



## **OSI Geospatial Inc.**

**Consolidated Financial Statements  
November 30, 2007 and 2006  
(expressed in U.S. dollars)**

(Prepared in accordance with Canadian Generally Accepted Accounting Principles)

## REPORT OF INDEPENDENT AUDITORS

To the Shareholders of  
**OSI Geospatial Inc.**

We have audited the consolidated balance sheet of **OSI Geospatial Inc.** as at November 30, 2007 and the revised consolidated balance sheet of the Company as at November 30, 2006 and the consolidated statement of operations, shareholders' equity, comprehensive income (loss), and cash flows for the year ended November 30, 2007 and the revised consolidated statements of operations, shareholders' equity, comprehensive income (loss), and cash flows for the years ended November 30, 2006 and 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards and the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at November 30, 2007 and 2006 and the results of its operations and its cash flows for each of the years in the three year period ended November 30, 2007 in conformity with Canadian generally accepted accounting principles.

As discussed in Note 3a to the consolidated financial statements, during 2007, the Company changed its accounting for financial instruments, hedges and comprehensive income.

As described in Notes 1 and 23, the consolidated financial statements of the Company as at November 30, 2006 and 2005 and for the years then ended, have been restated. We therefore withdraw our previous auditors' report dated February 16, 2007.

*Ernst & Young LLP*

Vancouver, Canada,  
February 5, 2008.

Chartered Accountants

# OSI Geospatial Inc.

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

## Consolidated Balance Sheets

As at November 30, 2007 and 2006

In thousands of U.S. dollars

	2007	2006
		(restated – see Notes 1 & 23)
<b>Assets</b>		
<b>Current assets</b>		
Accounts receivable and unbilled revenue (note 6)	\$ 13,055	\$ 12,707
Income taxes recoverable	-	28
Inventory (note 7)	1,216	1,063
Prepaid expenses and deposits	502	534
Current portion of future income tax asset (note 17)	132	104
	<hr/> 14,905	<hr/> 14,436
<b>Deferred development costs</b>	97	-
<b>Future income tax asset</b> (note 17)	271	1
<b>Equipment and furnishings</b> (note 8)	1,914	1,089
<b>Intangible and other assets</b> (note 9)	861	794
<b>Goodwill</b> (note 5)	8,300	8,130
	<hr/> \$ 26,348	<hr/> \$ 24,450
<b>Liabilities</b>		
<b>Current liabilities</b>		
Bank indebtedness	\$ 822	\$ 904
Accounts payable and accrued liabilities (note 10)	5,585	4,887
Income taxes payable	179	86
Unearned revenue	392	667
Current portion of deferred rent	38	-
Current portion of future income tax liability (note 17)	25	15
Current portion of capital lease obligations (note 12)	46	-
	<hr/> 7,087	<hr/> 6,559
<b>Deferred rent</b>	347	-
<b>Capital lease obligation</b> (note 12)	200	-
<b>Future income tax liability</b> (note 17)	100	110
	<hr/> 7,734	<hr/> 6,669
<b>Commitments and contingencies</b> (note 15)		
<b>Shareholders' Equity</b>		
Issued and outstanding		
30,262 Class A, Series A preference shares (2006 – 30,262) (note 13b)	19	19
178,530 Class B, Series 2 preference shares (2006 – 279,840) (note 13c)	4,542	7,115
46,956,439 common shares (2006 – 35,137,046) (note 13d)	21,293	15,887
	<hr/> 25,854	<hr/> 23,021
<b>Warrants</b> (note 13f)	4,618	4,286
<b>Contributed surplus</b>	1,679	1,343
<b>Accumulated deficit</b>	(16,564)	(13,296)
<b>Accumulated other comprehensive income</b>	3,027	2,427
	<hr/> 18,614	<hr/> 17,781
	<hr/> \$ 26,348	<hr/> \$ 24,450

### On behalf of the Board

“Raymond Johnston”

Director

“Donald Young”

Director

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

# OSI Geospatial Inc.

## Consolidated Statements of Operations

For the years ended November 30, 2007, 2006 and 2005

In thousands of U.S. dollars, except share related data

	2007	2006	2005
		(restated – see Notes 1 & 23)	(restated – see Notes 1 & 23)
<b>Revenue</b>			
Marine Systems	\$ 10,219	\$ 11,274	\$ 8,181
Land and air systems	10,703	8,761	-
Mapping	4,404	4,102	2,945
	25,326	24,137	11,126
<b>Cost of sales</b>	15,560	13,484	5,696
<b>Gross profit</b>	9,766	10,653	5,430
<b>Expenses</b>			
General and administrative	6,175	5,712	4,759
Engineering	1,361	1,783	1,527
Sales and marketing	3,859	2,527	2,354
Amortization	326	510	245
Interest expense	70	21	23
Interest income	(7)	(37)	(156)
Foreign exchange loss (gain)	316	(233)	90
Loss on disposal of fixed assets	9	2	4
Technology Partnerships Canada royalty (note 14)	471	493	243
Technology Partnerships Canada contribution (note 14)	-	(760)	(1,090)
	12,580	10,018	7,999
<b>Net earnings (loss) before income taxes</b>	(2,814)	635	(2,569)
Future income tax expense (recovery)	(298)	(364)	726
Current income tax expense	358	67	204
<b>Income tax expense (recovery) (note 17)</b>	60	(297)	930
<b>Net earnings (loss)</b>	\$ (2,874)	\$ 932	\$ (3,499)
<b>Net loss available to common shareholders (note 13g)</b>	\$ (3,588)	\$ (82)	\$ (4,252)
<b>Loss per share (note 13g)</b>			
Basic	\$ (0.09)	\$ 0.00	\$ (0.15)
Diluted	\$ (0.09)	\$ 0.00	\$ (0.15)
<b>Weighted average number of common shares outstanding (note 13g)</b>			
Basic	41,096,261	32,381,992	27,989,832
Diluted	41,096,261	48,843,168	27,989,832
<b>Dividends declared per share</b>			
Class B preference shares – Series 1	\$ -	\$ -	\$ 2.36
Class B preference shares – Series 2	\$ 1.64	\$ 3.13	\$ 3.52

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

# OSI Geospatial Inc.

## Consolidated Statements of Shareholders' Equity

For the years ended November 30, 2007, 2006 and 2005

In thousands of U.S. dollars except share numbers

	2007		2006 (restated – see Notes 1 & 23)		2005 (restated – see Notes 1 & 23)	
	Number	Amount	Number	Amount	Number	Amount
<b>Class A preference shares</b>						
Balance at beginning of year	30,262	\$ 19	30,262	\$ 19	30,262	\$ 19
Balance at end of year	30,262	\$ 19	30,262	\$ 19	30,262	\$ 19
<b>Class B preference shares</b>						
Balance at beginning of year	279,840	\$ 7,115	341,240	\$ 8,669	57,711	\$ 1,261
Repurchase of Class B Series 1 preference shares	-	-	-	-	(57,711)	(1,261)
Issue of Class B Series 2 preference shares, net	-	-	-	-	390,000	9,908
Class B preference shares converted to common shares	(101,310)	(2,573)	(61,400)	(1,560)	(48,760)	(1,239)
Share issue costs	-	-	-	6	-	-
Balance at end of year	178,530	\$ 4,542	279,840	\$ 7,115	341,240	\$ 8,669
<b>Common shares</b>						
Balance at beginning of year	35,137,046	\$ 15,887	30,367,309	\$ 13,515	27,488,074	\$ 12,269
Shares issued to CHI shareholders (note 5)	-	-	1,067,975	752	-	-
Shares issued to Liddy shareholders (note 5)	300,000	129	-	-	-	-
Shares issued (note 13d)	5,560,000	3,060	-	-	-	-
Share issue costs, net of tax benefit	-	(356)	-	-	-	-
Class B preference shares converted to common shares	5,959,393	2,573	3,611,762	1,560	2,868,235	1,239
Exercise of stock options	-	-	90,000	60	11,000	7
Balance at end of year	46,956,439	\$ 21,293	35,137,046	\$ 15,887	30,367,309	\$ 13,515
<b>Warrants</b>						
Balance at beginning of year	13,788,368	\$ 4,286	13,788,368	\$ 4,286	1,393,301	\$ 437
Warrants issued – net of issue costs	2,780,000	332	-	-	12,395,067	3,849
Balance at end of year	16,568,368	\$ 4,618	13,788,368	\$ 4,286	13,788,368	\$ 4,286
<b>Contributed surplus</b>						
Balance at beginning of year		\$ 1,343		\$ 1,239		\$ 161
Share based broker compensation		74		-		-
Stock-based compensation		262		104		1,078
Balance at end of year		\$ 1,679		\$ 1,343		\$ 1,239
<b>Accumulated deficit</b>						
Balance at beginning of year		\$ (13,296)		\$ (13,059)		\$ (7,701)
Repurchase of Class B Series 1 preference shares		-		-		(1,020)
Difference between conversion consideration and carrying value of Class B Series 2 preference shares		-		(15)		-
Dividends on Class B preference shares		(382)		(1,014)		(753)
Tax expense on dividends		(12)		(140)		(86)
Net earnings (loss) for the year		(2,874)		932		(3,499)
Balance at end of year		\$ (16,564)		\$ (13,296)		\$ (13,059)
<b>Accumulated other comprehensive income</b>						
Foreign currency translation adjustment						
Balance at beginning of year		\$ 2,427		\$ 2,291		\$ 1,691
Other comprehensive income		600		136		600
Balance at end of year		\$ 3,027		\$ 2,427		\$ 2,291
<b>Total shareholders' equity</b>		<b>\$ 18,614</b>		<b>\$ 17,781</b>		<b>\$ 16,960</b>

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

# OSI Geospatial Inc.

## Consolidated Statements of Comprehensive Income (Loss)

For the years ended November 30, 2007, 2006 and 2005

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In thousands of U.S. dollars	2007	2006	2005
		(restated – see Notes 1 & 23)	(restated – see Notes 1 & 23)
Net earnings (loss)	\$ (2,874)	\$ 932	\$ (3,499)
Other comprehensive income (loss), net of taxes			
Unrealized gains on translation of self-sustaining foreign operations	600	136	600
<b>Comprehensive (loss) income for year</b>	<b>\$ (2,274)</b>	<b>\$ 1,068</b>	<b>\$ (2,899)</b>

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

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# OSI Geospatial Inc.

