



# MANAGEMENT'S DISCUSSION AND ANALYSIS

for the year ended November 30, 2008

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## **OSI Geospatial Inc.**

Management's Discussion and Analysis  
Year ended November 30, 2008 and 2007  
(expressed in U.S. dollars)

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

The following discussion and analysis provides a review of activities, results of operations, and financial condition of OSI Geospatial Inc. for the fiscal year and fourth quarter ended November 30, 2008 in comparison with those for the fiscal year and fourth quarter ended November 30, 2007. References to "OSI Geospatial", "the Company", "we", "us", and "our" refer to OSI Geospatial Inc. and its subsidiaries, as applicable. The following discussion should be read in conjunction with our audited annual consolidated financial statements prepared in accordance with generally accepted accounting principles in Canada ("Canadian GAAP"), including the notes thereto, for the fiscal year ended November 30, 2008.

All references in this report to financial information, excluding backlog and working capital, concerning OSI Geospatial Inc. are in accordance with Canadian GAAP and all dollar amounts are in U.S. dollars unless otherwise indicated.

This report contains forward-looking statements within the meaning of the Ontario Securities Act including Section 138.4(9) and includes statements regarding the future achievement of corporate objectives, advancement of additional project interests, analysis and development of acquisition opportunities, various project interests and other matters. These statements are neither promises nor guarantees, but involve known and unknown risks and uncertainties that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed in or implied by these forward-looking statements. These risks include risks related to the effects of general economic conditions, changing foreign exchange rates, actions by government authorities, uncertainties associated with contract negotiations, and industry supply, as well as other factors discussed below and those risks which are discussed under the heading "Risks and Uncertainties". Readers should not place undue reliance on any such forward-looking statements, which speak only as of the date they were made. We disclaim any obligation to publicly update or revise any such statements to reflect any change in our expectations or in events, conditions or circumstances on which any such statements may be based, or that may affect the likelihood that actual results will differ from those set forth in the forward-looking statements.

ECPINS® and COP-IDS are registered trademarks of Offshore Systems Ltd., an OSI Geospatial company. iGEN™ and C3CORE are registered trademarks of CHI Systems Inc., an OSI Geospatial company. Other Company brand, product and service names are for identification purposes only and may be either trademarks, service marks or registered trademarks of their respective owners. Data subject to change without notice.

Additional information relating to OSI Geospatial, including our Annual Information Form, is filed on SEDAR at [www.sedar.com](http://www.sedar.com) and is also available on the Company's investor web site at [www.osigeospatial.com](http://www.osigeospatial.com).

This management's discussion and analysis is dated February 19, 2009.

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## OSI Geospatial Inc.

Management's Discussion and Analysis  
Year ended November 30, 2008 and 2007  
(expressed in U.S. dollars)

### Overview

Founded in 1977, the Company is a leader in providing real-time situational awareness solutions. The Company delivers products and services to the large and fast-growing defence and security markets. Our systems address critical issues - namely the need for enhanced real-time situational awareness and network-enabled operations. In the changing face of war where interoperability between forces and allies is critical, OSI Geospatial provides essential tactical, strategic, and operational information to help aid decision-making, improve efficiency, and provide real-time access to all available information.

