

# Interim Financial Report

## 2007 First Fiscal Quarter

ended February 28, 2007

**OSI Geospatial Inc.**

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# MANAGEMENT'S DISCUSSION AND ANALYSIS

for the three months ended February 28, 2007

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## **OSI Geospatial Inc.**

Management's Discussion and Analysis  
For the three months ended February 28, 2007  
(expressed in U.S. dollars)

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

The following discussion and analysis provides a review of activities, results of operations, and financial condition of OSI Geospatial Inc. for the three months ended February 28, 2007 in comparison with those for the three months ended February 28, 2006. The following discussion should be read in conjunction with our unaudited consolidated interim financial statements, including the notes thereto, for the three months ended February 28, 2007, and the audited annual consolidated financial statements for the year ended November 30, 2006 prepared in accordance United States generally accepted accounting principles ("U.S. GAAP").

Effective December 1, 2004, we elected to report our consolidated financial statements in accordance with U.S. GAAP as permitted by Canadian regulators. Effective March 1, 2006 we adopted the U.S. dollar as our reporting currency. All references in this report to financial information concerning OSI Geospatial Inc. are in accordance with U.S. GAAP and all dollar amounts are in U.S. dollars unless otherwise indicated.

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. On April 12, 2006 at the Company's annual general meeting, its shareholders voted in favor of changing the Company's name from Offshore Systems International Ltd. to OSI Geospatial Inc. The name change was effective June 5, 2006. For the purposes of this report, the Company is referred to by its new legal identity.

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](http://www.sedar.com), on EDGAR at [www.sec.gov](http://www.sec.gov), and is also available on the company's investor web site at [www.osigeospatial.com](http://www.osigeospatial.com).

This management's discussion and analysis is dated April 12, 2007.

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## **OSI Geospatial Inc.**

Management's Discussion and Analysis  
For the three months ended February 28, 2007  
(expressed in U.S. dollars)

### **Overview**

Founded in 1977 and headquartered in North Vancouver, Canada, the Company designs, develops and markets the proprietary ECPINS® line of electronic chart navigation systems for commercial and military customers. ECPINS® helps to reduce the risk of navigation-related incidents by giving bridge crews a precise, real-time display of their position, course and speed, against a background of fixed obstacles and other navigational hazards. The Company has developed a strong market position in military navigation, and has ECPINS® systems deployed with the Canadian and United States Coast Guards, the Canadian Navy, the Royal New Zealand Navy, the Royal Danish Navy, the Royal Australian Navy, the Royal Navy of the United Kingdom and the United States Navy.

The Company's growth strategy is built on four fronts – diversifying its technology, partnering with the best, building on its customer relationships and completing acquisitions complimentary to its existing lines of business.

In diversifying its technology, the Company will lever its market and technology position as a leader in the naval surface and subsurface navigation market to access adjacent markets. Building on its ECPINS® line of electronic chart navigation systems for commercial and military customers, the Company has expanded into the Command & Control (C2) and homeland security markets through the development of applications like the Common Operational Picture product line (COP-PL), Warship Automatic Identification System (W-AIS) and the C2 product line C3CORE. Also, the Company has expanded its product offerings in the commercial market with the introduction of its simplified voyage data recorder (S-VDR) product, the integrated ECPINS®/S-VDR 5000 system.

The Company continues to partner with the best using its technology dominance in the military navigation market to gain entry into major defence programs. We currently have partnering agreements with Terma A/S in Denmark, Lockheed Martin in the U.S. and the U.K. and, Raytheon, L3 Communications, General Dynamics and Northrop Grumman in the U.S.

The Company continues to build on its current customer base by leveraging the strong customer relationships it has developed through the successful execution of major projects. We have 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.

The Company has completed acquisitions complimentary to its existing businesses to gain access to key markets, build critical mass and expand its products and markets, In April 2005, the Company completed the acquisition of all the outstanding shares of Mapcon Mapping Consultants Inc. (Mapcon) of Salt Lake City, Utah for \$1.1 million. Mapcon is a land mapping company in the U.S. geomatics (digital map and electronic chart data production) market. In December 2005, the Company completed the acquisition of CHI Systems Inc., a United States defence contracting company for \$9 million. CHI has multiple offices in the United States, is a supplier of technology and services to the U.S. Department of Defence and key defence prime contractors. CHI has developed C2, training simulation and cognitive agent applications to support its customers in multiple U.S. military agencies.

## OSI Geospatial Inc.

Management's Discussion and Analysis  
For the three months ended February 28, 2007  
(expressed in U.S. dollars)

### SELECTED DATA

The following tables contain financial information that is derived from the unaudited interim consolidated financial statements for the three months ended February 28, 2007.

<b>Operations:</b>	<b>For the three months ended February 28</b>	
In thousands of U.S. dollars except share related data	<b>2007</b>	<b>2006</b>
	<b>\$</b>	<b>\$</b>
Revenue	3,571	3,663
Gross profit	669	1,194
Gross profit percentage	19%	33%
Net loss	(2,022)	(1,229)
Net loss attributable to common shareholders	(2,195)	(1,405)
Loss per share – basic	(0.06)	(0.04)
Loss per share – diluted	(0.06)	(0.04)
Weighted average common shares outstanding – basic	36,148,418	31,269,155
Weighted average common shares outstanding - diluted	36,148,418	31,269,155

Our quarterly 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 lower gross profit and gross profit percentage in the three months ended February 28, 2007 as compared to the three months ended February 28, 2006 is largely due to the mix of revenue. There was less software revenue and more engineering services revenue in the three months ended February 2007 than in the three months ended February 28, 2006.

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 and therefore lower gross profit. 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.

<b>Financial Position:</b>	<b>At February 28, 2007</b>	<b>At November 30, 2006</b>
In thousands of U.S. dollars		
	<b>\$</b>	<b>\$</b>
Cash and cash equivalents, including marketable securities and restricted cash	-	-
Working capital <sup>(1)</sup>	5,841	7,789
Current assets	10,262	14,333
Total assets	20,140	24,345
Current liabilities	4,421	6,544
Long term liabilities	-	20
Total liabilities	4,421	6,564
Shareholders' equity	15,719	17,781

(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.

