



MANAGEMENT'S DISCUSSION AND ANALYSIS

for the six months ended May 31, 2006

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MANAGEMENT'S DISCUSSION AND ANALYSIS of Financial Condition and Results of Operations

The following Management's Discussion and Analysis ("MD&A") provides a review of activities, results of operations, and financial condition of OSI Geospatial Inc. for the six months ended May 31, 2006 in comparison with those for the six months ended May 31, 2005. The following discussion should be read in conjunction with the unaudited consolidated interim financial statements of OSI Geospatial, including the notes thereto, for the six months ended May 31, 2006, and the audited annual consolidated financial statements prepared in accordance with United States generally accepted accounting principles ("U.S. GAAP") and the MD&A for the year ended November 30, 2005 as set out in our 2005 annual report. Except where otherwise indicated, the reader may assume that the economic and industry factors are substantially unchanged from the 2005 year-end MD&A.

Effective December 1, 2004, we elected to report our consolidated financial statements in accordance with U.S. GAAP as permitted by Canadian regulators. All references in this report to financial information concerning OSI Geospatial are in accordance with U.S. GAAP and all dollar amounts are in U.S. dollars unless otherwise indicated. A reconciliation of our results to Canadian generally accepted accounting principles ("Canadian GAAP") is provided in note 13 of the notes to the interim consolidated financial statements.

Beginning in the first quarter of fiscal 2006, we have changed our financial reporting segments in order to reflect changes in management's analysis of our business. Our consolidated revenue categories have changed to marine systems, land and air systems, and mapping and our reportable segments are now U.S. Systems Operations, International Systems Operations, Mapping Operations, and Corporate and Public Company costs.

This report contains forward-looking statements within the meaning of securities laws including Section 27a of the Securities Act of 1933, as amended, and Section 21e of the Securities Exchange Act of 1934, as amended, including statements regarding the future achievement of corporate objectives, advancement of additional project interests, analysis and development of acquisition opportunities, various project interests and other matters. These statements are neither promises nor guarantees, but involve known and unknown risks and uncertainties that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed in or implied by these forward-looking statements. These risks include risks related to the effects of general economic conditions, changing foreign exchange rates, actions by government authorities, uncertainties associated with contract negotiations, and industry supply, as well as other factors discussed below and those risks which are discussed under the heading "Risks and Uncertainties". Readers should not place undue reliance on any such forward-looking statements, which speak only as of the date they were made. We disclaim any obligation to publicly update or revise any such statements to reflect any change in our expectations or in events, conditions or circumstances on which any such statements may be based, or that may affect the likelihood that actual results will differ from those set forth in the forward-looking statements.

ECPINS and COP-IDS are registered trademarks of Offshore Systems Ltd., an OSI Geospatial company. Other company brand, product and service names are for identification purposes only and may be either trademarks, service marks or registered trademarks of their respective owners. Data is subject to change without notice.

Additional information relating to OSI Geospatial, including our Annual Information Form and our Form 20-F report is filed on SEDAR at www.sedar.com, on EDGAR at www.sec.gov, and is also available on the company's investor web site at www.osigeospatial.com.

This management's discussion and analysis is dated July 10, 2006.

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OVERVIEW

Founded in 1977 and headquartered in North Vancouver, Canada, OSI Geospatial designs, develops, and markets software and systems for enhancing situational awareness in command, control, communications, and intelligence applications.

We are the market leader in military navigation systems. Our advanced software and systems strengthen the analytical and decision-making ability of navies and commercial maritime operators around the world by enabling them to know their precise location as well as the details of their surroundings.

Our principal product is the proprietary ECPINS® line of electronic chart navigation systems for commercial and military customers. ECPINS® helps to reduce the risk of navigation-related incidents by giving bridge crews a precise, real-time display of their position, course, and speed, against a background of fixed obstacles and other navigational hazards. We have developed a strong market position in military navigation, and ECPINS® has been deployed with the Canadian and United States Coast Guards, the Royal Australian Navy, the Canadian Navy, the Royal Danish Navy, the Royal New Zealand Navy, the Royal Norwegian Navy, the Royal Navy of the United Kingdom and the United States Navy. Six NATO and allied navies have adopted our systems as their fleet standard.

In the second quarter of 2006, we released a new Integrated Electronic Chart Display and Information System (ECDIS) and Simplified Voyage Data Recorder (S-VDR) for the commercial shipping market. This new product will enable commercial ship operators to benefit from our world-leading navigation technology while meeting newly mandated International Maritime Organization (IMO) carriage requirements. Under the latest IMO carriage requirements, all existing ships over 3,000 gross tons engaged in international voyages must install an S-VDR by July 1, 2010. We are working with Radio Holland Group to provide our customers with installation, maintenance, and certification services in major ports around the world.

The need for interoperability during coalition operations combined with a growing emphasis on geospatial intelligence to support strategic decision-making is driving demand for enhanced situational awareness in land and air systems. Our advanced technology systems provide critical capability for defense and intelligence forces by enabling multiple users to share information from a variety of data sources. Our command and control applications address the needs of the Navy, Army, Air Force, Special Forces and joint forces operations.

Our Common Operational Picture product line launched in 2003 targets command and control, mission planning, navigation and mobile asset management applications for the situational awareness market. In November 2005, we were contracted for its first full deployment with the Royal Danish Navy and in May 2006 we won a \$1.8 million sale to the U.S. Navy through L-3 Communications Marine Systems.