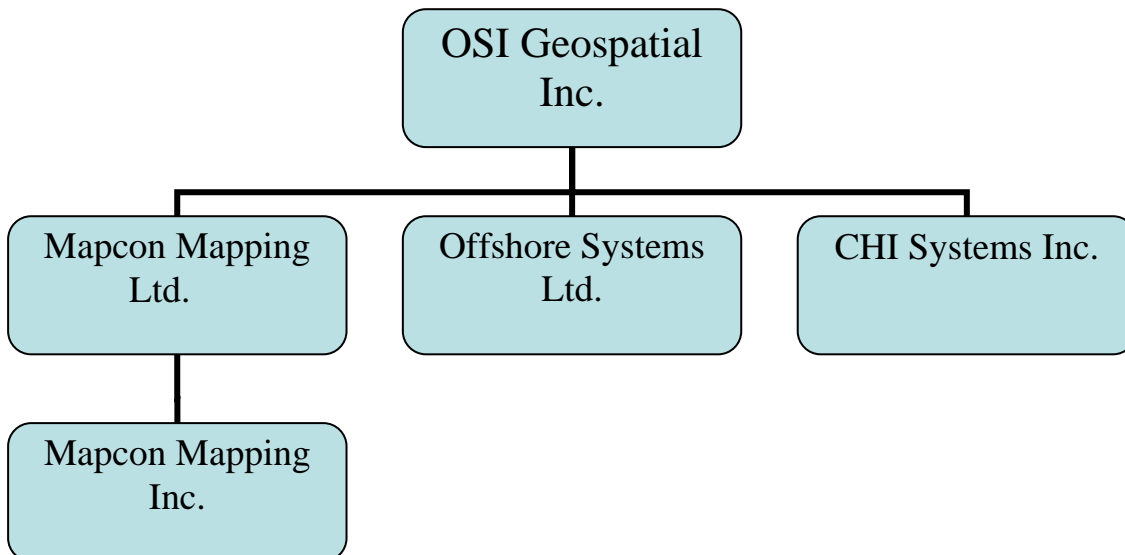
Headquartered in Ottawa, the Company is a globally focused organization with offices across North America and a sales office in the United Kingdom. The Company became a public company in 1990, and is currently listed on the Toronto Stock Exchange (symbol: OSI).

In April 2005, the Company completed the acquisition of all the outstanding shares of Mapcon Mapping Consultants Inc. ("Mapcon") of Salt Lake City, Utah. Mapcon is a land mapping company in the U.S. geospatial mapping market.

In December 2005, the Company completed the acquisition of CHI Systems Inc. ("CHI"), a United States defence contractor. CHI has four offices in the United States, is a supplier of technology and services to the U.S. Department of Defense and key defence prime contractors. CHI has developed C2, training simulation and cognitive agent applications to support its customers in multiple U.S. military agencies.

In April 2007, the Company, through its subsidiary CHI Systems Inc., acquired the assets of Liddy International Inc. ("Liddy"), a United States defence and security consultancy company and has established a new division, Layered Security Solutions ("LSS"). The Company's LSS division is primarily focused on developing the U.S. homeland security market.

The Company's current corporate structure is presented in the chart below.



Our mission is to provide our customers in the military and security markets with quality geospatial products and services that will enhance operational performance, security and safety through real-time situational awareness. Our clients include the United States Navy, Army, Coast Guard, and Department of Homeland Security, the Canadian Navy and Coast Guard, the UK Royal Navy and other NATO allies around the world. The Company is leveraging our world leading technologies, such as ECPINS®, C3CORE and iGEN™ to grow our market share, expand our customer base and enter into adjacent

## OSI Geospatial Inc.

Management's Discussion and Analysis  
Year ended November 30, 2008 and 2007  
(expressed in U.S. dollars)

markets. We will also continue to partner with the world's largest defence and security contractors, such as Lockheed Martin, BAE Systems, Northrop Grumman, L-3 Communications, General Dynamics and Raytheon. As we successfully integrate our technology into the solution provided by the large defence systems integrators, we will significantly increase our reach into the defence and security markets around the world.

Our Company delivers systems and services that provide situational awareness solutions that meet maritime and land command and control requirements. These include our Warship Electronic Chart Display and Information System (ECPINS®-W), Warship Automated Identification System (W-AIS), Asset Control and Tracking system (ACT) and Small Unit Situational Awareness system (SUSA).

Real-time situational awareness solutions are critical to mission execution. With the new face of war and the continuing threat of terror, OSI Geospatial's systems and services can provide the solutions that military, and security organizations need, including the essential tactical, strategic, and operational information that can be securely shared between forces, allies, and civilians to help ensure interoperability and mission success.

## SELECTED DATA

The following tables contain financial information that is derived from the audited consolidated financial statements for the years ended November 30, 2008 and 2007.