## OSI Geospatial Inc.

Management's Discussion and Analysis  
For the three months ended February 28, 2007  
(expressed in U.S. dollars)

Dividends declared per share In U.S. dollars	In three months ended February 28,	
	2007	2006
	\$	\$
Common shares	-	-
Class A preference shares	-	-
Class B preference shares – series 1	-	-
Class B preference shares – series 2	-	-

## RESULTS OF OPERATIONS – Three months ended February 28, 2007 as compared to three months ended February 28, 2006

### Overall Performance

Three months ended February 28	2007		2006	2007 to 2006		
In thousands of U.S. dollars						
Net loss before income taxes	\$	(1,917)	\$	(1,239)	\$	(678)
Net loss	\$	(2,022)	\$	(1,229)	\$	(793)
Net loss attributable to common shareholders	\$	(2,195)	\$	(1,405)	\$	(790)
Loss per share – basic and diluted		(0.06)		(0.04)		(0.02)

The net earnings reported in the year ended November 30, 2006 were largely driven by higher revenues offset 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, and an increase in staff to support our growth plans.

### Backlog

Total backlog is the sum of the firm and option backlogs. As at February 28, 2007 total backlog was \$61.4 million compared to \$27.2 million at February 28, 2006.

Firm backlog consists of firm, fixed, or signed orders issued and executable subsequent to the balance sheet date. Firm backlog as at February 28, 2007 was at \$39.8 million compared to \$12.1 million at February 28, 2006.

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 February 28, 2007 was at \$21.6 million compared to \$15.1 million at February 28, 2006.

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 awarded 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

## OSI Geospatial Inc.

Management's Discussion and Analysis  
For the three months ended February 28, 2007  
(expressed in U.S. dollars)

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

Three months ended February 28	2007	% of total revenue	2006	% of total revenue	2007 to 2006
In thousands of U.S. dollars					
Marine systems	\$ 700	20	\$ 1,282	35	\$ (582)
Land and air systems	2,348	66	1,852	51	496
Mapping	523	14	529	14	(6)
	<u>\$ 3,571</u>	<u>100</u>	<u>\$ 3,663</u>	<u>100</u>	<u>\$ (92)</u>

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 66% of our revenue for the three months ended February 28, 2007. 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 20% in the three months ended February 28, 2007.

The \$2.3 million revenue earned by our land and air systems during the three months ended February 28, 2007 relates to the acquisition of CHI Systems Inc.

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 three months ended February 28, 2007 were the U. S. Army, the U.S. Navy, the Defense Threat Reduction Agency, and the Royal Navy of the U.K. Revenue from these customers accounted for 62% of the consolidated revenue. The main customers for our products and services for the three months ended February 28, 2006 were the 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 68% of the consolidated revenue.

### Revenue by Segment

Three months ended February 28	2007	% of total revenue	2006	% of total revenue	2007 to 2006
In thousands of U.S. dollars					
International Systems operations	\$ 700	20	\$ 1,282	35	\$ (582)
U.S. Systems operations	2,348	66	1,852	51	496
Mapping operations	523	14	529	14	(6)
	<u>\$ 3,571</u>	<u>100</u>	<u>\$ 3,663</u>	<u>100</u>	<u>\$ (92)</u>

Revenue from the International Systems operations for the three months ended February 28, 2007 decreased 45% due to the timing of new contracts awarded, the delivery schedules of existing contracts and the mix of products and services delivered.

## OSI Geospatial Inc.

Management's Discussion and Analysis  
For the three months ended February 28, 2007  
(expressed in U.S. dollars)

Revenue from the U.S. Systems operations for the three months ended February 28, 2007 increased over the same period from the prior year by 43%. In the prior year, delays in the approval of the U.S. federal budget caused a reduction of revenues.

Revenue from our Mapping operations for the three months ended February 28, 2007 as compared to the three months ended February 28, 2006 was relatively stable.

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

Three months ended February 28	2007	2006	2007 to 2006
In thousands of U.S. dollars			
Gross profit	\$ 669	\$ 1,194	\$ (525)
Gross profit percentage	19%	33%	(14)%

Gross profit decreased by 525,000 in the three months ended February 28, 2007 compared to the three months ended February 28, 2006 and the gross profit percentage was 14 percentage points lower period-over-period. The reduced gross profit percentage compared to the prior fiscal year is due to the mix of contracts in the period.

### Gross Profit by Segment

Three months ended February 28	2007	2006	2007 to 2006
In thousands of U.S. dollars			
<b>Gross profit:</b>			
International Systems operations	\$ 37	\$ 678	\$ (641)
U.S. Systems operations	520	424	96
Mapping operations	112	92	20
Consolidated operations	<u>\$ 669</u>	<u>\$ 1,194</u>	<u>\$ (525)</u>
<b>Gross profit percentage:</b>			
International Systems operations	5%	53%	(48)%
U.S. Systems operations	22%	23%	(1)%
Mapping operations	21%	17%	4%
Consolidated operations	<u>19%</u>	<u>33%</u>	<u>(45)%</u>

Gross profit from the International Systems operations decreased 95% and gross profit percentage was 48 percentage points lower for the three months ended February 28, 2007 when compared to the prior period. The decreases in the first quarter of 2007 are the result of lower revenues in the International Systems operations and a decrease in our high margin software revenue compared to the three months ended February 28, 2006.

Gross profit from the U.S. Systems operations was up 23% for the three months ended February 28, 2007 as compared to the three months ended February 28, 2006 due to higher revenues in the current period.

Gross profit from the Mapping operations for the three months ended February 28, 2007 increased 22% compared to the same period last year. Gross profit percentage increased 4 percentage points period over period, consistent with the mix of contracts in the business unit.

