closed on the same day.

### (b) Private placement

The Company announced on March 8, 2005 its intention to proceed with a private placement (the "financing") of up to CDN\$19.5 million. The financing was fully subscribed prior to the release of these unaudited interim consolidated financial statements. The financing was led by SDS Capital Group SPC, Ltd. as the principal investor. A recognized United States investment bank acted as agent to offer the securities on a best efforts basis to other institutions and accredited investors. The proceeds of the financing will be used to pursue acquisitions to increase available cash for operations, and to redeem 57,711 issued and outstanding Class B preference shares Series 1 held by two institutional investors at a cost of approximately CDN\$2.9 million. The Company offered up to 19,500 units, each comprised of 20 voting Class B preference shares Series 2 ("preference shares") and 588 share purchase warrants ("warrants"). The issue price was CDN\$1,000 per unit. The preference shares entitle the holders to receive a fixed preferential cumulative 7% dividend payable semi-annually. Each preference share is convertible at the option of the holder at any time into 58.82 of the Company's common shares, calculated by dividing the issue price of CDN\$50.00 for each preference share by the conversion price of CDN\$0.85. Each warrant entitles the holder to purchase one of the Company's common shares at the exercise price of CDN\$0.85 for a period of five years.

TSX policies required that the Company obtain shareholder approval for the financing. Consequently, all subscription funds and agreements were held in escrow with an escrow agent pending receipt of shareholder approval. The Company received shareholder approval for the financing at its annual general meeting which was held on April 8, 2005. During the escrow period, the purchasers received interest on the subscription funds at the rate of 12% per annum. After shareholder approval was obtained, the financing is to be closed promptly and accrued interest paid to the purchasers. All payments of interest will be net of applicable withholding tax.

Mr. E. Brinton Coxe, a director of the Company assisted the Company in structuring and arranging the financing. In consideration for providing his services, the Company will pay Mr. Coxe an advisory services fee in the amount of \$800,000. In addition, the Company will issue to Mr. Coxe 350,000 common share purchase warrants which will have the same terms and conditions as the warrants to be issued to the institutions which assist in placing the financing. Mr. Coxe has also participated in the financing by purchasing 100 units personally. Mr. Coxe declared his interest in the proposed financing and related transactions and abstained from voting on all resolutions of the Company's board respecting the financing, including resolutions approving his compensation, at all stages of the review and approval process. Mr. Coxe also excused himself from all board meetings at which the proposed financing was considered so that the remaining members of the board could discuss freely the proposed financing and all matters related thereto, including the proposed compensation of Mr. Coxe.

After shareholder approval has been obtained and the Company has proceeded with the planned private placement, the issuance of the units, related costs including the tax impact, potential changes to the Company's current and deferred tax positions and the retirement of the existing preference shares will be recorded in the financial statements.

Completion of the financing was subject to satisfaction of a number of conditions precedent, including completion of legal documentation and due diligence satisfactory to both the Company and the purchasers, and receipt of all necessary regulatory approvals, including TSX acceptance.

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The private placement was fully subscribed and should the holders of the 19,500 units, each comprised of 20 voting Class B preference shares Series 2 and 588 share purchase warrants convert these securities into the Company's common shares, there would be an increase of 34,405,800 common shares.

The offered securities have not been, nor will be, registered under the United States Securities Act of 1933, as amended (the "U.S. Securities Act"), and may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons except in certain transactions exempt from the registration requirements of the U.S. Securities Act.