<b>Operations:</b>	<b>For the Year Ended November 30</b>	
In thousands of U.S. dollars, except per share related data	<b>2008</b>	<b>2007</b>
	<b>\$</b>	<b>\$</b>
Revenue	<b>25,498</b>	25,326
Gross profit	<b>9,208</b>	9,766
Gross profit percentage	<b>36%</b>	39%
Net (loss) earnings	<b>(1,584)</b>	(2,874)
Net loss available to common shareholders	<b>(2,143)</b>	(3,588)
Loss per share – basic and diluted	<b>(0.05)</b>	(0.09)
Weighted average common shares outstanding – basic	<b>46,956,439</b>	41,096,261
Weighted average common shares outstanding – diluted	<b>46,956,439</b>	41,096,261
<u>Dividends declared per share</u>		
Class A Preference Shares – Series A	–	–
Class B Preference Shares – Series 2	\$1.81	\$1.64
Common Shares	–	–

The Company's annual and quarterly operating results are primarily affected by the level, timing and duration of customer orders, relative mix of value added products and services, and fluctuations in material costs. The Company's operating results are also affected by factors such as price competition, manufacturing effectiveness and efficiency, the ability to manage inventory and capital assets effectively, the timing of expenditures in anticipation of increased sales, customer product delivery requirements and shortages of components or labour. Economic factors such as foreign exchange fluctuations, government and corporate spending patterns and regulatory developments may also affect our operating results.

We depend heavily on government contracts and derive a significant amount of revenue from a few customers, which may result in varying revenue, gross profit, and earnings. Some of our government customers have cyclical purchasing patterns which can also impact our quarterly and annual results.

## OSI Geospatial Inc.

Management's Discussion and Analysis  
Year ended November 30, 2008 and 2007  
(expressed in U.S. dollars)

The increase in revenue for the year ended November 30, 2008 as compared to the years ended November 30, 2007 and 2006 is largely due to the delivery schedules of existing contracts and the timing of new contracts that are awarded.

The lower gross profit percentage for the year ended November 30, 2008 as compared to the year ended November 30, 2007 is largely due to the mix of revenue. The decrease in the gross profit percentage is due to a decrease in higher margin software revenue and an increase in lower margin hardware and systems revenue generated by International Systems operations.

Fluctuations in gross profit are influenced by the proportion of engineering labour, third-party systems or third-party labour or portions of all three required for a project, and a high proportion of these factors can result in increased cost of sales and therefore lower gross profit. Certain contracts awarded may require the inclusion of engineering labour, third-party systems or third-party labour. In order to maintain competitiveness on these contracts, we may elect to reduce our usual margins on the third-party components.

During the year ended November 30, 2008 the Company experienced delays in project execution of contracts signed in prior years and in the signing of new contracts and contract options. As a result, the Company adjusted the size of its workforce and curtailed variable spending over the course of the past fiscal year. The full impact of these changes will not be realized until the fiscal year ended November 30, 2009.

The recent economic uncertainty has not affected the Company to date, either in a positive or negative way. The Company's sales strategy's focuses on markets such as military command and control, homeland security, and maritime defence that to date have not been impacted by the recent economic downturn. To date, there are no indications that government spending in the Company's niches in the defence market has been curtailed. The Company is aware of only one minor delay in project execution of an existing project for the fiscal year 2009 and has not had any contract cancellations as a result of current economic conditions.

### Financial Position:

In thousands of U.S. dollars	For the year ended November 30	
	2008	2007
	\$	\$
Working capital <sup>(1)</sup>	5,164	7,818
Current assets	10,763	14,905
Long term assets	11,312	11,443
Total assets	22,075	26,348
Current liabilities	5,599	7,087
Long term liabilities	602	647
Total liabilities	6,201	7,734
Shareholders' equity	15,874	18,614

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

## OSI Geospatial Inc.

Management's Discussion and Analysis  
Year ended November 30, 2008 and 2007  
(expressed in U.S. dollars)