## OSI Geospatial Inc.

Management's Discussion and Analysis  
For the three months ended February 28, 2007  
(expressed in U.S. dollars)

### Operating Expenses

Three months ended February 28	2007	% of total revenue	2006	% of total revenue	2007 to 2006
In thousands of U.S. dollars					
General and administrative	\$ 1,322	37%	\$ 1,346	37%	\$ (24)
Engineering	481	13%	542	15%	(61)
Sales and marketing	705	20%	552	15%	153

**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.

G&A decreased by 2% for three months ended February 28, 2007 compared to the previous year. There was little change in G&A staffing levels and costs between the two periods.

**Engineering** 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-related engineering costs in the period incurred.

Engineering costs decreased by 11% for the three months ended February 28, 2007, compared to the three months ended February 28, 2006. The decreases are related to lower staff levels and expenses for the period. 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 28% for three months ended February 28, 2007 compared to the three months ended February 28, 2006. The increases in S&M expenses are primarily due to additional sales and marketing emphasis. 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 will not result in closing orders during the current year but may yield orders in subsequent fiscal years.

### Depreciation and Amortization

Three months ended February 28	2007	2006	2007 to 2006
In thousands of U.S. dollars			
Depreciation and amortization	\$ 164	\$ 187	\$ (23)

Total depreciation and amortization decreased by 12% on the three months ended February 28, 2007 as compared to the three months ended February 28, 2006. For the years three months ended February 28, 2007 and 2006, portion of the depreciation, \$53,000 and \$55,000 respectively, was included in cost of sales for equipment used in revenue-generating activities.

## OSI Geospatial Inc.

Management's Discussion and Analysis  
For the three months ended February 28, 2007  
(expressed in U.S. dollars)

### Interest expense

Three months ended February 28	2007	2006	2007 to 2006
In thousands of U.S. dollars			
Interest expense	\$ 22	\$ 6	\$ 16

Interest expense increased by \$16,000 in the three months ended February 28, 2007 as compared to the three months ended February 28, 2006 as the result of the Company utilizing our operating line credit facility during the period.

### Interest income

Three months ended February 28	2007	2006	2007 to 2006
In thousands of U.S. dollars			
Interest income	\$ -	\$ 13	\$ (13)

Interest income decreased in the three months ended February 28, 2007 as compared to the three months ended February 28, 2006 because the Company had surplus cash in the three months ended February 28, 2006.

### Foreign Exchange

Three months ended February 28	2007	2006	2007 to 2006
In thousands of U.S. dollars			
Foreign exchange loss (gain)	\$ (85)	\$ 21	\$ (106)

Foreign exchange gain and loss is largely the result of exchange rate movements of the Australian dollar and the UK pound which were in the Company's favour during the three months ended February 28, 2007 as compared to February 28, 2006.

### Technology Partnerships Canada

Three months ended February 28	2007	2006	2007 to 2006
In thousands of U.S. dollars			
Royalty	\$ 30	\$ 57	\$ (27)
Contribution	-	(210)	(210)

As part of the agreement entered into on November 15, 1999 with TPC, 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, as part of the agreement entered into on April 26, 2004, 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.

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. As at August 31, 2006 the Company has received the entire \$2.9 million of the eligible TPC contributions.

## OSI Geospatial Inc.

Management's Discussion and Analysis  
For the three months ended February 28, 2007  
(expressed in U.S. dollars)

### Income Taxes

Three months ended February 28	2007	2006	2007 to 2006
In thousands of U.S. dollars			
Deferred income tax expense	\$ 14	\$ 16	(2)
Current income tax expense (recovery)	91	(26)	117
	<u>105</u>	<u>(10)</u>	<u>115</u>

Based on the information available at the time of the issue of the interim financial statements for the three months ended February 28, 2007, we estimated that we would not have sufficient taxable earnings in Canada in future periods to utilize a portion of our \$1.6 million Canadian non-capital losses carried forward, \$6.6 million scientific research and experimental development costs and other Canadian tax balances.

We have recognized deferred tax expense in the three months ended February 28, 2007 related to 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 future fiscal years. 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 - February 28, 2007 compared to November 30, 2006

In thousands of U.S. dollars	February 28, 2007	November 30, 2006	2007 to 2006
Cash and cash equivalents	\$ -	\$ -	\$ -
Current assets	10,262	14,333	(4,071)
Current liabilities	4,421	6,544	(2,123)
Working capital <sup>(1)</sup>	5,841	7,789	(1,948)

<sup>(1)</sup> 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 lines of credit borrowings of Canadian \$2.0 million and US \$600,000 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 next 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 February 28, 2007 our current assets and working capital decreased primarily due to a reduction in accounts receivable.

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 February 28, 2007, we had borrowings of \$348,000 against our

## OSI Geospatial Inc.

Management's Discussion and Analysis  
For the three months ended February 28, 2007  
(expressed in U.S. dollars)

operating line. We have an operating line of Canadian \$2.0 million available with a Canadian chartered bank collateralized by accounts receivable and US \$600,000 with a U.S. chartered bank. During the three months ended February 28, 2007, we utilized the facility which increased interest expense for the year.

### Cash Flows

Three months ended February 28	2007	2006	2007 to 2006
In thousands of U.S. dollars			
Cash flows provided by (used in):			
Operating activities	\$ 517	\$ 908	\$ (391)
Investing activities	(49)	(8,039)	8,088
Financing activities	(477)	-	(477)
Translation adjustment	9	58	(49)

Cash flows provided by operating activities for the three months ended February 28, 2007 were the result of a decrease in accounts payable and accrued liabilities. The increase in cash flows provided by operating activities was the result of the Company's decreased receivables.

Cash flows used in investing activities for the three months ended February 28, 2007 were primarily reflective of additions to plant and equipment, intangibles and other assets.

Cash flows used in financing activities for the three months ended February 28, 2007 were the result of a decrease in the operating line of credit.