In 2002, the company entered the land-based mapping market, utilizing the skills and experience gained in the production and distribution of marine charts. Through our U.S. mapping operations, we have developed visibility in high growth areas of the mapping market and are focused on securing prime contract work in the U.S. with government, military, and commercial customers.

Our long-term goal is to become the leading provider of software and systems for enhancing situational awareness in command, control, communications, and intelligence applications. We plan 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, and national and international commercial marine transportation companies. In addition, we are pursuing strategic alliances, investments, and acquisitions that are complementary to our existing lines of business.

SELECTED DATA

The following tables contain financial information that is derived from the unaudited consolidated financial statements for the six months ended May 31, 2006 and from the audited consolidated financial statements for the year ended November 30, 2003, 2004 and 2005.

| Operations: | For the six months ended May 31 | | For the year ended November 30 | | |
|---|------------------------------------|-------------|-----------------------------------|------------|------------|
| | 2006 \$ | 2005 \$ | 2005 \$ | 2004 \$ | 2003 \$ |
| Revenue | 9,802,620 | 3,371,129 | 11,126,693 | 10,411,096 | 8,101,876 |
| Gross profit | 3,788,678 | 1,321,793 | 5,430,414 | 6,019,444 | 4,468,585 |
| Gross profit percentage | 38.6% | 39.2% | 48.8% | 57.8% | 55.2% |
| Net earnings (loss) | (1,231,793) | (1,568,513) | (2,748,774) | 191,467 | 325,265 |
| Net loss attributable to common shareholders | (2,120,971) | (5,780,204) | (8,427,876) | (44,972) | (398,021) |
| Loss per share – basic and diluted | (0.07) | (0.21) | (0.30) | (0.00) | (0.02) |
| Weighted average common shares outstanding – basic | 31,790,928 | 27,488,074 | 27,989,832 | 27,147,246 | 25,977,123 |
| Weighted average common shares outstanding - diluted | 31,790,928 | 27,488,074 | 27,989,832 | 29,856,412 | 27,142,492 |

| Financial position: | At May 31 | | At November 30 | | |
|---|------------|------------|----------------|------------|------------|
| | 2006 \$ | 2005 \$ | 2005 \$ | 2004 \$ | 2003 \$ |
| Cash and cash equivalents, including restricted cash | 1,639,238 | 10,840,834 | 8,411,745 | 211,672 | 2,949,362 |
| Working capital ⁽¹⁾ | 6,690,723 | 15,483,498 | 15,244,689 | 6,986,341 | 6,125,422 |
| Current assets | 10,645,283 | 18,230,848 | 19,300,976 | 9,241,933 | 7,942,659 |
| Total assets | 20,726,869 | 20,033,916 | 21,201,854 | 10,377,481 | 8,982,214 |
| Current liabilities | 3,954,560 | 2,747,349 | 4,056,286 | 2,255,592 | 1,817,237 |
| Long term liabilities | 342,697 | - | 200,998 | - | 103,108 |
| Total liabilities | 4,297,257 | 2,747,349 | 4,257,285 | 2,255,592 | 1,920,345 |
| Shareholders' equity | 16,429,612 | 17,286,567 | 16,944,569 | 8,121,890 | 7,061,868 |

⁽¹⁾ Working capital is defined as current assets less current liabilities. Working capital does not have a standardized meaning or comparable measure under generally accepted accounting principles and may not be comparable to similar measures presented by other companies.

Dividends declared

| per share: | At May 31 | | During Year ended November 30 | | |
|---|------------|------------|-------------------------------|------------|------------|
| | 2006 \$ | 2005 \$ | 2005 \$ | 2004 \$ | 2003 \$ |
| Common shares | - | - | - | - | - |
| Class A preference shares | - | - | - | - | - |
| Class B preference shares – series 1 | - | - | 2.24 | 3.05 | 0.64 |
| Class B preference shares – series 2 | 1.59 | 0.41 | 3.41 | - | - |

For the six months ended May 31, 2006, we have delivered engineering services, software and system products to the U.S. Air Force, U.S. Army, U.S. Navy, Royal Australian Navy through Nautronix Ltd., and the Canadian Navy.

Our results are primarily influenced by the level, timing, and duration of customer orders and customer product delivery requirements. We depend heavily on government contracts and derive a significant amount of revenue from a few customers, which may result in varying revenue, gross profit, and earnings.

The increase in revenue for the six months ended May 31, 2006 as compared to the six months ended May 31, 2005 is largely due to the addition of \$4.2 million in land and air systems revenue gained through our recent U.S. Systems acquisition. Our revenue is influenced by the timing of new contracts that are awarded and the delivery schedules of existing contracts.

Fluctuations in gross profit are influenced by the proportion of engineering labor, third-party systems or third-party labor or portions of all three required for a project, and a high proportion of these factors can result in increased cost of sales. Certain contracts awarded may require the inclusion of engineering labor, third-party systems or third-party labor. In order to maintain competitiveness on these contracts, we may elect to reduce our usual margins on the third-party components. In addition, the product mix of services revenue, software, mapping, and systems and systems components in any given period may impact the gross profit for the period.

The lower gross profit percentage for the six months ended May 31, 2006 as compared to the six months ended May 31, 2005 is the result of lower software revenue and the addition of engineering services revenue generated in our acquired operations. Software revenue generates more favorable margins than our other revenue streams and services revenue generates less favorable margins than other revenue streams.