### RESULTS OF OPERATIONS – November 30 2008 compared to November 30, 2007

#### Overall Performance

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

	2008	2007	2008 to 2007
<b>Net loss before income taxes</b>	<b>\$ (2,481)</b>	<b>\$ (2,814)</b>	<b>\$ 333</b>
<b>Net loss</b>	<b>\$ (1,584)</b>	<b>\$ (2,874)</b>	<b>\$ 1,290</b>
<b>Net loss available to common shareholders</b>	<b>\$ (2,143)</b>	<b>\$ (3,588)</b>	<b>\$ 1,445</b>
<b>Loss per share – basic</b>	<b>\$ (0.05)</b>	<b>\$ (0.09)</b>	<b>\$ 0.04</b>
<b>Loss per share – diluted</b>	<b>\$ (0.05)</b>	<b>\$ (0.09)</b>	<b>\$ 0.04</b>

The net loss reported in the year ended November 30, 2008 was largely driven by the mix of contracts executed in the fiscal year, the delay in contract awards, and expansion of staffing complement in 2007 in anticipation of growth in sales for 2008. The lower net loss before income taxes is mainly due to an increase in revenue generated by International systems operations and a decrease in general and administration expenses.

#### Backlog

Firm backlog consists of firm, fixed, or signed orders issued and executable subsequent to the balance sheet date. Firm backlog as at November 30, 2008 was \$46 million compared to \$49 million at November 30, 2007. Of the \$46 million firm backlog, \$11 million is expected to be executed in fiscal 2009 and \$35 million is expected to be executed in fiscal year 2010 and beyond.

Firm backlog is a non-GAAP measure. This measure does not have a standardized meaning or comparable GAAP measure and is likely not comparable to similar measures presented by other companies and cannot be reconciled to any GAAP measurements. The Company discloses this non-GAAP measure as we believe it provides more insight into our performance specifically regarding revenue available for periods subsequent to November 30, 2008.

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

Multi-year contracts with government agencies have a termination-for-convenience clause because governments approve budget expenditures on an annual basis. This allows contracts to be terminated by the contracting government agency should future budget funding not be approved. In International Systems operations and U.S. Systems operations, the termination-for-convenience clause has not been exercised by any of our customers. In Mapping operations, a government contract was terminated for convenience in the quarter ended February 29, 2008. The Company negotiated a settlement with the customer and the customer paid the negotiated settlement. We have included the full value of multi-year government contracts having a termination-for-convenience clause in firm backlog.

## OSI Geospatial Inc.

Management's Discussion and Analysis  
Year ended November 30, 2008 and 2007  
(expressed in U.S. dollars)

### Revenue

In thousands of U.S. dollars	2008	% of total revenue	2007	% of total revenue	2008 to 2007
<b>Marine systems</b>	\$ 11,343	45%	\$ 10,219	40%	\$ 1,124
<b>Land and air systems</b>	10,057	39%	10,703	42%	(646)
<b>Mapping</b>	4,098	16%	4,404	18%	(306)
	<u>\$ 25,498</u>	<u>100%</u>	<u>\$ 25,326</u>	<u>100%</u>	<u>\$ 172</u>

Our core revenue stream is derived from three sources: marine systems, land and air systems, and mapping. In Marine systems, our principal developed product line, ECPINS®, delivers the majority of the marine systems revenue. We also derive revenue from the delivery of the ECPINS® software component of our system product. Marine systems delivered 45% and 40% of the revenue for the years ended November 30, 2008 and 2007, respectively. Our land and air systems through our U.S. Systems operations delivered 39% and 42% of the revenue for the years ended November 30, 2008 and 2007 respectively. Mapping delivered 16% and 18% of the revenue for the years ended November 30, 2008 and 2007, respectively.

Our results are primarily affected by the level, timing, and duration of customer orders and customer product delivery requirements. The main customers in fiscal 2008 were the Royal Australian Navy, the Royal Navy of the United Kingdom, and the U.S. Navy. Revenue from these customers accounted for 35% of the consolidated revenue. The main customers in fiscal 2007 were the Royal Navy of the United Kingdom, the U.S. Army and the U.S. Navy. Revenue from these customers accounted for 41% of the consolidated revenue.