As a result of the above mentioned changes, the line of credit utilization decreased by \$477,000 for the three months ended February 28, 2007.

In order to reduce the impact of U.S. dollar, Australian dollar, euro and British pound to Canadian dollar exchange rate fluctuations, for our Canadian operations we have used the forward exchange contract facility described above. We use the forward exchange contract facility to set the exchange rate between the U.S. and Canadian dollar, the Australian to Canadian dollar, British pound to Canadian dollar and the euro to Canadian dollar for specific transactions at a specific agreed upon rate, thereby mitigating any foreign exchange gain or loss that might occur on those transactions. We use the forward exchange contract facility only for known or reasonably certain future U.S. and Australian dollar and euro transactions.

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

Payments due by period	Total	Less than 1 year	1 to 3 years	4 to 5 years	After 5 years
In thousands of U.S. dollars					
Facility leases	\$ 3,457	\$ 546	\$ 871	\$ 783	\$ 1,257
Equipment leases	90	34	43	13	-
Total contractual obligations	\$ 3,547	\$ 580	\$ 914	\$ 796	\$ 1,257

## OSI Geospatial Inc.

Management's Discussion and Analysis  
For the three months ended February 28, 2007  
(expressed in U.S. dollars)

### 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 periods being reported on the Company had no related party transactions.

### PROPOSED TRANSACTIONS

We are not currently engaged in any proposed transactions.

### SELECTED QUARTERLY DATA (UNAUDITED)

In thousands of U.S. dollars

For the three months ended	February 28 2007	November 30 2006	August 31 2006	May 31 2006
Revenue	\$ 3,571	\$ 10,018	\$ 4,316	\$ 6,140
Gross profit	669	5,783	1,403	2,595
Gross profit percentage	19%	58%	32%	42%
Net earnings (loss)	(2,022)	2,691	(766)	(2)
Net earnings (loss) attributable to common shareholders	(2,195)	2,249	(953)	(715)
Loss per share – basic	(0.06)	0.07	(0.03)	(0.02)
Loss per share – diluted	(0.06)	(0.01)	(0.03)	(0.02)

  

For the three months ended	February 28 2006	November 30 2005	August 31 2005	May 31 2005
Revenue	\$ 3,663	\$ 5,137	\$ 2,618	\$ 1,533
Gross profit	1,194	2,636	1,472	317
Gross profit percentage	33%	51%	56%	21%
Net earnings (loss)	(1,229)	(872)	(308)	(1,370)
Net earnings (loss) attributable to common shareholders	(1,405)	(2,594)	(1,026)	(5,560)
Loss per share – basic	(0.04)	(0.09)	(0.04)	(0.20)
Loss per share – diluted	(0.04)	(0.15)	(0.08)	(0.20)

## **OSI Geospatial Inc.**

Management's Discussion and Analysis  
For the three months ended February 28, 2007  
(expressed in U.S. dollars)

### **CRITICAL ACCOUNTING POLICIES**

These items are substantially unchanged as discussed in the Company's MD&A for the year ended November 30, 2006 as contained in our 2006 Annual Report filed on SEDAR at [www.sedar.com](http://www.sedar.com) or our annual Form 20-F report filed on EDGAR at [www.sec.gov](http://www.sec.gov).

### **RECENT ACCOUNTING PRONOUNCEMENTS**

In June 2006, the Financial Accounting Standards Board issued FASB Interpretation No. 48 - Accounting for Uncertainty in Income Taxes ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. This Interpretation is effective for fiscal years beginning after December 15, 2006. The Company has not completed its analysis of the adoption of FIN 48 at this time.

In September 2006, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard 157, Fair Value Measurements ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles ("GAAP"), and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, the Board having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements. However, the application of this Statement will change current practice, effective December 1, 2007. The adoption of SFAS 157 will not have a material impact on the Company's consolidated financial statements.

In February, 2007 the Financial Accounting Standards Board issued Statement of Financial Accounting Standard 159, The Fair Value Option for Financial Assets and Financial Liabilities – Including an amendment of FASB Statement No. 115 ("SFAS 159"). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This Statement is expected to expand the use of fair value measurement, which is consistent with the Board's long-term measurement objectives for accounting for financial instruments. The adoption of SFAS 159 will not have a material impact on the Company's consolidated financial statements.

### **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, British pounds and euros. The purpose of our hedging activities is to reduce the level of exposure to exchange rate movements. At February 28, 2007, we had entered into the following foreign exchange forward contracts:

## OSI Geospatial Inc.

Management's Discussion and Analysis  
For the three months ended February 28, 2007  
(expressed in U.S. dollars)

Sell	Exchange rate in relation to CAD		Value date
	At February 28, 2007	At Value date	
GBP 200,000	2.2946	2.2449	March 30, 2007
AUD 125,000	0.9233	0.8442	April 16, 2007
USD 371,276	1.1700	1.1258	May 30, 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.

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.

### DISCLOSURE OF OUTSTANDING SHARE DATA

As at March 31, 2007, we had 38,788,221 issued and outstanding common shares and 3,210,916 outstanding stock options. As at March 31, 2007, we also had 30,262 issued and outstanding class A preference shares and 217,770 issued and outstanding class B preference shares series 2 convertible into common shares at conversion ratios of 1:1 and 1:58.82353 respectively which represents 12,840,262 common shares. Also at March 31, 2007, we had 13,788,365 outstanding common share purchase warrants convertible to common shares at a conversion ratio of 1:1, representing 13,788,365 common shares.

### DISCLOSURE CONTROLS AND PROCEDURES

The Company maintained a set of disclosure controls and procedures during the three months ended February 28, 2007 designed to ensure that information required to be disclosed is recorded, processed, summarized and reported within the time periods specified in provincial securities legislation as defined under Multilateral Instrument 52-109. The Chief Executive Officer and the Vice President Finance have determined that there were no changes to the company's disclosure controls and procedures during the three month period ended February 28, 2007 that have materially affected, or are reasonably likely to materially affect the design and operation of these disclosure controls and procedures.