RESULTS OF OPERATIONS

Overall Performance

| <i>Three months ended May 31</i> | 2006 | 2005 | 2006 to 2005 |
|--|-----------------------|----------------|---------------------|
| Earnings (loss) before income taxes | \$ 93,983 | \$ (1,190,082) | \$ 1,284,065 |
| Net loss | \$ (2,137) | \$ (1,370,047) | \$ 1,367,910 |
| Net loss attributable to common shareholders | \$ (715,055) | \$ (5,560,039) | \$ 4,844,984 |
| Loss per share - basic and diluted | \$ (0.02) | \$ (0.20) | \$ 0.18 |
| <hr/> | | | |
| <i>Six months ended May 31</i> | 2006 | 2005 | 2006 to 2005 |
| Loss before income taxes | \$ (1,145,681) | \$ (1,580,837) | \$ 435,156 |
| Net loss | \$ (1,231,793) | \$ (1,568,513) | \$ 336,720 |
| Net loss attributable to common shareholders | \$ (2,120,971) | \$ (5,780,204) | \$ 3,659,233 |
| Loss per share - basic and diluted | \$ (0.07) | \$ (0.21) | \$ 0.14 |

The net loss reported in the six months ended May 31, 2006 was largely driven by lower gross profit percentage driven by the mix of contracts executed in the period and higher operating expenses due to the addition of costs from our acquired operations, product launch activities, an increase in staff to support our growth plans, and a negative foreign exchange impact.

Backlog

Total backlog is the sum of the firm and option backlogs. As at May 31, 2006, total backlog was \$32.8 million compared to \$17.5 million at May 31, 2005.

Firm backlog consists of firm, fixed, or signed orders issued and executable subsequent to the balance sheet date. Firm backlog as at May 31, 2006 was at \$12.4 million compared to \$6.6 million at May 31, 2005.

Option backlog consists of unexercised contract options at the balance sheet date and indefinite-quantity contracts executable subsequent to the balance sheet date. Option backlog as at May 31, 2006 was at \$20.4 million compared to \$10.9 million at May 31, 2005.

There is no guarantee or certainty that our customers will elect to exercise their contract option backlog. Should our 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. Backlog metrics are non-GAAP measures. These measures do not have a standardized meaning or comparable GAAP measure and are likely not comparable to similar measures presented by other companies.

The timing of major contracts award can significantly impact our total backlog position and revenue. Historically, major contracts awarded have taken up to three years to finalize. The contracting process involves lengthy discussions and negotiations with several groups of people within the prospective customer's organization. We have continually pursued, and will continue to pursue, major contracts with lengthy sales cycles, and as a result, there could be large variations in our total backlog and revenue from quarter to quarter.

Multi-year contracts with government agencies have a termination-for-convenience clause because governments approve budget expenditures on an annual basis. This 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 of our customers. We have included the full value of these government contracts in total backlog.

Revenue

| <i>Three months ended May 31</i> | 2006 | % of total revenue | 2005 | % of total revenue | 2006 to 2005 |
|----------------------------------|---------------------|--------------------|---------------------|--------------------|---------------------|
| Marine systems | \$ 2,435,442 | 39.7 | \$ 783,225 | 51.1 | \$ 1,652,217 |
| Land and air systems | 2,370,117 | 38.6 | - | - | 2,370,117 |
| Mapping | 1,334,310 | 21.7 | 750,020 | 48.9 | 584,290 |
| | \$ 6,139,869 | 100.0 | \$ 1,533,245 | 100.0 | \$ 4,606,624 |

| <i>Six months ended May 31</i> | 2006 | % of total revenue | 2005 | % of total revenue | 2006 to 2005 |
|--------------------------------|---------------------|--------------------|---------------------|--------------------|---------------------|
| Marine systems | \$ 3,717,882 | 37.9 | \$ 2,367,597 | 70.2 | \$ 1,350,285 |
| Land and air systems | 4,221,681 | 43.1 | - | - | 4,221,681 |
| Mapping | 1,863,057 | 19.0 | 1,003,532 | 29.8 | 859,525 |
| | \$ 9,802,620 | 100.0 | \$ 3,371,129 | 100.0 | \$ 6,431,491 |

Our core revenue stream is derived from three sources: marine systems, land and air systems, and mapping. Our land and air systems through our U.S. Systems operations delivered 43.1% of our revenue for the six months ended May 31, 2006. Our principal developed and manufactured product, ECPINS®, delivers the majority of the marine systems revenue. We also derive revenue from the delivery of the ECPINS® software component of our system product. Combined, ECPINS® systems and software delivered 37.9% and 70.2% in the six months ended May 31, 2006 and 2005, respectively.

Our results are primarily affected by the level, timing, and duration of customer orders and customer product delivery requirements. The main customers for our products and services in the first half of fiscal 2006 were U.S. Air Force, U.S. Army, U.S. Navy's Naval Aviation, the Royal Australian Navy through Nautronix, and the Canadian Navy. Revenue from these customers accounted for 65.6% of the consolidated revenue. In the first half of fiscal 2005, the main customers for our products and services, accounting for 58.8% of the consolidated revenue, were the Royal Navy of the United Kingdom through Lockheed-Martin UK, the Royal New Zealand Navy through Air Affairs Ltd, and the Royal Australian Navy through Nautronix Ltd.