### Revenue by Segment

In thousands of U.S. dollars	2008	% of total revenue	2007	% of total revenue	2008 to 2007
<b>International Systems operations</b>	\$ 10,203	40%	\$ 8,214	33%	\$ 1,989
<b>U.S. Systems operations</b>	11,197	44%	12,708	50%	(1,511)
<b>Mapping operations</b>	4,098	16%	4,404	17%	(306)
	<u>\$ 25,498</u>	<u>100%</u>	<u>\$ 25,326</u>	<u>100%</u>	<u>\$ 172</u>

Revenue from International Systems operations for the year ended November 30, 2008 increased by 24% as compared to the year ended November 30, 2007 due to, the delivery and installation schedules of existing contracts, timing of new contracts awarded, and, and the general growth in the segment.

Revenue from U.S. Systems operations for the year ended November 30, 2008 decreased by 12% as compared to the year ended November 30, 2007. The decrease in revenue is due to delays in project execution as a result of changes in customer schedules and the timing of new contracts awarded to the business unit.

Revenue from Mapping operations for the year ended November 30, 2008 decreased by 7% as compared to the year ended November 30, 2007. The decrease is the result of poor flight conditions which resulted in lower production levels during the third and fourth quarters of 2008.

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

## OSI Geospatial Inc.

Management's Discussion and Analysis  
Year ended November 30, 2008 and 2007  
(expressed in U.S. dollars)

### Gross Profit

In thousands of U.S. dollars	2008	2007	2008 to 2007
<b>Gross profit</b>	\$ 9,208	\$ 9,766	\$ (558)
<b>Gross profit percentage</b>	36%	39%	(3)%

Gross profit decreased by 6% in the year ended November 30, 2008 compared to the year ended November 30, 2007 and the gross profit percentage was 3% lower period-over-period. The reduced gross profit and gross profit percentage compared to the prior fiscal year is largely due to the mix of revenue. The decrease in the gross profit percentage is due to a decrease in higher margin software revenue and an increase in lower margin hardware and systems revenue generated by the U.S. and International Systems operations.

### Gross Profit by Segment

In thousands of U.S. dollars	2008	2007	2008 to 2007
<b>Gross profit:</b>			
<b>International Systems operations</b>	\$ 5,054	\$ 4,070	\$ 984
<b>U.S. Systems operations</b>	3,113	4,204	(1,091)
<b>Mapping operations</b>	1,041	1,492	(451)
<b>Consolidated operations</b>	<u>\$ 9,208</u>	<u>\$ 9,766</u>	<u>\$ (558)</u>

### Gross profit percentage:

<b>International Systems operations</b>	50%	50%	- %
<b>U.S. Systems operations</b>	28%	33%	(5)%
<b>Mapping operations</b>	25%	34%	(9)%
<b>Consolidated operations</b>	<u>36%</u>	<u>39%</u>	<u>(3)%</u>

Gross profit from the International Systems operations for the year ended November 30, 2008 increased 24% and gross profit percentage was the same when compared to the prior year. The increase in fiscal 2008 is mainly the result of higher revenues in the International Systems operations.

Gross profit from the U.S. Systems operations for the year ended November 30, 2008 decreased 26% and gross profit percentage was 5% lower when compared to the prior year. The decrease in revenues is due to delays in project execution as a result of changes in customer schedules and delays in the timing of new contracts awarded.

Gross profit from the Mapping operations for the year ended November 30, 2008 decreased 30% and gross profit percentage was 9% lower when compared to the prior year. The decrease in gross profit was largely as a result of lower revenues for the fiscal year ended November 30, 2008 compared to the fiscal year ended November 30, 2007. Gross profit percentages are influenced by the mix of projects executed. The gross profit percentage of any given mapping project is largely influenced by two factors:

1. the proportion of production services that are performed in-house versus subcontracted to either specialized production service companies in North America or offshore production companies in India or China, and
2. the customer's primary driver, being either price or quality.