### INTERNAL CONTROLS OVER FINANCIAL REPORTING

The Company maintains internal controls over financial reporting which have been designed to provide reasonable assurance of the reliability of external financial reporting in accordance with US GAAP as required by Multilateral Instrument 52-109. The Chief Executive Officer and the Vice President Finance, along with other employees to the extent considered necessary and appropriate, have designed internal controls over financial reporting that are effective as at February 28, 2007.

Nonetheless, the Chief Executive Officer and the Vice President Finance have identified areas where the Company can enhance process controls and they intend to incorporate such enhancements into the internal controls over financial reporting during the current fiscal year. The Company employs entity level controls to compensate for any deficiencies that may exist. Under 52-109, the Chief Executive Officer and the Vice President Finance are not required to, and have not yet tested the actual effectiveness of the Company's internal controls over financial reporting.

**OSI Geospatial Inc.**

Management's Discussion and Analysis  
For the three months ended February 28, 2007  
(expressed in U.S. dollars)

There were no changes in the Company's internal control over financial reporting that occurred since the beginning of the Company's current fiscal year to the date of this document that have materially affected, or are reasonably likely to materially affect the Company's internal control over financial reporting.

**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, 2006 as contained in our 2006 Annual Report filed on SEDAR at [www.sedar.com](http://www.sedar.com) or our annual Form 20-F which will be reported on EDGAR at [www.sec.gov](http://www.sec.gov).

# **OSI Geospatial Inc.**

**Interim Consolidated Financial Statements (Unaudited)  
Three months ended February 28, 2007 and 2006  
(expressed in U.S. dollars)**

(Prepared in accordance with Canadian Generally Accepted Accounting Principles)

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# OSI Geospatial Inc.

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

## Consolidated Balance Sheets (unaudited)

In thousands of U.S. dollars	February 28, 2007	November 30, 2006
<b>Assets</b>		
<b>Current assets</b>		
Accounts receivable (note 5)	\$ 7,887	\$ 12,707
Income taxes recoverable	94	28
Inventory (note 6)	1,295	1,063
Prepaid expenses and deposits	974	535
	<u>10,250</u>	<u>14,333</u>
<b>Future income tax asset</b>	10	-
<b>Plant and equipment</b>	1,025	1,089
<b>Intangible and other assets</b>	714	794
<b>Goodwill</b>	8,129	8,129
	<u>\$ 20,128</u>	<u>\$ 24,345</u>
<b>Liabilities</b>		
<b>Current liabilities</b>		
Bank indebtedness	\$ 378	\$ 904
Accounts payable and accrued liabilities	3,519	4,887
Income taxes payable	-	86
Unearned revenue	524	667
	<u>4,421</u>	<u>6,544</u>
<b>Future income tax liability</b>	-	20
	<u>4,421</u>	<u>6,564</u>
<b>Contingency</b> (note 8)		
<b>Shareholders' Equity</b>		
Issued and outstanding		
30,262 Class A Series A preference shares (2006 – 30,262) (note 7a)	19	19
224,570 Class B, Series 2 preference shares (2006 – 279,840)	5,711	7,115
38,388,221 common shares (2006 – 35,137,046) (note 7b)	17,291	15,887
	<u>23,021</u>	<u>23,021</u>
<b>Warrants</b>	4,286	4,286
<b>Contributed surplus</b>	1,396	11,343
<b>Accumulated deficit</b>	(15,285)	(13,296)
<b>Accumulated other comprehensive income</b>	2,289	2,427
	<u>15,707</u>	<u>17,781</u>
	<u>\$ 20,128</u>	<u>\$ 24,345</u>

The accompanying notes are an integral part of the consolidated financial statements.

# OSI Geospatial Inc.

## Consolidated Statements of Operations (unaudited)

In thousands of U.S. dollars, except share related data	Three months ended February 28,	
	2007	2006
<b>Revenue</b>		
Marine systems	\$ 700	\$ 1,282
Land and air systems	2,348	1,852
Mapping	523	529
	<hr/>	<hr/>
	3,571	3,663
<b>Cost of sales</b>	<hr/>	<hr/>
	2,902	2,469
	<hr/>	<hr/>
<b>Gross profit</b>	669	1,194
<b>Expenses</b>		
General and administrative	1,322	1,346
Engineering	481	542
Sales and marketing	705	552
Depreciation and amortization	111	132
Interest expense	22	6
Interest income	-	(13)
Foreign exchange loss (gain)	(85)	21
Technology Partnerships Canada royalty	30	57
Technology Partnerships Canada contribution	-	(210)
	<hr/>	<hr/>
	2,586	2,433
	<hr/>	<hr/>
<b>Net loss before income taxes</b>	(1,917)	(1,239)
	<hr/>	<hr/>
Future income tax expense (recovery)	(30)	16-
Current income tax expense (recovery)	102	(26)
	<hr/>	<hr/>
<b>Income tax expense (recovery)</b> (note 9)	72	(10)
	<hr/>	<hr/>
<b>Net loss</b>	\$ (1,989)	\$ (1,229)
	<hr/>	<hr/>
<b>Net loss attributable to common shareholders</b> (note 7d)	\$ (1,989)	\$ (1,229)
	<hr/>	<hr/>
<b>Loss per share</b> (note 7d) - basic and diluted	\$ (0.06)	\$ (0.04)
<b>Weighted average number of common shares outstanding</b> (note 7d) – basic and diluted	36,148,418	31,269,155
<b>Dividends declared per share</b>		
Class B preference shares – Series 2	\$ -	\$ -

The accompanying notes are an integral part of the consolidated financial statements.