Revenue by Segment

| <i>Three months ended May 31</i> | 2006 | % of total revenue | 2005 | % of total revenue | 2006 to 2005 |
|----------------------------------|---------------------|--------------------|---------------------|--------------------|---------------------|
| International Systems operations | \$ 2,435,442 | 39.7 | \$ 783,225 | 51.1 | \$ 1,652,217 |
| U.S. Systems operations | 2,370,117 | 38.6 | - | - | 2,370,117 |
| Mapping operations | 1,334,310 | 21.7 | 750,020 | 48.9 | 584,290 |
| | \$ 6,139,869 | 100.0 | \$ 1,533,245 | 100.0 | \$ 4,606,624 |

| <i>Six months ended May 31</i> | 2006 | % of total revenue | 2005 | % of total revenue | 2006 to 2005 |
|----------------------------------|---------------------|--------------------|---------------------|--------------------|---------------------|
| International Systems operations | \$ 3,717,882 | 37.9 | \$ 2,367,597 | 70.2 | \$ 1,350,285 |
| U.S. Systems operations | 4,221,681 | 43.1 | - | - | 4,221,681 |
| Mapping operations | 1,863,057 | 19.0 | 1,003,532 | 29.8 | 859,525 |
| | \$ 9,802,620 | 100.0 | \$ 3,371,129 | 100.0 | \$ 6,431,491 |

Revenue from the International Systems operations for the three and six months ended May 31, 2006 increased 210.9% and 57.0% respectively due to the timing of new contracts awarded, the delivery schedules of existing contracts and the mix of products and services delivered.

Revenue from the U.S. Systems operations has no comparatives as this revenue comes from CHI Systems Inc., which was acquired December 15, 2005.

Revenue from our Mapping operations for the three and six months ended May 31, 2006 as compared to the three and six months ended May 31, 2005 increased 77.9% and 85.6% respectively primarily the result of changes in our strategy implemented to improve our market position in the U.S. through the acquisition of a U.S. land mapping company based in Salt Lake City, Utah.

We continue to invest significant corporate, sales, and marketing resources in identifying and pursuing new opportunities and contracts, both in our existing customer base and with new prospective customers.

Gross Profit

| <i>Three months ended May 31</i> | 2006 | 2005 | 2006 to 2005 |
|----------------------------------|--------------|-------------|---------------------|
| Gross profit | \$ 2,594,972 | \$ 316,677 | \$ 2,278,295 |
| Gross profit percentage | 42.3% | 20.6% | 21.7% |

| <i>Six months ended May 31</i> | 2006 | 2005 | 2006 to 2005 |
|--------------------------------|--------------|--------------|---------------------|
| Gross profit | \$ 3,788,678 | \$ 1,321,793 | \$ 2,466,885 |
| Gross profit percentage | 38.6% | 39.2% | (0.6)% |

Gross profit increased over eight times in the three months ended May 31, 2006 compared to the three months ended May 31, 2005 and the gross profit percentage was 21.7% higher period-over-period. Gross profit increased by 186.6% in the six months ended May 31, 2006 compared to the six months ended May 31, 2005 while the gross profit percentage was 0.6% lower period-over-period. The reduced gross profit percentage compared to the prior six month period is due to higher software sales realized in the second quarter of fiscal 2006 in combination with the addition of lower margin revenue in our acquired operations.

Gross Profit by Segment

| <i>Three months ended May 31</i> | 2006 | 2005 | 2006 to 2005 |
|----------------------------------|---------------------|-------------------|---------------------|
| Gross profit: | | | |
| International Systems operations | \$ 1,614,222 | \$ 93,515 | \$ 1,520,707 |
| U.S. Systems operations | 544,238 | - | 544,238 |
| Mapping operations | 436,512 | 223,162 | 213,350 |
| | <u>\$ 2,594,972</u> | <u>\$ 316,677</u> | <u>\$ 2,278,295</u> |
| Gross profit percentage: | | | |
| International Systems operations | 66.3% | 11.9% | 54.4% |
| U.S. Systems operations | 23.0% | - | 23.0% |
| Mapping operations | 32.7% | 29.8% | 2.9% |
| | <u>42.3%</u> | <u>20.6%</u> | <u>21.7%</u> |

| <i>Six months ended May 31</i> | 2006 | 2005 | 2006 to 2005 |
|----------------------------------|---------------------|---------------------|---------------------|
| Gross profit: | | | |
| International Systems operations | \$ 2,292,925 | \$ 1,073,096 | \$ 1,219,829 |
| U.S. Systems operations | 967,280 | - | 967,280 |
| Mapping operations | 528,473 | 248,699 | 279,774 |
| | <u>\$ 3,788,678</u> | <u>\$ 1,321,795</u> | <u>\$ 2,466,883</u> |
| Gross profit percentage: | | | |
| International Systems operations | 61.7% | 45.3% | 16.4% |
| U.S. Systems operations | 22.9% | - | 22.9% |
| Mapping operations | 28.4% | 24.8% | 3.6% |
| | <u>38.6%</u> | <u>39.2%</u> | <u>(0.6)%</u> |

Gross profit from the International Systems operations increased over 17 times and gross profit percentage was 54.4% higher for the three months ended May 31, 2006 when compared to the same period last year. Gross profit increased 113.7% for the six months ended May 31, 2006 compared to the

six months ended May 31, 2005. The increases are the result of higher revenues in the International Systems operations in second quarter and the first six months of fiscal 2006 and an increase in our high margin software revenue compared to the first six months of fiscal 2005.

Gross profit from the U.S. Systems operations did not exist for the six months ended May 31, 2005 as CHI Systems was acquired in the current period.