## Consolidated Statements of Cash Flows

### For the years ended November 30, 2007, 2006 and 2005

In thousands of U.S. dollars

	2007	2006	2005
		(restated – see Note1 & 23)	(restated – see Note1 & 23)
<b>Cash flows from (used) in operating activities</b>			
Net earnings (loss) for the year	\$ (2,874)	\$ 932	\$ (3,499)
Items not affecting cash			
Amortization	554	763	404
Loss on disposal of equipment	9	2	3
Stock-based compensation	262	104	1,078
Future income taxes	(298)	(558)	678
	<u>(2,347)</u>	<u>1,243</u>	<u>(1,336)</u>
Changes in non-cash working capital items			
Accounts receivable	69	(1,995)	(1,222)
Inventory	47	(109)	(363)
Prepaid expenses and deposits	138	185	(362)
Accounts payable and accrued liabilities	459	809	1,079
Income taxes payable	86	(173)	131
Unearned revenue	(275)	197	356
Deferred rent	367	-	-
	<u>891</u>	<u>(1,086)</u>	<u>(381)</u>
	<u>(1,456)</u>	<u>157</u>	<u>(1,717)</u>
<b>Cash flows used in investing activities</b>			
Purchase of Liddy International Inc. (note 5)	(25)	-	-
Purchase of CHI Systems, Inc., net of cash acquired (note 5)	-	(8,146)	-
Purchase of Mapcon Mapping Consultants Inc., net of cash acquired	-	-	(973)
Decrease (increase) in restricted cash	-	189	(189)
Development costs deferred	(97)	-	-
Additions to equipment and furnishings	(400)	(290)	(70)
Additions to leaseholds	(663)	-	-
Additions to intangibles and other assets	(247)	(237)	(216)
	<u>(1,432)</u>	<u>(8,484)</u>	<u>(1,448)</u>
<b>Cash flows from (used in) financing activities</b>			
(Repayments to) advances from operating line of credit	(103)	904	-
Capital lease financing	246	-	-
Issue of common shares, net of issue costs	2,812	60	7
Issue of warrants	332	-	-
Issue of Class B Series 2 preference shares and warrants, net of issue costs	-	-	13,756
Class B preference share issue costs	-	6	-
Repurchase of Class B Series 1 preference shares	-	-	(2,281)
Class B preference share dividends declared and paid	(382)	(1,014)	(753)
	<u>2,905</u>	<u>(44)</u>	<u>10,729</u>
<b>Effect of foreign exchange on cash balances</b>	<u>(17)</u>	<u>149</u>	<u>446</u>
<b>Increase (decrease) in cash and cash equivalents</b>	<u>-</u>	<u>(8,222)</u>	<u>8,010</u>
<b>Cash and cash equivalents – beginning of year</b>	<u>-</u>	<u>8,222</u>	<u>212</u>
<b>Cash and cash equivalents – end of year</b>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 8,222</u>

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

# OSI Geospatial Inc.

## Notes to Consolidated Financial Statements

November 30, 2007 and 2006

### 1 Basis of presentation

These audited consolidated financial statements have been prepared by management and include the accounts of OSI Geospatial Inc. and its wholly owned subsidiaries, collectively referred to as OSI Geospatial or the Company. These consolidated financial statements have been prepared in accordance with generally accepted accounting principles in Canada ("Canadian GAAP") and all amounts herein have been expressed in thousands of U.S. dollars unless otherwise noted. Note 22 to these financial statements presents a comparison to generally accepted accounting principles in the United States ("U.S. GAAP").

The annual and interim consolidated financial statements previously issued in 2005 and 2006 were prepared in accordance with "U.S. GAAP". These previously released financial statements included a reconciliation to Canadian GAAP. The Company has restated all comparative amounts presented in the financial statements in accordance with Canadian GAAP. In the process of this restatement to Canadian GAAP, certain GAAP differences that were previously not identified in prior years' GAAP reconciliation notes to the financial statements have now been identified and corrected. See Note 23 for additional information.

On April 12, 2006 at the Company's annual general meeting its shareholders voted in favour 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.

### 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 (formerly the Geomatics 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 relating to the adoption of Canadian GAAP

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, and have been applied retroactively.

#### (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 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

# OSI Geospatial Inc.

## Notes to Consolidated Financial Statements

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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 and liabilities classified as loans and receivables, held to maturity and other liabilities 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) 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 accumulated 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.

### (iii) Comprehensive Income

This section establishes standards for the reporting and disclosure of other comprehensive income ["OCI"] in a new category, Accumulated Other Comprehensive Income, which will be included in 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 Other 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.

The adoption of Section 1530 alongside with the conversion to Canadian GAAP has not resulted in any change in disclosure on the Company's balance sheet. The Company has presented a Statement of Other Comprehensive Income in the consolidated financial statements.

### b) Change in reporting currency

Effective March 1, 2006, the Company adopted the U.S. dollar as its reporting currency. In general this change resulted from the acquisition of CHI Systems Inc. which increased the overall proportion of business activities of the OSI Geospatial Inc. Group of Companies 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 period, while earnings were translated at the average rate for period. 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.

# OSI Geospatial Inc.

## Notes to Consolidated Financial Statements

November 30, 2007 and 2006

### c) Recent pronouncements

The following recent pronouncements issued by the CICA will be monitored by the Company:

The CICA has issued two accounting standards related to the disclosure and presentation of financial instruments. CICA Handbook Section 3862 *Financial Instruments – Disclosure* and CICA Handbook Section 3863 *Financial Instruments – Presentation*, which will replace Section 3861 “Financial Instruments – Disclosure and Presentation”. These standards apply to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007. 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 CICA has issued CICA Handbook Section 1535 *Capital Disclosures* which will require disclosure of information about an entity’s objectives, policies and processes for managing capital, as well as quantitative data about capital and whether the entity has complied with any capital requirements. This standard applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007.

The CICA has issued CICA Handbook Section 3031 *Inventories* which will replace CICA 3030 *Inventories*. CICA 3031 will create changes from current practice, including the reversal of impairment write-downs, which is not permitted currently and more extensive disclosure. The section is effective for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2008.

The CICA has issued CICA Handbook Section 3064 *Goodwill and Intangible Assets* which replaces Section 3062 *Goodwill and Other Intangibles* and Section 3450 *Research and Development Costs*. This Section establishes standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets, including the development, maintenance or enhancement of intangible resources such as scientific or technical knowledge, design and implementation of new processes or systems, licenses, intellectual property, market knowledge and trademarks. This Section applies to annual and interim financial statements relating to fiscal years beginning on or after October 1, 2008.

The Company is assessing the impact on its consolidated financial statements of the above recent pronouncements.

## 4 Summary of significant accounting policies

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. A reconciliation of amounts presented in accordance with United States generally accepted accounting principles is detailed in note 22. The following is a summary of significance accounting principles used in the preparation of these consolidated financial statements.

### a) Principles of consolidation

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All material intercompany transactions and balances have been eliminated on consolidation.

### b) Foreign currency translation

The Company’s Canadian subsidiaries’ functional currency is Canadian Dollar. The Company’s United States subsidiaries’ functional currency is United States Dollars.

Monetary assets and liabilities denominated in foreign currencies are recorded at the rate of exchange prevailing at the balance sheet date. Non-monetary assets and liabilities denominated in foreign currencies are translated at historical rates. Revenue and expenses are translated at the average exchange rate

# OSI Geospatial Inc.

## Notes to Consolidated Financial Statements

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prevailing during the period. Foreign currency translation gains and losses are included in income in the period in which they occur.

The cumulative foreign currency translation adjustment included under accumulated other comprehensive income within shareholders' equity on the consolidated balance sheets relates to the unrealized foreign currency translation gains or losses of Canadian subsidiaries. Financial statements of Canadian subsidiaries, all of which are self-sustaining, are translated into U.S. dollars using the current rate method. Under the current rate method, assets and liabilities are translated at the rate of exchange prevailing at the balance sheet date. Revenue and expenses are translated at the average exchange rate prevailing during the period.

### **c) Use of estimates**

The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions which affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses for the years reported. Actual results could differ from these estimates.

### **d) Cash and cash equivalents**

Cash and cash equivalents consist of cash and deposit instruments with an initial maturity of three months or less.

### **e) Accounts receivable**

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

### **f) Inventory**

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

### **g) Research and development costs**

The Company annually incurs costs on activities that relate to the research and development of new products.

Research costs are expensed in the period incurred.

Product development costs include investigative and development expenditures incurred on specific potential products. These costs are expensed in the period incurred unless, in the opinion of management, the deferral criteria are satisfied in all material respects, in which case development expenditures are capitalized and amortized over the estimated life of the related products.

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## Notes to Consolidated Financial Statements

November 30, 2007 and 2006

### h) Equipment and furnishings

Equipment, furniture and fixtures and leasehold improvements are recorded at cost less accumulated amortization. Amortization is provided using the methods indicated below and rates based on the assets' estimated useful lives as follows:

	<b>Method</b>	<b>Percentage</b>
Equipment	Declining balance	20 – 25
Furniture and fixtures	Declining balance	20
Leasehold improvements	Straight line	10

An impairment loss is recognized when the undiscounted cash flows expected from use and eventual disposition of the asset are less than the carrying amount of the asset. An impairment charge is recorded to reduce the carrying value of the asset to its fair value.