# OSI Geospatial Inc.

## Consolidated Statements of Shareholders' Equity and Accumulated Deficit (unaudited)

In thousands of U.S. dollars except share numbers

Three months ended February 28, 2007

	Units		
<b>Class A preference shares</b>			
Balance at November 30, 2006	30,262	\$	19
Balance at February 28, 2007	30,262	\$	19
<b>Class B preference shares</b>			
Balance at November 30, 2006	279,840	\$	7,115
Class B preference shares converted to common shares	(55,720)		(1,404)
Balance at February 28, 2007	224,120	\$	5,711
<b>Common shares</b>			
Balance at November 30, 2006	35,137,046	\$	15,887
Class B preference shares converted to common shares	3,251,175		1,404
Balance at February 28, 2007	38,388,221	\$	17,291
<b>Warrants</b>			
Balance at November 30, 2006	13,788,368	\$	4,286
Balance at February 28, 2007	13,788,368	\$	4,286
<b>Contributed surplus</b>			
Balance at November 30, 2006		\$	1,343
Stock-based compensation			53
Balance at February 28, 2007		\$	1,396
<b>Accumulated deficit</b>			
Balance at November 30, 2006		\$	(13,296)
Net loss for the quarter			(1,989)
Balance at February 28, 2007		\$	(15,285)
<b>Accumulated other comprehensive income</b>			
Foreign currency translation adjustment			
Balance at November 30, 2006		\$	2,427
Adjustment for the quarter			(138)
Balance at February 28, 2007		\$	2,289
<b>Total shareholders' equity</b>		<b>\$</b>	<b>15,707</b>

The accompanying notes are an integral part of the consolidated financial statements.

# OSI Geospatial Inc.

## Consolidated Statements of Cash Flows (unaudited)

In thousands of U.S. dollars	For the three months ended February 28,	
	2007	2006
<b>Cash flows from operating activities</b>		
Net loss for the period	\$ (1,989)	\$ (1,229)
Items not affecting cash		
Depreciation and amortization	164	187
Stock-based compensation	53	25
Future income taxes	(30)	(10)
	<u>(1,802)</u>	<u>(1,027)</u>
Changes in non-cash working capital items		
Accounts receivable	4,597	3,637
Inventory	(258)	(94)
Prepaid expenses and deposits	(423)	60
Accounts payable and accrued liabilities	(1,294)	(1,779)
Income taxes payable	(176)	(141)
Unearned revenue	(127)	252
	<u>2,319</u>	<u>1,935</u>
	<u>517</u>	<u>908</u>
<b>Cash flows used in investing activities</b>		
Purchase of CHI Systems Inc., net of cash acquired	-	(7,883)
Increase in marketable securities	-	(258)
Decrease in restricted cash	-	190
Additions to plant and equipment	(27)	(48)
Additions to intangibles and other assets	(22)	(40)
	<u>(49)</u>	<u>(8,039)</u>
<b>Cash flows used in financing activities</b>		
Repayment to operating line of credit	<u>(477)</u>	-
	<u>(477)</u>	-
<b>Effect of foreign exchange on cash and cash equivalents</b>	<u>9</u>	<u>58</u>
<b>Decrease in cash and cash equivalents</b>	-	(7,073)
<b>Cash and cash equivalents – beginning of period</b>	-	<u>8,222</u>
<b>Cash and cash equivalents – end of period</b>	<u>\$ -</u>	<u>\$ 1,149</u>

The accompanying notes are an integral part of the consolidated financial statements.

# OSI Geospatial Inc.

Notes to the Consolidated Financial Statements (unaudited)

Three Months Ended February 28, 2007 and 2006

## 1 Basis of presentation

These unaudited consolidated financial statements have been prepared by management and include the accounts of OSI Geospatial Inc. and its subsidiaries, collectively referred to as the Company. These unaudited interim consolidated financial statements have been prepared in accordance with generally accepted accounting principles in Canada ("Canadian GAAP") and all amounts have been expressed in thousands of U.S. dollars unless otherwise noted.

The annual and interim consolidated financial statements originally issued for February 28, 2007 and prior periods were prepared in accordance with generally accepted accounting principles in the United States ("U.S. GAAP"). These previously released financial statements included a reconciliation to Canadian GAAP. The Company has restated all comparative amounts presented in accordance with Canadian GAAP.

These unaudited interim consolidated financial statements do not include all the information and footnote disclosures required by Canadian GAAP for annual financial statements. These unaudited interim consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and notes thereto.

On April 12, 2006 at the Company's annual general meeting its shareholders voted in favor of changing the Company's name from Offshore Systems International Ltd. to OSI Geospatial Inc. The name change was effective June 5, 2006. For the purposes of this report, the Company is referred to by its new legal identity.

The preparation of these unaudited interim consolidated financial statements requires management to make estimates and assumptions that affect the amounts reported. 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 Nature of operations

OSI Geospatial Inc. designs, develops, and markets software and systems for enhancing situational awareness in command, control, and intelligence applications. OSI Geospatial's principal product is the proprietary ECPINS® line of electronic chart navigation systems for commercial and military customers. OSI Geospatial conducts its operations through three business units – International Systems Operations, U.S. Systems Operations and Mapping Operations. The Company's International and U.S. Systems business units develop and produce geographic information display systems and software for the marine navigation, and command and control markets, and situational awareness products for land-based and aeronautical command and control markets. The Company's Mapping business unit provides digital land map and electronic nautical chart production services, and produces and distributes electronic nautical chart data.

## 3 Accounting changes

### a) Changes in accounting policies

In line with the conversion to Canadian GAAP referred to in Note 1 above, the Company has adopted the provisions of CICA Handbook Section 3855 *Financial Instruments – Recognition and Measurement*, CICA Handbook Section 3861 *Financial Instruments – Presentation and Disclosure*, CICA Handbook Section 3865 *Hedges* and CICA Handbook Section 1530 *Comprehensive Income*. These provisions became effective for the fiscal year beginning December 1, 2006.