Gross profit from the Mapping operations for the three months ended May 31, 2006 increased 95.6% compared to the same period last year. Gross profit for the six months ended May 31, 2006 increased 112.5% compared to the same period last year. The increases are the result of our successful entrance into the U.S. mapping market through the acquisition of Mapcon Mapping. Gross profit percentage increased 2.9% and 3.6% period over period respectively, consistent with the mix of contracts in the business unit.

Operating Expenses

| <i>Three months ended May 31</i> | 2006 | % of total revenue | 2005 | % of total revenue | 2006 to 2005 |
|----------------------------------|--------------|--------------------|--------------|--------------------|---------------------|
| General and administrative | \$ 1,514,184 | 24.7% | \$ 836,773 | 54.6% | \$ 677,411 |
| Research and development | 450,592 | 7.3% | 372,761 | 24.3% | 77,831 |
| Sales and marketing | 605,817 | 9.9% | 543,530 | 35.4% | 62,287 |
| | | | | | |
| <i>Six months ended May 31</i> | 2006 | % of total revenue | 2005 | % of total revenue | 2006 to 2005 |
| General and administrative | \$ 2,859,976 | 29.2% | \$ 1,678,981 | 49.8% | \$ 1,180,995 |
| Research and development | 992,859 | 10.1% | 633,270 | 18.8% | 359,589 |
| Sales and marketing | 1,158,039 | 11.8% | 992,314 | 29.4% | 165,725 |

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, and other income.

G&A increased by 80.9% for the three months ended May 31, 2006 and by 70.3% for six months ended May 31, 2006 compared to the same periods last year. As a percentage of revenue, G&A was lower 29.9% and 20.6% respectively when compared to the same periods last year. The dollar increases for the second quarter of 2006 over the second quarter of 2005, and the first six months of 2006 over first six months of 2005 are the result of the addition of our U.S. Systems operations and the increase of staff to support our growth plans.

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. We expense research and development costs in the period incurred.

R&D costs increased by 20.9% for the three months ended May 31, 2006 and by 56.8% in the six months ended May 31, 2006 compared to the same periods last year. The increases are related to higher staff levels and expenses for new product activities for the six months ended May 31, 2006 and approximately \$200,000 in engineering labor costs charged to cost of sales from R&D for the six months ended May 31, 2005 compared to the six months ended May 31, 2006, where there were no costs similarly charged. These engineering labor costs are to support the needs of specific customer orders. We believe that in order to maintain our technological leadership, we must continue to develop existing products and introduce innovative new products that challenge and redefine the industry standards.

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 our products and services.

S&M expenses increased by 11.5% for the three months ended May 31, 2006 and by 16.7% in the six months ended May 31, 2006 compared to the periods in fiscal 2005. The increases in S&M expenses are primarily due to the addition of our U.S. Systems operations. We believe our current level of S&M staff continues to allow us to pursue business development activities relating to our expansion efforts targeting new and existing customers in the military agencies of Canada, the U.S., European NATO, and other allies of Canada, and national and international commercial marine transportation companies. To increase our profile and our products, and to broaden our customer base in international markets, we have established marketing agreements with companies local to the targeted regions. Some of these activities may not result in closing orders during the current year but may yield orders in subsequent fiscal years.

Depreciation and Amortization

| <i>Three months ended May 31</i> | | 2006 | | 2005 | | 2006 to 2005 |
|----------------------------------|----|----------------|----|-------------|----|---------------------|
| Depreciation and amortization | \$ | 137,878 | \$ | 63,712 | \$ | 74,166 |
| <i>Six months ended May 31</i> | | 2006 | | 2005 | | 2006 to 2005 |
| Depreciation and amortization | \$ | 269,905 | \$ | 107,478 | \$ | 162,427 |

Total depreciation and amortization increased 116.4% for the three months ended May 31, 2006 and 151.1% in the six months ended May 31, 2006 over the same periods for fiscal 2005 reflecting our U.S. acquisition in the period, the mix of plant and equipment at May 31, 2006, and the amortization of intangibles related to our U.S. acquisitions. For the six months ended May 31, 2006 and 2005, a portion of the depreciation, \$120,051 and \$56,546 respectively, was included in cost of sales for equipment used in revenue-generating activities.

Interest expense

| <i>Three months ended May 31</i> | | 2006 | | 2005 | | 2006 to 2005 |
|----------------------------------|----|---------------|----|-------------|----|---------------------|
| Interest expense | \$ | 6,218 | \$ | 6,950 | \$ | (732) |
| <i>Six months ended May 31</i> | | 2006 | | 2005 | | 2006 to 2005 |
| Interest expense | \$ | 12,264 | \$ | 17,234 | \$ | (4,970) |

Interest expense decreased in the first six months of fiscal 2006 over the first six months of fiscal 2005 as the result of the company not utilizing our operating line credit facility of \$2.0 million.

Interest income

| <i>Three months ended May 31</i> | | 2006 | | 2005 | | 2006 to 2005 |
|----------------------------------|----|---------------|----|-------------|----|---------------------|
| Interest income | \$ | 6,849 | \$ | 31,347 | \$ | (24,498) |
| <i>Six months ended May 31</i> | | 2006 | | 2005 | | 2006 to 2005 |
| Interest income | \$ | 19,683 | \$ | 31,437 | \$ | (11,754) |

Interest income decreased in the first six months of fiscal 2006 as the result of the company having surplus cash for the period after the Preferred Share financing closed on April 11, 2005 until the acquisition of CHI Systems on December 14, 2005.