### i) Intangible and other assets

Intangible and other assets are recorded at cost less accumulated amortization. Amortization is provided using the methods indicated below and rates based on the assets' estimated useful lives as follows:

	<b>Method</b>	<b>Percentage</b>
Computer software	Declining balance	33
Customer contracts	Straight line	33 – 100
Customer relationships	Straight line	10 – 25
Security clearance	Straight line	17
Licenses and patents	Declining balance	10

An impairment loss is recognized when the undiscounted cash flows expected from use and eventual disposition of the asset are less than the carrying amount of the asset. An impairment charge is recorded to reduce the carrying value of the asset to its fair value.

### j) Leases

Leases are classified as either capital or operating leases. A lease that transfers substantially all benefits and risks incidental to the ownership of property is classified as a capital lease. All other leases are accounted for as operating leases wherein rental payments are expensed as incurred. At the inception of a capital lease, an asset and a lease obligation are recorded at an amount equal to the lesser of the present value of the minimum lease payments and the property's fair value at the beginning of such lease. Assets recorded under the capital leases are amortized over the estimated useful lives of the respective assets on commencement of use of the related assets.

### k) Goodwill

Acquisitions are accounted for using the purchase method whereby acquired assets and liabilities are recorded at fair value as of the date of acquisition. The excess of the purchase price over such fair value is recorded as goodwill. The Company evaluates, on at least an annual basis, the carrying amounts of goodwill for impairment. To accomplish this, the Company compares the fair value of the reporting unit to the carrying amount. If the carrying value of the reporting unit were to exceed its fair value, the Company would perform the second step of the impairment test. In the second step, the Company would compare the fair value of the reporting unit goodwill to the carrying amount and any excess would be written off. Any impairment of goodwill would be recognized as an expense in the period of impairment, and subsequent reversals of impairment are prohibited. The Company performs its testing for impairment of goodwill and other intangible assets on an annual basis. Based on testing performed as of November 30, 2007, there was no impairment.

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## Notes to Consolidated Financial Statements

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### l) Lease inducements

Lease inducements are recorded on the balance sheet as deferred rent and are amortized against rent expense over 10 years, the economic life of the lease, on a straight line basis.

### m) Income taxes

The Company accounts for income taxes using the liability method of tax allocation. Under the liability method, future income tax assets and liabilities are determined based on differences between their financial reporting and tax bases and are measured using substantially enacted tax rates and laws expected to be in effect when the differences are expected to reverse. The Company provides a valuation allowance against future tax assets to the extent that the Company does not consider them to be more likely than not of being realized.

### n) Revenue recognition

#### *International Systems Operations and US Systems Operations*

The Company recognizes revenue from the sale of systems and software licenses upon the transfer of title and software locks to the customer, so long as persuasive evidence of an arrangement exists, delivery has occurred, the price is fixed or determinable, collection is reasonably assured, and there are no ongoing obligations of the Company to provide future services with the exception of warranties and maintenance. The Company uses the residual method to recognize revenue on delivered elements when a license agreement includes one or more elements to be delivered at a future date if evidence of the fair value of all undelivered elements exists. If an undelivered element for the arrangement exists under the license arrangement, revenue related to the undelivered element is deferred based on vendor-specific objective evidence ("VSOE") of the fair value of the undelivered element. If VSOE of fair value does not exist for all undelivered elements, all revenue is deferred until sufficient evidence exists or all elements are delivered.

The Company recognizes revenue from the sales of hardware products upon the transfer of title of the hardware product to the customer so long as persuasive evidence of an arrangement exists, delivery has occurred, the price is fixed or determinable, and collection is reasonably assured.

The Company also enters into contracts that are primarily fixed fee arrangements to render specific consulting and software modification services. The percentage of completion method is applied to these more complex contracts that involve the provision of services relating to the design or building of complex systems that require significant modification and that are essential to the functionality of other elements in the arrangement. Under this method, revenue is recognized using the percentage of completion basis and is calculated based on actual labour dollars incurred compared to the estimated total labour dollars for the services under the arrangement, so long as persuasive evidence of an arrangement exists, the price is fixed or determinable, and collection is reasonably assured. If the Company does not have a sufficient basis to measure progress towards completion, revenue is recognized when final acceptance is received by the Company from the customer.

Service revenues consist of revenues from consulting, implementation, training, integration services and research and development services. These services are set forth separately in the contractual arrangements such that the total price of the customer arrangement is expected to vary as a result of the inclusion or exclusion of these services. For those contracts where the services are not essential to the functionality of any other element of the transaction, the Company determines VSOE of fair value for these services based upon normal pricing and discounting practices for these services when sold separately. These services contracts are primarily time and material based contracts. Revenue from these services is recognized at the time such services are rendered by the Company so long as persuasive evidence of an arrangement exists, delivery has occurred, the price is fixed or determinable, and collection is reasonably assured.

The Company's multiple-element sales arrangements include arrangements where software licenses and the associated post contract customer support ("PCS") are sold together. The Company endeavours to establish

# OSI Geospatial Inc.

## Notes to Consolidated Financial Statements

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VSOE of the fair value of the undelivered PCS element based on the contracted price for standalone PCS services previously provided. The Company's multiple-element sales arrangements may include rights for the customer to renew PCS after the bundled term ends. These rights are irrevocable to the customer's benefit, are for specified prices, are consistent with the initial price in the original multiple-element sales arrangement, and the customer is not subject to any economic or other penalty for failure to renew. Further, the renewal PCS options are for services comparable to the bundled PCS.

PCS revenue associated with systems and software licenses is recognized rateably over the term of the PCS period, so long as persuasive evidence of an arrangement exists, the price is fixed or determinable, and collection is reasonably assured. PCS revenue may include software license updates, rights to unspecified software product revisions addressing latent defects, maintenance releases and patches released during the term of the PCS period. PCS revenue may also include hardware maintenance and upgrades throughout the PCS period including maintaining the continual performance standards of the hardware, making modifications, alterations and repairs as required and other hardware related support services.

Revenue under bill-and-hold arrangements is recognized when risks of ownership have been passed on to the customer, there is a signed contract with the customer, the customer has a substantial business purpose for ordering the goods on a bill-and-hold basis, a fixed delivery schedule has been established with the customer, and the Company does not retain any specific performance obligations such that the earnings process is not complete. Goods held under such arrangements are segregated, ready for shipment and not subject to being used to fill other orders. The customers are charged additional fees for storage and other associated costs until shipment occurs.

### ***Mapping Operations***

Revenue from mapping services are recognized using the proportional performance method of accounting, whereby revenue in the period are based on the output completed to total units of work to be completed of the project for each segment of the project. A provision is made for the entire amount of future estimated losses, if any, on contracts in progress.

Revenue from the sale of mapping products is recorded at the time of delivery of the product to the customer so long as persuasive evidence exists of an agreement with the customer, the price is fixed or determinable, and collection is reasonably assured.

### **o) Unbilled revenue**

Unbilled revenue is revenue that has been recognized using the percentage of completion or the proportional performance methods of accounting less amounts billed to the customer in accordance with the milestone terms of the contract. Unbilled revenue is reduced when customers are invoiced and the respective accounts receivable is recorded.

### **p) Unearned revenue**

Unearned revenue is amounts that have been billed to the customer but have not been recognized in revenue.

### **q) Government assistance**

Government assistance is recorded when there is reasonable assurance that the Company has complied with, and will continue to comply with, all conditions necessary to obtain the government assistance. Government assistance towards current research expenditures is recorded as a reduction of expenses in the consolidated statements of operations. The liability to repay government assistance is recognized as an expense in the period in which conditions arise that cause the government assistance to be repayable.

# OSI Geospatial Inc.

## Notes to Consolidated Financial Statements

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### r) Stock-based compensation

The Company has stock option plans as described in note 13. The Company uses the fair value method to account for such plans. Under this method, the Company measures the fair value of stock-based awards as of the grant date and recognizes the cost as an expense on a straight-line basis over the applicable vesting period with a corresponding increase in contributed surplus. When stock-based compensation awards vest, contributed surplus is reduced by the applicable amount and share capital is increased by the same amount.

### s) Earnings per share

Basic earnings per share are computed using the weighted average number of common shares outstanding during the year. The treasury stock method is used for the calculation of diluted earnings per share. Under the treasury stock method, the weighted average number of common shares outstanding for the calculation of diluted earnings per share assumes that the proceeds to be received on the exercise of dilutive stock options and warrants are applied to repurchase common shares at the average market price for the period. Stock options and warrants are dilutive when the average market price of the common shares during the period exceeds the exercise price of the options and warrants.

### t) Guarantees

The Company guarantees that its 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. The Company accrues for known warranty issues if a loss is probable and can be reasonably estimated, and accrues for estimated incurred but unidentified warranty issues based on historical activity. To date, the Company has had no material warranty claims.

### u) Derivative financial instruments

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

Changes in fair value of foreign currency denominated derivative financial instruments used to hedge anticipated or committed foreign currency exposures are recognized as an adjustment to the related operating costs or revenue when the hedged transaction is recorded. Derivatives that are not subject to hedge accounting are recorded on the consolidated balance sheets with the changes in fair value being recorded in the consolidated statement of operations each period.

The Company purchases foreign exchange forward contracts to mitigate the exposure to sales and the related accounts receivable to customers denominated in U.S. dollars, UK pounds, Australian dollars and Euros.