### (i) Financial Instruments – Recognition and Measurement

This standard prescribes the recognition and measurement of financial instruments. Section 3855 requires that all financial assets and liabilities (including derivatives) be measured at fair value on initial recognition except for certain related party transactions. Measurement in subsequent periods depends on the classification of the instruments. All financial instruments must be classified as one of the following

# OSI Geospatial Inc.

## Notes to the Consolidated Financial Statements (unaudited)

### Three Months Ended February 28, 2007 and 2006

categories: held for trading, held to maturity, loans and receivables, available for sale assets and other financial liabilities.

The financial assets categorized as held for trading are measured at fair value with unrealized gains and losses recognized in net income. Section 3855 permits an entity to designate any financial instruments as held for trading on initial recognition or adoption of this standard, even if that instrument would not otherwise meet the definition of held for trading as specified in Section 3855. The Company's financial instruments classified as held for trading have included forward contracts and marketable securities, when used. The Company has historically measured these instruments at fair value and any unrealized gains and losses have been included in income.

Available for sale financial assets are measured at fair value with unrealized gains and losses recognized in other comprehensive income. The Company currently has no assets classified as available for sale.

The financial assets classified as loans and receivables and held to maturity are measured at amortized cost. There is no change in accounting treatment for these financial instruments as a result of adoption of Section 3855.

#### **(ii) Financial Instruments – Presentation and Disclosure**

CICA Handbook Section 3861 establishes standards for presentation of financial instruments and non-financial derivatives, and identifies the information that should be disclosed about them. Effective December 1, 2007, the Company will be required to adopt two new CICA standards: Section 3862 Financial Instruments – Disclosures; and Section 3863 Financial Instruments – Presentation, which will replace Section 3861 Financial Instruments – Disclosure and Presentation. The new disclosure standard increases the emphasis on the risks associated with both recognized and unrecognized financial instruments and how those risks are managed. The new presentation standard carries forward the former presentation requirements. The new financial instruments presentation and disclosure requirements were issued in December 2006 and the Company is assessing the impact on its consolidated financial statements.

#### **(iii) Hedges**

This standard sets out the criteria of when hedge accounting is applied and how it is applied. It provides the option of designating qualifying transactions as hedges for accounting purposes. The qualifying hedging relationships include fair value hedges, cash flow hedges, and hedges of foreign currency exposures of net investments in self-sustaining foreign operations. The changes in the fair value of the hedging derivatives will be recognized in net earnings or other comprehensive income depending on the nature of the hedging relationships. Any gains and losses resulting from any ineffectiveness in hedging relationships are recognized in net income immediately. The Company does not currently have any hedges and as a result there is no change on adoption of Section 3865.

#### **(iv) Comprehensive Income**

This section establishes standards for the reporting and disclosure of other comprehensive income ["OCI"] in a new category, Accumulated Comprehensive Income, which will be added to shareholders' equity on the consolidated balance sheet. Comprehensive income includes all changes in equity of the Company during a period except those resulting from investments by shareholders and distributions to shareholders. The major components included in Accumulated Comprehensive Income are unrealized gains and losses on financial assets classified as available for sale, and unrealized foreign exchange gains and losses arising on translation of the financial statements of self-sustaining foreign operations.

As a result of previously preparing the Company's financial statements in accordance with U.S. GAAP, the adoption of Section 1530 alongside the conversion to Canadian GAAP has not resulted in any change in disclosure on the Company's balance sheet.

# OSI Geospatial Inc.

Notes to the Consolidated Financial Statements (unaudited)

Three Months Ended February 28, 2007 and 2006

## b) 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. 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 foreign currency translation adjustment.

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

## 4 Acquisition

### CHI Systems Inc.

On December 14, 2005, the Company acquired CHI Systems Inc. ("CHI Systems"), a United States defense contracting company. CHI Systems has multiple offices in the United States and is a supplier of technology and services to the U.S. Department of Defense and key defense prime contractors. Under the terms of the agreement, the Company paid approximately \$9.0 million for 100% of the outstanding shares of CHI Systems, of which \$8.1 million was paid in cash with the balance paid by the issuance of 1,067,975 common shares of the Company. Information regarding this acquisition can be found in the company's audited consolidated financial statements for the year ended November 30, 2006 as reported in our 2006 Annual Report filed on SEDAR at [www.sedar.com](http://www.sedar.com) or our annual Form 20-F which will be reported on EDGAR at [www.sec.gov](http://www.sec.gov). The results of CHI Systems' operations have been included in the consolidated financial statements commencing December 14, 2005.

## 5 Accounts receivable

In thousands of U.S. dollars

	<b>February 28, 2007</b>	<b>November 30, 2006</b>
Trade	\$ 3,112	\$ 5,143
Unbilled revenue	4,681	7,257
Technology Partnerships Canada contribution	93	269
Other	58	97
Allowance for doubtful accounts	(57)	(59)
	<b>\$ 7,887</b>	<b>\$ 12,707</b>

# OSI Geospatial Inc.

## Notes to the Consolidated Financial Statements (unaudited) Three Months Ended February 28, 2007 and 2006

### 6 Inventory

In thousands of U.S. dollars

	February 28, 2007	November 30, 2006
Materials and components	\$ 810	\$ 958
Finished goods	485	105
	<u>\$ 1,295</u>	<u>\$ 1,063</u>

### 7 Capital Stock

#### a) Class A preference shares

The Company has 30,262 (November 30, 2006 – 30,262) Class A preference shares outstanding that have a value of \$19,000 (November 30, 2006 - \$19,000) 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.

#### b) Issued and outstanding common shares

During the three months ended February 28, 2007, 55,720 Preference shares were converted into 3,251,175 common shares. The Preference shares were reduced, and the common shares were increased, by \$1.4 million, the carrying value of the shares converted.