Foreign Exchange

| <i>Three months ended May 31</i> | | 2006 | | 2005 | | 2006 to 2005 |
|----------------------------------|----|-----------------|----|-------------|----|---------------------|
| Foreign exchange loss (gain) | \$ | (21,147) | \$ | 62,307 | \$ | (83,454) |
| <i>Six months ended May 31</i> | | 2006 | | 2005 | | 2006 to 2005 |
| Foreign exchange loss (gain) | \$ | 267 | \$ | 24,328 | \$ | (24,061) |

Foreign exchange loss is the result of exchange rate movements of the Australian dollar and our Canadian dollar exposure which were not in the company's favor during the six months ended May 31 2006, as compared to the six months ended May 31, 2005.

Technology Partnerships Canada

| <i>Three months ended May 31</i> | | 2006 | | 2005 | | 2006 to 2005 |
|----------------------------------|----|------------------|----|-------------|----|---------------------|
| Royalty | \$ | 107,668 | \$ | 30,459 | \$ | 77,209 |
| Contribution | | (293,372) | | (378,386) | | 85,014 |
| <i>Six months ended May 31</i> | | 2006 | | 2005 | | 2006 to 2005 |
| Royalty | \$ | 164,572 | \$ | 74,861 | \$ | 89,711 |
| Contribution | | (503,840) | | (594,399) | | 90,559 |

The company has entered into two agreements with Technology Partnerships Canada ("TPC") whereby TPC granted financial assistance for the purpose of funding research and development activities to be completed on or before March 31, 2007. The contributions we received are based on the eligible expenditures we make during each period.

We are required to pay a royalty of 3% on annual gross revenue in our subsidiary Offshore Systems Ltd. for the period December 1, 1999 to November 30, 2008. In addition, we are required to pay a royalty of 1.4% on annual gross revenue in our subsidiary Offshore Systems for the period January 1, 2006 to December 31, 2008 and a royalty of 2.5% on annual gross revenue for the period January 1, 2009 to December 31, 2013.

Income Taxes

| <i>Three months ended May 31</i> | | 2006 | | 2005 | | 2006 to 2005 |
|----------------------------------|----|-----------------|----|-------------|----|---------------------|
| Deferred income tax recovery | \$ | (23,321) | \$ | 113,378 | \$ | (136,699) |
| Current income tax expenses | | 119,441 | | 66,587 | | 52,854 |
| <i>Six months ended May 31</i> | | 2006 | | 2005 | | 2006 to 2005 |
| Deferred income tax recovery | \$ | (7,594) | \$ | (94,440) | \$ | (86,846) |
| Current income tax expenses | | 93,706 | | 82,116 | | 11,590 |

Based on the information available at the time of the issue of the audited annual financial statements for the year ended November 30, 2005, we estimated that we would not have sufficient taxable earnings in Canada in future periods to utilize a portion of our Canadian approximately \$5 million non-capital losses carried forward and other Canadian tax balances. We have recognized deferred tax recovery in the six months ended May 31, 2006 related to year-to-date losses recognized and temporary timing differences between accounting income and income for tax purposes in our U.S. subsidiaries as we believe that it is more likely than not that these differences will be realized in the current fiscal year. In accordance with U.S. GAAP, we provided a valuation allowance against deferred tax assets where realization did not meet the requirements of "more likely than not" under the liability method of tax allocation. We continue to evaluate our taxable position quarterly and consider factors such as estimated taxable income, the history of losses for tax purposes, and the growth of the Company, among others.

LIQUIDITY AND CAPITAL RESOURCES

| | May 31, 2006 | November 30, 2005 | 2006 to 2005 |
|--------------------------------|--------------|-------------------|----------------|
| Cash | \$ 1,419,553 | \$ 8,222,225 | \$ (6,802,672) |
| Current assets | 10,645,283 | 19,300,976 | (8,655,693) |
| Current liabilities | 3,954,560 | 4,056,287 | (101,727) |
| Working capital ⁽¹⁾ | 6,690,723 | 15,244,689 | (8,553,966) |

⁽¹⁾ Working capital is defined as current assets less current liabilities. Working capital does not have a standardized meaning or comparable measure under generally accepted accounting principles and may not be comparable to similar measures presented by other companies.

We strive to maintain cash-contributing profitable operations that provide an adequate liquidity and capital resource base for growth. We believe that cash flow from operating activities, together with line of credit borrowings of \$2.0 million available under our revolving credit facilities, will be sufficient to fund currently anticipated working capital, planned capital spending, and debt service requirements for the next 12 months. We expect cash flow from operations will continue to improve for the remainder of the year as scheduled contract milestone payments will be made on several contracts. The expenditures associated with these contracts have been incurred in prior periods.

At May 31, 2006 our current assets and working capital decreased primarily due to the acquisition of our U.S. Systems operations.

We have credit facilities consisting of an operating line, standby letters of credit, and forward exchange contract facilities. The credit facilities permit us to borrow funds directly for general corporate purposes, including acquisitions, at floating rates. At May 31, 2006, we had no borrowings against our Canadian or U.S. dollar operating line. We have an operating line of \$2.0 million available with a Canadian chartered bank collateralized by accounts receivable. During fiscal 2005, we utilized the facility which increased interest expense for the year. There were no borrowings in the six months ended May 31, 2006. We had issued a standby letter of credit totaling Australian \$283,886 during fiscal 2005. We had utilized the standby letter of credit to support certain performance obligations to our customers. This standby letter of credit has since been cancelled. We utilize our forward exchange contract facility to reduce our exposure to exchange rate movements.