# OSI Geospatial Inc.

## Notes to Consolidated Financial Statements November 30, 2007 and 2006

### 5 Acquisitions

#### a) Liddy International Inc.

On April 23, 2007, the Company through its subsidiary CHI Systems, Inc., acquired the assets of Liddy International Inc. ("Liddy"), a United States defence contracting company and established Layered Security Solutions ("LSS"). LSS provides business continuity solutions against hazards and has the capability to develop deterrence, response and recovery strategies designed to deal with global threats to business and government. Under the terms of the agreement, the Company paid approximately \$154,000 for assets and goodwill of Liddy, of which \$25,000 was paid in cash with the balance paid by the issuance of 300,000 common shares of the Company of which 200,000 common shares are held in escrow subject to the satisfaction of certain contractual provisions.

The following table summarizes the fair value of the assets acquired by the Company at April 23, 2007, the date of acquisition. The acquisition was accounted for using the purchase method whereby assets acquired were recorded at their fair values at April 23, 2007. The excess of the purchase price over the fair market value was recorded as goodwill.

In thousands of U.S. dollars

<b>Assets</b>	
Furniture and Fixtures	\$ 8
Computer Equipment	17
Goodwill	170
<b>Total assets acquired</b>	<u>195</u>
Net assets acquired (cash and common share consideration)	154
Direct acquisition costs incurred by the Company	<u>41</u>
<b>Total acquisition costs</b>	\$ 195
Less fair value of net identifiable assets acquired	<u>25</u>
<b>Goodwill</b>	<u>\$ 170</u>

#### b) Mapcon Mapping Consultants Inc,

On April 8, 2005, the Company acquired all of the issued and outstanding shares of Mapcon Mapping Consultants Inc. ("Mapcon Mapping") of Salt Lake City, Utah for cash consideration of \$1.1 million. The acquisition was effective April 1, 2005. Mapcon Mapping was a privately held land mapping company in the U.S. digital and electronic geomatics data production market. The results of Mapcon Mapping's operations have been included in the consolidated financial statements commencing April 1, 2005.

The acquisition was accounted for using the purchase method whereby assets acquired and liabilities assumed were recorded at their fair values at April 1, 2005. The excess of the purchase price over the fair market value of \$403,000 was recorded as goodwill.

#### c) CHI Systems Inc.

On December 14, 2005, the Company acquired CHI Systems, Inc. ("CHI Systems"), a United States defence 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 defence 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. The results of CHI Systems' operations have been included in the consolidated financial statements commencing December 14, 2005. The acquisition was accounted for using the purchase method

# OSI Geospatial Inc.

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whereby assets acquired and liabilities assumed were recorded at their fair values at December 14, 2005. The excess of the purchase price over the fair market value was recorded as goodwill as highlighted below.

In thousands of U.S. dollars

### Assets

Current assets	\$ 2,058
Plant and equipment	225
Intangible and other assets	439
Goodwill	7,727
<b>Total assets acquired</b>	<b>\$ 10,449</b>

### Liabilities

Current liabilities not including future tax liabilities	720
Future tax liabilities	181
<b>Total liabilities assumed</b>	<b>\$ 901</b>

Net assets acquired (cash and common share consideration)	\$ 8,849
Direct acquisition costs incurred by the Company	699

**Total acquisition costs** 9,548

Less fair value of net identifiable assets acquired 1,821

**Goodwill** **\$ 7,727**

**Cash of acquired operations** **\$ 627**

The fair value of the assets acquired, including goodwill, and liabilities assumed in the acquisition have been "pushed down" to CHI Systems.

The following table presents details of the purchased intangible assets:

In thousands of U.S. dollars

	<b>Estimated useful life</b>	<b>Amount</b>
Patents	5 years	\$ 6
Customer contracts	2 to 36 months	158
Security clearance	6 years	275
<b>Total intangible assets</b>		<b>\$ 439</b>

## 6 Accounts receivable and unbilled revenue

In thousands of U.S. dollars

	<b>November 30,</b>	
	<b>2007</b>	<b>2006</b>
Trade	\$ 7,570	\$ 5,143
Unbilled revenue	5,312	7,257
Technology Partnerships Canada contribution	-	269
Other	182	97
Allowance for doubtful accounts	(9)	(59)
	<b>\$ 13,055</b>	<b>\$ 12,707</b>

As at November 30, 2007, government contract trade receivables were \$3,506,000 (2006 - \$4,044,000) and unbilled government contract revenues were \$5,003,000 (2006 - \$6,680,000).

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## Notes to Consolidated Financial Statements November 30, 2007 and 2006

### 7 Inventory

In thousands of U.S. dollars

	November 30,	
	2007	2006
Materials and components	\$ 1,012	\$ 958
Finished goods	204	105
	<u>\$ 1,216</u>	<u>\$ 1,063</u>

### 8 Equipment and furnishings

In thousands of U.S. dollars

	November 30, 2007		
	Cost	Accumulated Amortization	Net Amount
Equipment	\$ 5,468	\$ 4,399	\$ 1,069
Furniture and fixtures	728	554	174
Leasehold improvements	751	80	671
	<u>\$ 6,947</u>	<u>\$ 5,033</u>	<u>\$ 1,914</u>

In thousands of U.S. dollars

	November 30, 2006		
	Cost	Accumulated Amortization	Net Amount
Equipment	\$ 4,638	\$ 3,713	\$ 925
Furniture and fixtures	599	482	117
Leasehold improvements	300	253	47
	<u>\$ 5,537</u>	<u>\$ 4,448</u>	<u>\$ 1,089</u>

### 9 Intangible and other assets

In thousands of U.S. dollars

	November 30, 2007		
	Cost	Accumulated Amortization	Net Amount
Computer software	\$ 1,583	\$ 1,050	\$ 533
Customer contracts	288	286	2
Customer relationships	160	64	96
Security clearance	275	92	183
Licenses and patents	85	38	47
	<u>\$ 2,391</u>	<u>\$ 1,530</u>	<u>\$ 861</u>

# OSI Geospatial Inc.

## Notes to Consolidated Financial Statements

November 30, 2007 and 2006

In thousands of U.S. dollars

November 30, 2006

	Cost	Accumulated Amortization	Net Amount
Computer software	\$ 1,189	\$ 791	\$ 398
Customer contracts	288	278	10
Customer relationships	160	42	118
Security clearance	275	46	229
Licenses and patents	80	41	39
	<u>\$ 1,992</u>	<u>\$ 1,198</u>	<u>\$ 794</u>

The aggregate amortization expense for intangible assets for the fiscal year was \$219,000 (2006 - \$288,000, 2005 - \$81,000).

### 10 Accounts payable and accrued liabilities

In thousands of U.S. dollars

November 30,

	2007	2006
Trade	\$ 1,798	\$ 2,016
Accrued employee compensation	1,542	1,318
Accrued employee benefits and payroll deductions	217	280
Accrued royalties (note 14)	472	490
Other accrued liabilities	1,556	783
	<u>\$ 5,585</u>	<u>\$ 4,887</u>

### 11 Credit facilities

The Company has certain credit facilities with a Canadian chartered bank, which consist of an operating line, a foreign exchange forward contract facility and standby letters of credit. The operating line bears interest at the chartered bank's prime lending rate plus 0.5% with interest payable monthly. The prime lending rate at November 30, 2007 was 6.25% (2006 - 6.00%). The Company also has an operating line with a U.S. chartered bank which bears interest at the bank's prime lending rate plus 0.5%. The prime lending rate at November 30, 2007 was 7.5% (2006 - 8.25%). Funds drawn on the operating lines and the standby letters of credit are repayable on demand. The Company utilizes letters of credit to back certain performance obligations with its customers. As of November 30, 2007 and 2006, no letters of credit were issued.

The maximum amount available to the Company under the operating lines are CAD \$2,000,000 and US \$600,000. The credit facilities are collateralized by a general assignment of book debts, a general security agreement and general security agreements, from each of Offshore Systems Ltd., Mapcon Mapping Ltd. and Mapcon Mapping Inc. In addition, the Company is required to meet certain covenants as outlined in the credit facilities agreement.

The Company has a foreign exchange facility with a Canadian chartered bank whereby it can enter into forward foreign exchange contracts. The maximum facility is based on a bank formula for deemed risk and is calculated using recent volatility in the currency of the contract as well as the length of the contract. At November 30, 2007, our foreign exchange facility would enable the Company to enter into USD denominated forward foreign exchange contracts for approximately US \$7 million. As at November 30, 2007, the Company has drawn on it forward foreign exchange contract facility in the amount of US \$4.9 million (2006: \$nil). A foreign exchange loss of \$137,000 (2006: nil) has been included in other liabilities.

# OSI Geospatial Inc.

## Notes to Consolidated Financial Statements

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### 12 Capital lease obligation

Finance leases have been established for the purchase of certain capital assets with terms ranging from three to five years. The lease obligations are capitalized at the lease inception at the lower of fair value of the leased property and the present value of the minimum lease payments. The weighted average interest rate implicit in the leases is approximately 4%.

Commitments in relation to capital leases are payable as follows:

In thousands of U.S. dollars	November 30,	
	2007	2006
Within one year	\$ 89	\$ -
Later than one year but less than five years	222	-
Minimum lease payments	311	-
Future financing charges	(65)	-
Recognized as a liability	246	-
Less: current portion	(46)	-
Long term portion of capital lease obligation	\$ 200	-

### 13 Capital Stock

#### a. Authorized

100,000,000 Class A preference shares with no par value, issuable in series, of which:

10,000,000 shares are designated Series A voting non-cumulative, retractable, convertible at a ratio of 1:1, 1% preference shares

100,000,000 Class B preference shares with a par value of \$50 each, issuable in series, of which:

10,000,000 shares are designated Series 1 voting, cumulative, convertible shares at a ratio of 1:45.5, 6% preference shares, and

10,000,000 shares are designated Series 2 voting, cumulative, convertible shares at a ratio of 1:58.82, 7% preference shares

Unlimited Class C preference shares without par value, issuable in series

Unlimited common shares without par value

#### b. Class A preference shares

The Company has 30,262 (November 30, 2006 – 30,262) Class A preference shares outstanding. 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.