#### c) Stock option plans

A summary of the status of the Company's stock option plans at February 28, 2007 is as follows:

In U.S. dollars

	Number of shares	Weighted average exercise price
Outstanding - beginning of period	3,417,584	\$ 0.83
Granted	170,000	0.61
Forfeited	(5,000)	0.75
Expired	(176,668)	0.87
Outstanding - end of period	<u>3,405,916</u>	<u>\$ 0.80</u>
Exercisable – end of period	<u>3,405,916</u>	<u>\$ 0.80</u>

#### Stock-based compensation

For the three months ended February 28, 2007 the Company incurred non-cash stock-based compensation expense of \$53,000 (three months ended February 28, 2006 - \$25,000) related to stock options granted, all of which vested immediately. The expense was included in general and administrative costs and was recorded in contributed surplus.

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

# OSI Geospatial Inc.

Notes to the Consolidated Financial Statements (unaudited)

Three Months Ended February 28, 2007 and 2006

	<u>2007</u>	<u>2006</u>
Risk-free interest rate	4.02%	2.98%
Volatility	54%	54%
Estimated average option lives	5 years	5 years
Dividend yield	0.0%	0.0%

## d) Loss per share

In thousands of U.S. dollars except share related data	<b>For the three months ended February 28,</b>	
	<u>2007</u>	<u>2006</u>
<b>Loss per share – basic and diluted</b>		
Net loss for the period	\$ (1,989)	\$ (1,229)
Net loss available to common shareholders	\$ (1,989)	\$ (1,229)
Weighted average number of common shares outstanding – basic and diluted	36,148,418	31,269,155
Loss per share – basic and diluted	\$ (0.06)	\$ (0.04)

If all preferred shares were converted, and all warrants and options were exercised, there would be a total of 68,822,757 common shares outstanding at February 28, 2007 (November 30, 2006 – 68,834,425). As a result of the exercise of all warrants and options, the company would receive cash of \$13.2 million (November 30, 2006 - \$13.4 million).

## 8 Contingency

In July 2002, two of the Company's subsidiaries, Offshore Systems Ltd. and OSI Geomatics Ltd. (now Mapcon Mapping 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, 2007 in respect of these claims because the potential liability for the claims and the amount of damages, if any, cannot be reasonably estimated.

## 9 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, 2007 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 items not deductible for income tax purposes. The change in effective tax rate from 2007 to 2006 was due primarily to the effect of the change in valuation allowance.

At February 28, 2007, the Company adjusted its valuation allowance against future income 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 future income tax assets for which there is uncertainty of future realization.

# OSI Geospatial Inc.

Notes to the Consolidated Financial Statements (unaudited)

Three Months Ended February 28, 2007 and 2006

In thousands of U.S. dollars

	Three months ended February 28,	
	2007	2006
Future income tax expense (recovery)	\$ (30)	\$ 16
Current income tax expense (recovery)	102	(26)
Income tax expense (recovery)	<u>\$ 72</u>	<u>\$ (10)</u>
Effective tax rate	<u>(4%)</u>	<u>1%</u>

## 10 Segmented information

The Company's reportable segments are as outlined below. 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.

In thousands of U.S. dollars

	Three Months Ended February 28, 2007				
	International Systems Operations	U.S. Systems Operations	Mapping Operations	Corporate and Public Company Costs	Total
Revenue	\$ 700	\$ 2,348	\$ 523	\$ -	\$ 3,571
Gross profit	37	520	112	-	669
Technology Partnerships Canada	30	-	-	-	30
Interest expense	-	-	-	22	22
Income tax expense	-	54	(12)	32	72
Net earnings (loss)	(1,156)	79	(208)	(704)	(1,989)
Plant and equipment expenditures	14	6	7	-	27
Intangible expenditures	10	7	5	-	22
Depreciation and amortization	\$ 50	\$ 77	\$ 36	\$ 1	\$ 164

In thousands of U.S. dollars

	Three Months Ended February 28, 2006				
	International Systems Operations	U.S. Systems Operations	Mapping Operations	Corporate and Public Company Costs	Total
Revenue	\$ 1,282	\$ 1,851	\$ 529	\$ -	\$ 3,663
Gross profit	679	423	92	-	1,194
Technology Partnerships Canada - net	(153)	-	-	-	(153)
Interest expense	-	-	-	6	6
Income tax expense (recovery)	-	(3)	(7)	-	(10)
Net earnings (loss)	(392)	-	(241)	(596)	(1,229)
Plant and equipment expenditures	18	5	25	-	48
Intangible expenditures	33	-	7	-	40
Depreciation and amortization	\$ 46	\$ 73	\$ 67	\$ 1	\$ 187

# OSI Geospatial Inc.

Notes to the Consolidated Financial Statements (unaudited)

Three Months Ended February 28, 2007 and 2006

In thousands of U.S. dollars

Total assets employed	International	U.S.	Mapping	Corporate	Total
	Systems Operations	Systems Operations	Operations	and Public Company Costs	
As at February 28, 2007	\$ 6,745	\$ 10,611	\$ 2,677	\$ 95	\$ 20,128
As at November 30, 2006	\$ 10,483	\$ 10,599	\$ 3,283	\$ (20)	\$ 24,345

Geographically, revenues reported are based on the location of the Company's customers as follows:

In thousands of U.S. dollars

For the three months ended February 28,

	2007		2006
Europe	\$	353	\$ 173
Australia/New Zealand		156	387
United States		2,578	2,285
Canada		484	818
Total	\$	3,571	\$ 3,663

Geographically, plant and equipment and intangible and other assets are reported based on location. At February 28, 2007 and November 30, 2006, all of the Company's plant and equipment and intangible and other assets were located in Canada and the U.S. as follows:

In thousands of U.S. dollars

February 28, 2007

	Canada		U.S.	Total
Plant and equipment	\$	810	\$ 215	\$ 1,025
Intangible and other assets		301	413	714
Goodwill		-	8,129	8,129
Total	\$	1,111	\$ 8,757	\$ 9,868

In thousands of U.S. dollars

November 30, 2006

	Canada		U.S.	Total
Plant and equipment	\$	859	\$ 230	\$ 1,089
Intangible and other assets		322	472	794
Goodwill		-	8,129	8,129
Total	\$	1,181	\$ 8,831	\$ 10,012