Cash Flows

| <i>Three months ended May 31</i> | 2006 | 2005 | 2006 to 2005 |
|---|--------------|--------------|---------------------|
| Cash flows provided by (used in): | | | |
| Operating activities | \$ 1,021,472 | \$ 1,212,439 | \$ (190,967) |
| Investing activities | (293,083) | (1,227,674) | 934,591 |
| Financing activities | (519,926) | 10,924,510 | 11,444,436 |
| Exchange impact on acquired cash balances | 62,209 | (243,712) | 305,921 |
| <i>Six months ended May 31</i> | 2006 | 2005 | 2006 to 2005 |
| Cash flows provided by (used in): | | | |
| Operating activities | \$ 1,929,751 | \$ 588,324 | \$ 1,341,427 |
| Investing activities | (8,332,982) | (1,260,880) | (7,072,102) |
| Financing activities | (519,926) | 11,297,947 | (11,817,873) |
| Exchange impact on acquired cash balances | 120,484 | (171,500) | 291,984 |

Cash flows provided by operating activities for the six months ended May 31, 2006, were the result of the decrease in accounts receivable offset by the loss for the six months ended May 31, 2006 and a decrease in accounts payable and accrued liabilities. Cash flows provided by operating activities for the three months ended May 31, 2006 were the result of a decrease in accounts payable and non-cash income statement items.

Cash flows used in investing activities for the six months ended May 31, 2006 were primarily reflective of our U.S. systems acquisition as well as the acquisitions of plant, equipment and intangibles commensurate with our plans to obtain additional systems and facilities to accommodate our current and future anticipated growth. Cash flows used in investing activities for the three months ended February 28, 2005 were the result of acquisitions of plant, equipment and intangibles.

Cash flows used in financing activities for the three and six months ended May 31, 2005 were the result of Class B preference share dividends paid.

As a result of the above mentioned changes, cash decreased by \$6,802,672 for the six months ended May 31, 2006. For the three months ended May 31, 2006, a \$62,209 foreign exchange benefit was realized and cash increased \$270,672.

There can be no assurance that we will have adequate financial resources, financing, or cash flows to support the company into the future.

Contractual Obligations

| | Total | Payments due by period | | | |
|-------------------------------|---------------------|------------------------|-------------------|-------------------|-------------------|
| | | Less than 1 year | 1 to 3 years | 4 to 5 years | After 5 years |
| Facility leases | \$ 1,778,075 | \$ 599,919 | \$ 574,644 | \$ 436,610 | \$ 166,902 |
| Equipment leases | 69,363 | 45,134 | 22,248 | 1,981 | - |
| Total contractual obligations | <u>\$ 1,847,438</u> | <u>\$ 645,053</u> | <u>\$ 596,892</u> | <u>\$ 438,591</u> | <u>\$ 166,902</u> |

Off-Balance Sheet Arrangements

Guarantees

We warrant that our software and hardware products will operate substantially in conformity with product documentation and that the physical media will be free from defect. The specific terms and conditions of the warranties are generally one year but may vary depending on the country in which the products are sold. We accrue for known warranty issues if a loss is probable and can be reasonably estimated, and accrue for estimated incurred but unidentified warranty issues based on historical activity. To date, we have had no material warranty claims.

Transactions with Related Parties

In the second quarter of 2005, E. Brinton Coxe, a member of our Board of Directors, became a related party by virtue of the fact that we have paid him compensation of Canadian \$815,908 and 350,000 common share purchase warrants in consideration of the provision of advisory services in connection with the private placement completed on April 8, 2005. Mr. Coxe has also participated in the financing by purchasing 100 units personally. Mr. Coxe was paid an additional Canadian \$145,940 for professional services provided during the year and to be provided to April 2006. For the six months ended May 31, 2006, \$20,856 was charged to expenses.

On April 8, 2005, Gerald J. Shields was elected to our Board of Directors. Mr. Shields provides legal services to the company through a law firm in which he has an interest. The fees billed to the company by Mr. Shields' firm for the three months and six months ended May 31, 2006 were \$100,305 and \$135,873, respectively (three and six months ended May 31, 2005 –\$42,285).

Proposed Transactions

We are not currently engaged in any proposed transactions.

SELECTED QUARTERLY DATA

The following tables contain financial information that is derived from the unaudited consolidated financial statements from the named periods.

| <i>For the three months ended</i> | May 31 2006 | February 28 2006 | November 30 2005 | August 31 2005 |
|--|------------------------|-----------------------------|-----------------------------|---------------------------|
| Revenue | \$ 6,139,869 | \$ 3,662,751 | \$ 5,137,424 | \$ 2,618,150 |
| Gross profit | 2,594,972 | 1,193,706 | 2,636,483 | 1,472,145 |
| Gross profit percentage | 42.3% | 32.6% | 51.3% | 56.2% |
| Net loss | (2,137) | (1,293,000) | (894,918) | (359,156) |
| Net loss attributable to common shareholders | (715,055) | (1,468,223) | (1,555,992) | (1,076,828) |
| Loss per share – basic and diluted | (0.02) | (0.05) | (0.06) | (0.04) |

| <i>For the three months ended</i> | May 31 2005 | February 28 2005 | November 30 2004 | August 31 2004 |
|--|------------------------|-----------------------------|-----------------------------|---------------------------|
| Revenue | \$ 1,533,245 | \$ 1,837,884 | \$ 3,053,762 | \$ 2,248,010 |
| Gross profit | 316,677 | 1,005,116 | 1,639,914 | 1,124,610 |
| Gross profit percentage | 20.6% | 54.7% | 53.7% | 50.0% |
| Net loss | (1,370,047) | (178,822) | (183,290) | (342,670) |
| Net loss attributable to common shareholders | (5,560,039) | (241,299) | (218,095) | (400,334) |
| Loss per share – basic and diluted | (0.20) | (0.01) | (0.01) | (0.01) |

CRITICAL ACCOUNTING POLICIES

These items are substantially unchanged as discussed in the Company's MD&A for the year ended November 30, 2005 as contained in our 2005 Annual Report filed on SEDAR at www.sedar.com or our annual Form 20-F report filed on EDGAR at www.sec.gov.