#### c. Class B Series 2 preference shares

Each Series 2 preference share entitles the holder to one vote either in person or by proxy at any general meeting of the shareholders of the Company. The Company has the right to require the shareholders of the preference shares to convert each such share into 58.8235 common shares if (i) at any time after 13 months following the issuance of the preference shares, the closing trade price of the Company's common shares exceeds CAD \$2.13 for at least 20 consecutive trading days, or (ii) at any time, the Company completes a firm public underwritten offering of its common shares for more than CAD\$40 million at a price per common share greater than CAD \$1.70. The preference shares are redeemable at the option of the Company at any time after the third anniversary of the issuance date for an amount equal to the original issuance price plus a premium of 20% of the original issue price. The preference shares are not subject to any right of redemption at the option of the holder.

# OSI Geospatial Inc.

## Notes to Consolidated Financial Statements

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During the fiscal year 2007, 101,310 preference shares were converted into 5,959,393 common shares (2006 – 61,400 preference shares were converted into 3,611,762 common). The Class B preference shares were reduced, and the common shares were increased by \$2.6 million (2006 - \$1.6 million), the carrying value of the shares converted.

### **d. Common shares**

On July 31, 2007, the Company closed a private placement offering resulting in the placement of 5,560,000 units (the "Units") of the Company at a price of \$0.65 per Unit, for gross proceeds of \$3.4 million. Each Unit consists of one common share and one-half of one common share purchase warrant. Each warrant entitles the holder to purchase one common share of the Company at a price of \$0.80 per common share for a period of 24 months expiring July 31, 2009.

The gross proceeds from the private placement were allocated as follows: \$3.1 million was allocated to the 5,560,000 common shares issued and \$332,000 was allocated to the 2,780,000 warrants issued. Share issue costs associated with the private placement amounted to \$356,000 and included a \$74,000 broker compensation warrant entitling the broker to purchase up to 333,600 Units of the Company at a price of \$0.65 per Unit for a period of 24 months from the closing of the offering.

An additional 300,000 common shares were issued as part of the Liddy acquisition (note 5a).

### **e. Stock option plans**

The Company has established three stock option plans under which stock options to purchase common shares may be granted to directors, officers and employees of the Company and to any other person or Company permitted by the applicable regulatory authorities to purchase unissued common shares. The number of common shares authorized for grant under the Company's stock option plans is 10,930,732, of which 4,274,494 are available for future granting. The exercise price of stock options granted pursuant to the plans may not be less than the market price of the common shares at the time of grant. The plans provide that stock options may be granted with vesting periods and expiry dates at the discretion of the board of directors. Stock options granted to directors, management and employees vest over periods ranging from immediately to five years.

# OSI Geospatial Inc.

## Notes to Consolidated Financial Statements November 30, 2007 and 2006

A summary of the status of the Company's stock option plans at November 30 is as follows:

In Canadian dollars		2007		2006		2005	
	Number of shares	Weighted average exercise price	Number of shares	Weighted average exercise price	Number of shares	Weighted average exercise price	
Outstanding - beginning of year	3,417,584	\$ 0.95	3,674,417	\$ 0.81	2,254,047	\$ 0.94	
Granted	1,150,000	0.55	247,500	0.65	3,054,666	0.79	
Exercised	-	-	(90,000)	0.73	(11,000)	0.65	
Forfeited	(273,000)	0.90	(196,000)	0.82	(18,384)	0.80	
Surrendered	-	-	-	-	(632,784)	0.87	
Expired	(698,418)	1.08	(218,333)	0.87	(972,128)	0.98	
Outstanding - end of year	3,596,166	\$ 0.80	3,417,584	\$ 0.83	3,674,417	\$ 0.82	
Exercisable - end of year	3,531,582	\$ 0.80	3,417,584	\$ 0.83	3,378,417	\$ 0.81	

A summary of the Company's stock options outstanding and exercisable at November 30, 2007 is as follows:

In Canadian dollars		Options outstanding		Options exercisable	
Range of Exercise prices	Number outstanding at November 30, 2007	Weighted average remaining contractual life (years)	Weighted average exercise price	Number exercisable at November 30, 2007	Weighted average exercise price
\$ 0.46 - 0.63	980,000	4.72	\$ 0.53	915,416	\$ 0.52
0.64 - 0.96	1,725,166	2.94	0.86	1,725,166	0.86
0.97 - 1.21	891,000	2.72	0.99	891,000	0.99
\$ 0.46 - 1.21	3,596,166	3.37	\$ 0.80	3,531,582	\$ 0.80

A summary of the Company's stock options outstanding and exercisable at November 30, 2006 is as follows:

In Canadian dollars		Options outstanding		Options exercisable	
Range of exercise prices	Number outstanding at November 30, 2006	Weighted average remaining contractual life (years)	Weighted average exercise price	Number outstanding at November 30, 2006	Weighted average exercise price
\$0.64 - 0.96	2,902,916	3.58	\$ 0.80	2,902,916	\$ 0.80
0.97 - 1.21	514,668	0.35	1.00	514,668	1.00
\$0.64 - 1.21	3,417,584	3.10	\$ 0.83	3,417,584	\$ 0.83

# OSI Geospatial Inc.

## Notes to Consolidated Financial Statements November 30, 2007 and 2006

A summary of the Company's stock options outstanding and exercisable at November 30, 2005 is as follows:

In Canadian dollars	Options outstanding			Options exercisable		
	Range of exercise prices	Number outstanding at November 30, 2005	Weighted average remaining contractual life (years)	Weighted average exercise price	Number outstanding at November 30, 2005	Weighted average exercise price
	\$0.64 – 0.96	3,101,416	4.19	\$ 0.79	2,951,416	\$ 0.79
	0.97 – 1.21	573,001	1.26	0.98	427,001	0.98
	\$0.64 – 1.21	3,674,417	3.73	\$ 0.82	3,378,417	\$ 0.81

### Stock-based compensation

For the year ended November 30, 2007, the Company incurred non-cash stock-based compensation expense of \$262,000 (2006 - \$104,000, 2005 - \$1,078,000) related to 1,150,000 stock options granted. Of the options granted in the year ended November 30, 2007, 1,046,000 options vested immediately, 52,000 will vest over one year and 52,000 will vest over two years from the grant date. 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:

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Risk-free interest rate	3.96%	4.14%	2.87%
Volatility	47%	53%	49%
Estimated average option lives	5 years	5 years	3.2 years
Dividend yield	0.0%	0.0%	0.0%

Option valuation models require the input of highly variable assumptions including the expected stock price volatility. Because the Company's stock options have characteristics significantly different from those of traded options, and because changes in the input assumptions can materially affect the fair value estimate, the Black-Scholes model does not necessarily provide a reliable single measure of the fair value of the Company's stock options.

### Shareholder rights plan

On April 18, 2001, the Board of Directors of the Company adopted a shareholder rights plan (the Rights Plan). The Rights Plan was approved by the Toronto Stock Exchange in accordance with its policies. On March 19, 2007, the Board of Directors carried a resolution regarding the continued existence of the Rights Plan as amended and restated as of March 19, 2007, subject to receipt of shareholder approval, for an additional three year period. The continued existence of the Rights Plan was approved by the shareholders of the Company by ordinary resolution at the annual general meeting of the Company held on April 19, 2007.

The objectives of the Rights Plan are to ensure, to the extent possible, that all shareholders of the Company are treated equally and fairly in connection with any take-over offer for the Company. Take-over offers may not always result in shareholders receiving equal or fair treatment or full value for their investment. In addition, current Canadian securities legislation only requires a take-over offer to remain open for 35 days. The Board believes that this period may be insufficient for the shareholders to evaluate a bid, or for the Board to pursue alternatives that could maximize shareholder value and to make informed recommendations to shareholders.

The Rights Plan is designed to discourage discriminatory or unfair take-over offers for the Company and gives the board time, if appropriate, to pursue alternatives to maximize shareholder value in the event of an

# OSI Geospatial Inc.

## Notes to Consolidated Financial Statements

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unsolicited take-over bid for the Company. The Rights Plan will encourage an offeror to proceed by way of a permitted bid or to approach the Board of Directors with a view to negotiation by creating the potential for substantial dilution of the offeror's position. The permitted bid provisions of the Rights Plan are designed to ensure that, in any take-over bid, all shareholders are treated equally, receive the maximum value for their investment and are given adequate time to properly assess the take-over bid on a fully informed basis.

**f. Warrants**

In Canadian dollars

Number of Warrants	Exercise Price	Weighted average remaining contractual life in years
1,393,301	\$1.10	0.21
12,395,067	0.85	2.36
2,780,000	0.80	1.67
<hr/>		
16,568,368	\$0.86	2.06

**g. Loss per share**

In thousands of U.S. dollars, except share related data

	Years ended November 30,		
	2007	2006	2005
<b>Basic loss per share</b>			
Net earnings (loss)	\$ (2,874)	\$ 932	\$ (3,499)
Less:			
Class B Series 1 preference share dividends	-	-	(51)
Class B Series 2 preference share dividends (*A)	(714)	(1,014)	(702)
Loss available to common shareholders	<hr/> \$ (3,588)	<hr/> \$ (82)	<hr/> \$ (4,252)
Weighted average number of common shares outstanding	<hr/> 41,096,261	<hr/> 32,381,992	<hr/> 27,989,832
Basic loss per share	<hr/> \$ (0.09)	<hr/> \$ (0.00)	<hr/> \$ (0.15)

(\*A) Dividends of \$332,000 are included which represents the dividends earned by the shareholders of the Class B Series 2 cumulative preference shares. These dividends were declared and paid in December 2007 (Note 24)

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In thousands of U.S. dollars, except share related data

Years ended November 30,

<b>Diluted loss per share</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>
Net earnings (loss)	\$ (2,874)	\$ 932	\$ (3,499)
Class B Series 1 preference share dividends	-	-	(51)
Class B Series 2 preference share dividends (*A)	(714)	(1,014)	(702)
Loss available to common shareholders	\$ (3,588)	\$ (82)	\$ (4,252)
Weighted average number of common shares outstanding	41,096,261	32,381,992	27,989,832
Dilutive effect of Class A preference shares – Series A (*1)	-	-	-
Dilutive effect of Class B preference shares – Series 1 (*2)	-	-	-
Dilutive effect of Class B preference shares – Series 2 (*1)	-	-	-
Dilutive effect of warrants (*3)	-	16,461,176	-
Dilutive effect of stock options (*1)	-	-	-
Adjusted weighted average number of common shares outstanding	41,096,261	48,843,168	27,989,832
Diluted loss per share	\$ (0.09)	\$ (0.00)	\$ (0.15)

(\*A) Dividends of \$332,000 are included which represents the dividends earned by the shareholders of the Class B Series 2 cumulative preference shares. These dividends were declared and paid in December 2007 (Note 24)

(\*1) The Class A preference shares – Series A, Class B preference shares Series 2 and stock options were anti-dilutive for the purposes of calculating diluted earnings per share for the years ended November 30, 2007, 2006 and 2005.

(\*2) The Class B preference shares – Series 1 were anti-dilutive for the purposes of calculating diluted earnings per share for the years ended November 30, 2005. There were no Class B preference shares – Series 1 outstanding at November 30, 2007 and 2006.

(\*3) The outstanding warrants were anti-dilutive for the purposes of calculating diluted earnings per share for the years ended November 30, 2007 and 2005.

### 14 Technology Partnerships Canada

On April 26, 2004, the Company entered into an agreement with Technology Partnerships Canada (“TPC”) whereby TPC granted financial assistance to the Company for the purpose of funding research and development activities to be completed on or before March 31, 2007. The maximum eligible contribution by TPC is \$3.3 million. Accounts receivable at November 30, 2007 includes \$nil of amounts receivable from TPC in connection with these claims (2006 – \$269,000), which represents the maximum allowed under the agreement.

In addition, the Company is required to pay a royalty of 1.4% on annual gross revenue in the International Systems Operations segment for the period January 1, 2006 to December 31, 2008 and a royalty of 2.5% on annual gross revenue in the International Systems Operations segment for the period January 1, 2009 to December 31, 2013. The Company has paid royalties of \$178,000 to date (2006 – \$nil) and has accrued

# OSI Geospatial Inc.

## Notes to Consolidated Financial Statements

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royalties of \$150,000 at November 30, 2007 (November 30, 2006 - \$155,000). Royalty payments will continue until the cumulative royalties paid or payable to December 31, 2013 are at least \$5.3 million or until December 31, 2017.

In addition, the Company is required to pay a royalty of 3% on annual gross revenue in the International Systems Operations segment for the period December 1, 1999 to November 30, 2008. The Company has paid royalties of \$1.7 million to date (2006 – \$1.3 million) and has accrued royalties of \$322,000 at November 30, 2007 (November 30, 2006 - \$335,000). Royalty payments will continue until the cumulative royalties paid or payable to November 30, 2008 are at least \$6.8 million or until November 30, 2014.

Although the Company believes that its submissions for TPC funding meet the terms and conditions of the TPC agreements, the final determination may be subject to audit by government authorities in the ordinary course of business.

During the year ended November 30, 2005, the Company was subject to three audits by government authorities. The results of the cost audit did not have a financial impact on the Company's results. The results of the compliance audit required a repayment of contributions received of \$105,000 recognized in the 2006 fiscal year as a reduction in TPC contributions. The royalty audit concluded in 2007 and resulted in a requirement to pay an additional \$16,000.

TPC royalties paid and accrued are as follows:

In thousands of U.S. dollars	Years ended November 30,		
	2007	2006	2005
Royalties paid	\$ 476	\$ 256	\$ 263
Accrued royalties – current	\$ 472	\$ 490	\$ 256

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

### 15 Commitments and contingencies

The Company has entered into a one year guarantee for one of the Company's subsidiaries, CHI Systems, Inc. ("CHI"). The Company has guaranteed CHI's bank line of credit that was put in place by the previous owners prior to OSI Geospatial's acquisition of CHI. The maximum potential amount of future payments the Company could be required to make under this guarantee is \$600,000 U.S. dollars. At November 30, 2007, the carrying amount CHI's line of credit was \$520,000 U.S. dollars.

In January 2007, the Company signed a 10 year lease for new office facilities in Burnaby, British Columbia. It relocated its North Vancouver, British Columbia operations to Burnaby, British Columbia on August 1, 2007.

In April 2007, the Company signed a three year lease for new office facilities in Ottawa, Ontario. It opened the corporate head office in Ottawa on June 1, 2007.

# OSI Geospatial Inc.

## Notes to Consolidated Financial Statements

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The company has entered into operating leases for its office premises in Canada, United States and for certain equipment. Minimum lease payments required under the remaining terms of the leases are as follows:

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	\$ 4,320	\$ 855	\$ 1,406	\$ 942	\$ 1,116
Equipment leases	66	29	34	4	-
Total contractual obligations	<u>\$ 4,386</u>	<u>\$ 884</u>	<u>\$ 1,440</u>	<u>\$ 946</u>	<u>\$ 1,116</u>

For the fiscal year ended November 30, 2007, the Company paid basic rent of \$809,000 (2006 - \$709,000). In addition to basic rent, the Company is required to pay a portion of certain costs and property taxes for the above commitments. In 2007, the Company paid \$110,000 (2006 - \$88,000) for these costs.

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. The Company is currently negotiating a settlement and has accrued an amount that it anticipates will be paid to settle this matter.

### 16 Related party transactions

On April 11, 2005, Mr. E. Brinton Coxe, a director of the Company at the time, assisted the Company in structuring and arranging the private placement financing and issuance of the Class B – Series 2 preference shares. In consideration for his services, the Company paid him compensation of \$672,000 and 350,000 common share purchase warrants. Mr. Coxe has also participated in the financing by purchasing 100 units personally. Mr. Coxe was paid an additional \$125,000 for professional services provided during 2005 and to be provided to April 2006. For the year ended November 30, 2006, \$25,000 was charged to expenses (2005 - \$100,000). As of April 2006, Mr. Coxe ceased being a director of the Company.

On April 8, 2005, Gerald J. Shields, a related party by virtue of the provision of legal services to the Company by two law firms in which he has an interest was elected to the Company's Board of Directors. Fees paid to these two law firms for services Mr. Shields provided to the Company during the fiscal year 2006 totalled \$177,000 (2005 - totalled \$164,000). As of November 17, 2006, Mr. Shields no longer has an interest in any law firm that provided or provides legal services to the Company.

All related party transactions were conducted at market value prices and were approved by the board of directors.

# OSI Geospatial Inc.

## Notes to Consolidated Financial Statements

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### 17 Income taxes

The Company is subject to Canadian federal, British Columbia and Ontario provincial taxes in Canada. The Company is also subject to federal income taxes in the U.S and state taxes in Pennsylvania, Utah, California, Virginia and Florida.

Earnings (loss) before income taxes consisted of the following:

In thousands of U.S. dollars	2007	2006	2005
Canadian income (loss)	\$ (2,450)	\$ 1,112	\$ (2,868)
U.S. income (loss)	(364)	(477)	299
	<u>\$ (2,814)</u>	<u>\$ 635</u>	<u>\$ (2,569)</u>

Income tax expense (recovery) consisted of the following:

In thousands of U.S. dollars	2007	2006	2005
Canadian income tax expense	\$ 103	\$ 1	\$ 786
U.S. income tax expense (recovery)	(43)	(298)	144
	<u>\$ 60</u>	<u>\$ (297)</u>	<u>\$ 930</u>

The Company has non-capital losses for Canadian income tax purposes of approximately \$3,936,000, which are available for carry forward to reduce future years' taxable income. These income tax losses expire as follows:

Year ending November 30	
2014	222,000
2015	1,431,000
2026	949,000
2027	1,334,000

The Company has net operating losses for U.S. income tax purposes of approximately \$929,000, which are available for carry forward to reduce future years' taxable income. These income tax losses expire as follows:

Year ending November 30	
2020	\$ 188,000
2021	27,000
2026	327,000
2027	387,000

# OSI Geospatial Inc.

## Notes to Consolidated Financial Statements

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The Company also has investment tax credits for Canadian income tax purposes of approximately \$2.7 million, which can be used to offset future income taxes otherwise payable and expire as follows:

Year ending November 30		
2011	\$	152,000
2012		192,000
2013		200,000
2014		485,000
2015		601,000
2016		221,000
2017		146,000
2026		397,000
2027		263,000

The Company has capital losses for Canadian income tax purposes of approximately \$354,000, which are available for carry forward to reduce future years' income from capital gains. These capital losses carry forward indefinitely.

The Company has un-deducted scientific research and experimental development expenses for Canadian income tax purposes of approximately \$8.6 million, which are available for carry forward to reduce future years' income for tax purposes. These expenses carry forward indefinitely.