CHANGE IN REPORTING CURRENCY

Effective March 1, 2006 the Company adopted the U.S. dollar as its reporting currency. In general this change results from an increase in the overall proportion of business activities conducted in U.S. dollars. Under U.S. GAAP, the change was effected by translating assets and liabilities at the existing U.S./Canadian dollar foreign exchange spot rate on the last day of the month, while earnings were translated at the average rate for each month. Equity transactions have been translated at historical rates; with opening equity restated at the rate of exchange on December 1, 2001. The resulting net translation adjustment has been credited to the cumulative translation adjustment.

Prior to March 1, 2006 the reporting currency of the company was Canadian dollars.

CHANGES IN ACCOUNTING POLICIES

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard 123R, Share-Based Payment, ("SFAS 123(R)") a revision to SFAS 123. SFAS 123(R) 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.

Prior to December 1, 2005, the company's stock-based employee compensation plans were accounted for under the recognition and measurement provisions of Accounting Principles Board Opinion ("APB") No. 25, "Accounting for Stock Issued to Employees" ("APBO 25") and related Interpretations, as permitted by FASB Statement No. 123, "Accounting for Stock-Based Compensation ("SFAS 123"). The company generally did not recognize stock-based compensation costs in its statement of operations for periods prior to December 1, 2005, as all options granted had an exercise price equal to the market value of the underlying common stock on the date of the grant.

Effective December 1, 2005, the company adopted the fair value recognition provisions of SFAS No. 123(R), using the modified-prospective-transition method. Under this transition method, stock-based compensation cost recognized in the first three months of 2006 includes (a) compensation costs for all unvested stock-based awards based on the grant-date fair value, including those granted, modified or settled prior to September 1, 2005, that were previously disclosed on a pro forma basis, and (b) compensation cost for all stock-based awards granted subsequent to December 1, 2005, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123(R) .

As a result of adopting SFAS 123(R) on December 1, 2005, the company's loss from operations, loss before income taxes and net loss for the six months ended May 31, 2006 increased by \$10,328.

FINANCIAL INSTRUMENTS AND OTHER INSTRUMENTS

Foreign Exchange Forward Contracts

We use foreign exchange forward contracts to hedge transactions denominated in U.S. dollars, Australian dollars, and euros. The purpose of our hedging activities is to reduce the level of exposure to exchange rate movements. At May 31, 2006 we had foreign exchange forward contracts to sell Australian \$500,000 and buy Canadian funds. The exchange rates set in the foreign exchange forward contracts ranged between Canadian \$0.8373 and \$0.8374 for Australian \$1.00. The contracts mature September 30, 2006. At May 31, 2006 we also had foreign exchange forward contracts to sell U.S. \$1,518,726 and buy Canadian funds. The exchange rates set in the foreign exchange forward contracts ranged between Canadian \$1.0978 and \$1.1030 for U.S. \$1.00. The contracts mature between July 21, 2006 and January 31, 2007.

Derivative financial instruments are utilized by the company to reduce our exposure to fluctuations in foreign exchange on certain committed and anticipated transactions. We formally document the relationships between derivative financial instruments and hedged items, as well as the risk management objective and strategy. We assess, 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.

Derivatives are recorded as assets or liabilities, measured at fair value. Derivatives that are not hedges are adjusted to fair value through income or loss. 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 loss, or recognized in other comprehensive income or loss until the hedged item is recognized in income. The ineffective portion of a derivative's change in fair value is immediately recognized into income or loss. The requirement to record derivatives at their fair market value has not had a material impact on our financial statements.

DISCLOSURE OF OUTSTANDING SHARE DATA

As at May 31, 2006, we had 32.8 million issued and outstanding common shares and 3.7 million outstanding stock options. We also had 30,262 issued and outstanding class A preference shares and 317,240 issued and outstanding class B Series 2 preference shares convertible into common shares at conversion ratios of 1:1 and 1:58.82353 respectively which represents 18.7 million common shares. Also at May 31, 2006, we had 13.8 million outstanding common share purchase warrants convertible to common shares at a conversion ratio of 1:1, representing 13.8 million common shares.

If all preferred shares were converted, and all warrants and options were exercised, there would be a total of 69,055,426 common shares outstanding at May 31, 2006 (May 31, 2005 – 66,696,813). As a result of the exercise of all warrants and options, the company would receive cash of \$14,133,042 (May 31, 2005 - \$11,572,200).

RISKS AND UNCERTAINTIES

The primary risks and uncertainties that affect and may affect us and our business, financial condition and results of operations substantially unchanged as discussed in the company's MD&A for the year ended November 30, 2005 as contained in our 2005 Annual Report filed on SEDAR at www.sedar.com or our annual Form 20-F report filed on EDGAR at www.sec.gov.