The net future tax consists of the following:

In thousands of U.S. dollars	2007	2006
<b>Future tax assets</b>		
Non-capital loss carry-forwards and net operating losses	\$ 1,574	\$ 585
Net capital loss carry-forwards	54	48
Interest deduction carry-forwards	314	-
Scientific research and experimental development costs	2,625	2,110
Share issue costs	395	376
Investment tax credits	2,009	1,494
Equipment and furnishings	1,115	900
Accrued operating expenses	132	238
Other	-	20
	<u>8,218</u>	<u>5,771</u>
Valuation allowance	<u>(7,815)</u>	<u>(5,666)</u>
Future tax assets	403	\$ 105
Less: current portion	<u>(132)</u>	<u>(104)</u>
<b>Future tax assets – long term</b>	<u>\$ 271</u>	<u>\$ 1</u>

# OSI Geospatial Inc.

## Notes to Consolidated Financial Statements November 30, 2007 and 2006

In thousands of U.S. dollars	2007	2006
<b>Future tax liabilities</b>		
Change in tax accounting method	\$ 25	\$ 36
Intangible assets	74	35
Equipment and furnishings	26	54
Future tax liabilities	125	125
Less: current portion	(25)	(15)
<b>Future tax liabilities – long term</b>	\$ 100	\$ 110
<b>Future tax assets</b>	403	105
<b>Future tax liabilities</b>	(125)	(125)
<b>Net future tax</b>	\$ 278	\$ (20)

The Company increased its valuation allowance in 2007 against deferred 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 deferred income tax assets for which the more likely than not criteria of future realization has not been met. Although the Company believes that its tax estimates are reasonable, the ultimate tax determination involves significant judgment that could become subject to audit by tax authorities in the ordinary course of business.

A reconciliation of the combined Canadian federal and provincial income tax rate with the Company's effective income tax rate is as follows:

In thousands of U.S. dollars	2007	2006	2005
Expected statutory rate	34.12%	34.12%	35.00%
Expected provision for income taxes	\$ (961)	\$ 217	\$ (899)
Change in tax rates applied in valuation allowance	138	372	128
Change in valuation allowance	2,399	338	1,881
Foreign tax differentials	(21)	(27)	(3)
Foreign exchange effect on valuation allowance	(993)	(114)	-
Investment tax credits and share issue cost adjustments	(332)	(351)	(439)
Withholding taxes	103	-	-
Part VI.1 tax deduction	(12)	(106)	(68)
Non-deductible expenses and other	(261)	(626)	330
Income tax expense (recovery)	\$ 60	\$ (297)	\$ 930

### 18 Segmented information

Beginning in the first quarter of fiscal 2006, the Company changed its financial reporting segments in order to reflect changes in management's analysis of the business. The consolidated revenue categories have changed to marine systems, land and air systems, and mapping, and the reportable segments are now International Systems Operations, U.S. Systems Operations, Mapping Operations and Corporate and Public Company costs. The comparative information for 2005 has been adjusted to conform to the presentation adopted in 2006.

The Company's reportable segments are as outlined below. Accounting policies used by these segments are the same as those described in the significant accounting policies as disclosed in note 4. The Company defines

# OSI Geospatial Inc.

## Notes to Consolidated Financial Statements

November 30, 2007 and 2006

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

2007

	International Systems Operations	U.S. Systems Operations	Mapping Operations	Corporate and Public Company Costs	Total
Revenue	\$ 8,214	12,708	4,404	-	25,326
Gross profit	4,070	4,204	1,492	-	9,766
Technology Partnerships Canada - net	471	-	-	-	471
Interest expense	19	3	1	47	70
Income tax expense (recovery)	-	87	(130)	103	60
Net earnings (loss)	(1,206)	1,959	63	(3,690)	(2,874)
Equipment and furnishings expenditures	594	193	219	57	1,063
Intangible expenditures	39	136	70	2	247
Amortization	\$ 236	162	148	8	554

In thousands of U.S. dollars

2006

	International Systems Operations	U.S. Systems Operations	Mapping Operations	Corporate and Public Company Costs	Total
Revenue	\$ 9,518	10,517	4,102	-	24,137
Gross profit	5,963	3,350	1,340	-	10,653
Technology Partnerships Canada - net	267	-	-	-	267
Interest expense	-	-	-	21	21
Income tax expense (recovery)	-	(95)	(202)	-	(297)
Net earnings (loss)	1,720	1,853	205	(2,846)	932
Equipment and furnishings expenditures	182	66	40	2	290
Intangible expenditures	114	88	35	-	237
Amortization	\$ 209	296	253	5	763

In thousands of U.S. dollars

2005

	International Systems Operations	U.S. Systems Operations	Mapping Operations	Corporate and Public Company Costs	Total
Revenue	\$ 8,181	-	2,945	-	11,126
Gross profit	4,381	-	1,049	-	5,430
Technology Partnerships Canada - net	847	-	-	-	847
Interest expense	11	-	2	10	23
Income tax expense	554	-	225	151	930
Net earnings (loss)	191	-	(270)	(3,420)	(3,499)
Equipment and furnishings	157	-	(92)	5	70
Intangible expenditures	21	-	193	2	216
Amortization	\$ 177	-	221	6	404

# OSI Geospatial Inc.

## Notes to Consolidated Financial Statements

November 30, 2007 and 2006

In thousands of U.S. dollars

	<b>Total assets employed</b>				<b>Total</b>
	<b>International Systems Operations</b>	<b>U.S. Systems Operations</b>	<b>Mapping Operations</b>	<b>Corporate and Public Company Costs</b>	
As at November 30, 2007	\$ 8,704	\$ 13,859	\$ 3,648	\$ 137	\$ 26,348
As at November 30, 2006	\$ 10,483	\$ 10,704	\$ 3,283	\$ (20)	\$ 24,450

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

In thousands of U.S. dollars

	<b>2007</b>	<b>2006</b>	<b>2005</b>
Europe	\$ 5,899	\$ 6,816	\$ 4,093
Australia/New Zealand	910	1,200	2,149
United States	15,678	13,717	2,410
Canada	2,839	2,404	2,415
Other	-	-	59
<b>Total</b>	<b>\$ 25,326</b>	<b>\$ 24,137</b>	<b>\$ 11,126</b>

Approximately 41% of revenue for the year ended November 30, 2007 (2006 - 47%, 2005 - 40%) is derived from the three largest customers at 18%, 13% and 11%, respectively (2006 - 24%, 15%, 8%, 2005 - 22%, 10%, 8%).

The three largest customers for 2007 were the Royal Navy of the United Kingdom, the U.S. Army and the U.S. Navy. The three largest customers for 2006 were the Royal Navy of the United Kingdom, the U.S. Army and the U.S. Navy. The three largest customers for 2005 were the Royal Navy of the United Kingdom, Royal Australian Navy and the Canadian Navy.

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

In thousands of U.S. dollars

	<b>November 30, 2007</b>		
	<b>Canada</b>	<b>U.S.</b>	<b>Total</b>
Equipment and furnishings	\$ 1,588	\$ 326	\$ 1,914
Intangible and other assets	300	561	861
Goodwill	-	8,300	8,300
<b>Total</b>	<b>\$ 1,888</b>	<b>\$ 9,187</b>	<b>\$ 11,075</b>

In thousands of U.S. dollars

	<b>November 30, 2006</b>		
	<b>Canada</b>	<b>U.S.</b>	<b>Total</b>
Equipment and furnishings	\$ 859	\$ 230	\$ 1,089
Intangible and other assets	322	472	794
Goodwill	-	8,130	8,130
<b>Total</b>	<b>\$ 1,181</b>	<b>\$ 8,832</b>	<b>\$ 10,013</b>

# OSI Geospatial Inc.

## Notes to Consolidated Financial Statements November 30, 2007 and 2006

### 19 Financial Instruments and Risk Management

#### Fair values

The Company's financial instruments consist of accounts receivable, bank indebtedness, accounts payable and accrued liabilities. The carrying values of current assets and current liabilities approximate their fair values due to their short maturities.

#### Credit and foreign currency risk

The Company is exposed to credit risk on its cash and cash equivalents in the event of non-performance of other parties. To mitigate this risk, the Company maintains substantially all of its cash and cash equivalents with major financial institutions. Financial instruments that potentially subject the Company to credit risk are primarily accounts receivable. Management is of the opinion that any risk of accounting loss is significantly reduced due to the financial strength of the Company's major customers.

A substantial portion of the Company's revenues are received in foreign currencies including US dollar, UK pound and Euros. Fluctuations in the exchange rates between these currencies could have a material effect on the business, financial condition and results of operations. The Company attempts to mitigate this risk with the use foreign exchange forward contracts to hedge transactions denominated in U.S. dollars, UK pounds, Australian dollars and Euros. The purpose of the Company's hedging activities is to reduce the level of exposure to exchange rate movements.

### 20 Derivative Financial instruments and Foreign Exchange Contracts

#### Fluctuations in foreign currency exchange rates

The Company's Canadian subsidiaries enter into transactions denominated in U.S. dollars, UK pounds, Australian dollars and Euros and as such their revenue, expenses, monetary assets and liabilities will be affected by fluctuations in the various currencies relative to the functional currency, the Canadian dollar.

The Company's Canadian subsidiaries use foreign exchange forward contracts to mitigate the foreign exchange exposure related to transactions denominated in U.S. dollars, UK pounds, Australian dollars and Euros. At November 30, 2007, the Company had foreign exchange forward contracts maturing in the following year to sell US \$2,200,000 (2006 – US \$1,262,000), £1,330,000 (2006 – £107,000) and Australian \$nil (2006 – Australian \$500,000).

The fair value of derivative instruments generally reflects the estimated amounts that the Company would receive or pay to settle the contracts at November 30, 2007. The fair value of the above derivative financial instruments was a recorded liability in accounts payable and accrued liabilities of \$137,000 at November 30, 2007 (2006 – \$55,000).

### 21 Supplemental cash flow information

In thousands of U.S. dollars	2007	2006	2005
Cash paid during the year for interest	\$ 71	\$ 21	\$ 23
Cash paid during the year for income taxes	\$ -	\$ 263	\$ 5
Cash received during the year for interest	\$ 14	\$ -	\$ -

# OSI Geospatial Inc.

## Notes to Consolidated Financial Statements

November 30, 2007 and 2006

### 22 Reconciliation of generally accepted accounting principles

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

(a) Under U.S. GAAP prior to December 1, 2005, the Company accounted for stock-based compensation to employees and directors in accordance with the intrinsic value method of the Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees". Effective December 1, 2005, under U.S. GAAP the Company accounts for stock-based compensation to employees and directors in accordance with the fair value based method of FASB Statement 123(R). Under Canadian GAAP, for stock option awards granted by the Company after December 1, 2003, the Company is required to recognize compensation when stock options are granted to employees and directors under stock option plans with no cash settlement feature based on the fair value based method. As permitted by the standard, the Company had applied this change prospectively for new awards granted on or after December 1, 2003. Under U.S. GAAP, this resulted in a decrease to stock based compensation of \$206,000 in 2005.

(b) Under U.S. GAAP, the Company is required to record stock-based compensation for options granted to non-employees based on the fair value based method as required by SFAS 123(R) retroactive for all prior periods. Under Canadian GAAP, the Company is not required to record stock-based compensation for stock options granted to non-employees prior to December 1, 2001. These stock-based compensation transactions result in differences of \$649,000 (November 30, 2006 - \$649,000, November 30, 2005 - \$649,000) when compared to the same balances as previously reported under Canadian GAAP.

(c) Under U.S. GAAP, share issue costs are amortized over 5 years and give rise to a future tax expense. Under Canadian GAAP, share issue costs are deductible in the year incurred. For U.S. GAAP purposes, there is a deferred tax expense for the year ended November 30, 2007 of \$133,000 (for the year ended November 30, 2006, \$99,000, for the year ended November 30, 2005, \$19,000).

(d) Under U.S. GAAP, taxes owing on dividends paid (Part VI.1 tax) are included in tax expense in the income statement. Under Canadian GAAP, Part VI.1 taxes are included in accumulated deficit, alongside the cost of the dividends. Under U.S. GAAP, for the year ended November 30, 2007, tax expense related to dividends was \$12,000 (for the year ended November 30, 2006, \$140,000, for the year ended November 30, 2005, \$86,000).

(e) Under Canadian GAAP, there is no requirement to record the beneficial conversion feature and accretion of discount when preference shares are issued with attached warrants. For U.S. GAAP purposes, during the fiscal year 2005 the Company recorded beneficial conversion features of \$3.9 million on the issuance of Class B Series 1 and 2 preference shares, as a reduction to the net earnings available to common shareholders calculated on the effective conversion price of the preference shares to common shares based on the proceeds allocated to the preference shares. In both cases, the conversion feature of the preference shares vested immediately and the Company recorded the accretion of the full amount of the beneficial conversion feature. For both the Series 1 and Series 2 Class B preference shares, the discount on these shares that resulted from the allocation of the gross proceeds to the Class B preference shares and to the attached warrants is accreted over the five-year life of the warrants. This resulted in an accretion of \$676,000 for the year ended November 30, 2007 (\$674,000 for the year ended November 30, 2006, \$431,000 for the year ended November 30, 2005).

(f) Additionally, when convertible shares are converted to common shares under U.S. GAAP, the conversion is recorded by reducing preference shares at the historical share price, increasing common shares at the current market value, proportionally reducing the beneficial conversion feature included in additional paid in capital and adjusting accumulated deficit by the difference. Under Canadian GAAP, both the preference shares and common shares are adjusted by the historical value. As a result of the above, under U.S. GAAP for the year ended November 30, 2007, preference shares were reduced by \$378,000 (for the year ended

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## Notes to Consolidated Financial Statements

### November 30, 2007 and 2006

November 30, 2006, \$148,000), common shares were increased by \$1,306,000 (for the year ended November 30, 2006, \$576,000), additional paid in capital was reduced by \$598,000, (for the year ended November 30, 2006, \$1,054,000), and accumulated deficit was increased by \$125,000 (for the year ended November 30, 2006, \$170,000),

(g) Under US GAAP, investment tax credits applied to taxable income are recorded as a tax recovery. Under Canadian GAAP, investment tax credits are considered a reduction of engineering expenses on the income statement. For US GAAP purposes for the year ended November 30, 2005, the current income tax expense would be \$143,000 lower and the engineering expenses would be \$143,000 higher.

(h) Under Canadian GAAP, development costs are eligible for deferral subject to meeting the requirements of CICA Section 3064 *Goodwill and Intangible Assets* (formerly CIC Section 3450 *Research and Development Costs*), Under U.S. GAAP, development costs are expensed as incurred. As a result, under U.S. GAAP, deferred development costs would be nil (2006: nil) and engineering costs would increase by \$97,000.

(i) If U.S. GAAP were followed:

i) the effect on the Consolidated Statements of Earnings would be:

In thousands of U.S. dollars except earnings (loss) per share	For the year ended November 30,		
	2007	2006	2005
		(restated – see Notes 1 & 23)	(restated – see Notes 1 & 23)
Earnings (loss), Canadian GAAP	\$ (2,874)	\$ 932	\$ (3,499)
Adjustment for stock based compensation (a),(b)	-	-	855
Future income tax on preferred share issue costs (c)	(133)	(99)	(19)
Development costs not eligible for deferral (h)	(97)	-	-
Part VI.1 tax on dividends paid (d)	(12)	(140)	(86)
Earnings (loss), U.S. GAAP	\$ (3,116)	\$ 693	\$ (2,749)
Loss attributable to common shareholders, U.S. GAAP	\$ (4,381)	\$ (825)	\$ (9,400)
Basic loss per common share, U.S. GAAP	\$ (0.11)	\$ (0.03)	\$ (0.34)
Diluted loss per common share, U.S. GAAP	\$ (0.11)	\$ (0.02)	\$ (0.34)
Weighted average number of common shares - basic, U.S. GAAP	41,096,261	32,381,992	27,989,832
Weighted average number of common shares – diluted, U.S. GAAP	41,096,261	48,843,168	27,989,832

ii) Balance Sheet items which would differ under U.S. GAAP are as follows:

In thousands of U.S. dollars	At November 30,	
	2007	2006
		(restated – see Notes 1 & 23)
Deferred development costs	\$ -	\$ -
Common shares (f)	24,934	18,222
Class B Series 2 preference shares (e), (f)	6,552	8,695
Additional paid in capital (f)	2,639	3,357
Accumulated deficit (c), (e), (f)	(23,175)	(19,225)

# OSI Geospatial Inc.

## Notes to Consolidated Financial Statements

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### 23 Restatement of prior years' U.S. to Canadian GAAP reconciliation notes

As disclosed in Note 1, the Company began preparing its consolidated financial statements in accordance with Canadian GAAP during the year ended November 30, 2007. Prior period financial statements were prepared in accordance with U.S. GAAP. During the conversion to Canadian GAAP, the Company identified certain GAAP differences that were previously not included in the prior years' GAAP reconciliation notes. The GAAP differences have been highlighted below:

#### Statement of operations - prior years' Canadian GAAP reconciliations

In thousands of U.S. dollars

	At November 30, 2006	
	As previously reported	Restated
Net earnings, Canadian GAAP	\$ 688	\$ 932
Loss attributable to common shareholders, Canadian GAAP	(326)	(82)
Basic and diluted loss per share	(0.01)	0.00

	At November 30, 2005	
	As previously reported	Restated
Earnings (loss), Canadian GAAP	\$ (3,604)	\$ (3,499)
Loss attributable to common shareholders, Canadian GAAP	(4,357)	(4,252)
Basic and diluted loss per share	(0.16)	(0.15)

The differences previously not identified between the reported and restated amounts in the November 30, 2006 and 2005 Canadian GAAP reconciliations are largely attributable to the adjustments described in Note 22 paragraphs (c) and (d) above.

#### Balance sheet - prior year Canadian GAAP reconciliations

In thousands of U.S. dollars

	At November 30, 2006	
	As previously reported	Restated
Class A Series A preference shares	\$ 19	\$ 19
Class B Series 2 preference shares	7,148	7,115
Common shares	17,573	15,887
Warrants	4,286	4,286
Contributed surplus	(79)	1,343
Accumulated deficit *	(13,593)	(13,296)
Accumulated other comprehensive income *	2,427	2,427
Total shareholders' equity	\$ 17,781	\$ 17,781

\* These amounts were combined in the prior year's U.S. to Canadian GAAP reconciliation note

The main differences not identified in the equity accounts reconciliation in the prior year Canadian GAAP reconciliation note are described in Note 22 paragraph (f) above and impacted Class B Series 2 preference shares, common shares, contributed surplus and accumulated deficit. These restatements were within the equity accounts and did not impact total shareholders' equity.

# **OSI Geospatial Inc.**

## **Notes to Consolidated Financial Statements**

**November 30, 2007 and 2006**

### **24 Subsequent events**

On December 13, 2007, the Board of Directors declared the semi-annual dividend of \$332,000 on the Class B Preference Share – Series 2.

### **25 Comparative figures**

The comparative consolidated financial statements have been reclassified from financial statements previously presented prepared in accordance with generally accepted accounting principles in the United States to conform to the presentation of the 2007 consolidated financial statements prepared in accordance with generally accepted accounting principles in Canada.