## OSI Geospatial Inc.

Management's Discussion and Analysis  
Year ended November 30, 2008 and 2007  
(expressed in U.S. dollars)

Projects where the Company can rely heavily on offshore production will typically have higher gross margin percentages than those that include a large component of specialized or in-house services. Projects where the primary customer driver is quality will generally have higher margins than projects where the primary driver is price.

### Operating Expenses

In thousands of U.S. dollars	2008	% of total revenue	2007	% of total revenue	2008 to 2007
<b>General and administrative</b>	\$ 5,429	21%	\$ 6,175	24%	\$ (746)
<b>Engineering</b>	1,144	4%	1,361	5%	(217)
<b>Sales and marketing</b>	3,917	15%	3,859	15%	58

**General and administrative** ("G&A") expenses consist mainly of salaries and benefits of management and administrative personnel, professional fees, public company expenses, related facility costs, and other general administrative expenses.

G&A decreased by 12% for the fiscal year ended November 30, 2008 compared to the previous fiscal year. G&A expenses for the fiscal year ended November 30, 2007 included a one-time accrual of estimated settlement costs relating to the lawsuit with Triathlon Ltd., severance costs associated with restructuring in the fourth quarter of 2007 as well as costs associated with the relocation of corporate headquarters to Ottawa, Ontario.

**Engineering** expenses consist mainly of salaries and benefits of software and hardware engineering personnel, facilities expenses, and related expenses. The company expenses research and development-related costs in the period incurred unless, in the opinion of management, certain development costs meet the deferral criteria under Canadian GAAP, in which case development expenditures are capitalized and amortized over the estimated lives of the related products.

Engineering expenses decreased by 16% for fiscal 2008 compared to the previous year. The decrease is related to engineering staff and related costs being charged to cost of sales to support specific customer orders during the year. The decrease is also due to capitalizing a portion of development-related costs of \$256,000 in fiscal 2008. We believe that in order to maintain our technological leadership, we must continue to develop existing products and introduce innovative new products that challenge and redefine the industry standards.

**Sales and marketing** ("S&M") expenses consist primarily of compensation of sales and marketing personnel, as well as expenses associated with advertising, trade shows, facilities, and other expenses related to the sales and marketing of our products and services.

S&M expenses increased by 2% for fiscal 2008 compared to the previous year. There was little change in S&M staffing levels and costs incurred between the two fiscal years. We believe our current level of S&M staff continues to allow us to pursue business development activities relating to our expansion efforts targeting new and existing customers in the military agencies of Canada, the U.S., European Union, other NATO allies of Canada, and national and international commercial marine transportation companies. To increase our profile and our products, and to broaden our customer base in international markets, we have established marketing agreements with companies local to the targeted regions. Some of these activities will not result in closing orders during the current year but are expected to yield orders in subsequent fiscal years.

## OSI Geospatial Inc.

Management's Discussion and Analysis  
Year ended November 30, 2008 and 2007  
(expressed in U.S. dollars)

### Amortization

In thousands of U.S. dollars	2008	2007	2008 to 2007
<b>Amortization</b>	<b>\$ 696</b>	<b>\$ 554</b>	<b>\$ 142</b>

Total amortization increased by 26% in fiscal 2008 reflecting the mix of equipment and furnishings at November 30, 2008. For the years ended November 30, 2008 and 2007, a portion of the depreciation, \$217,000 and \$228,000 respectively, was included in cost of sales for equipment used in revenue-generating activities.

### Interest expense

In thousands of U.S. dollars	2008	2007	2008 to 2007
<b>Interest expense</b>	<b>\$ 136</b>	<b>\$ 70</b>	<b>\$ 66</b>

Interest expense increased in fiscal 2008 as compared to fiscal 2007. The Company increased its utilization of its credit facility during fiscal 2008. The increase is also due to the interest incurred on capital lease obligations.

### Interest income

In thousands of U.S. dollars	2008	2007	2008 to 2007
<b>Interest income</b>	<b>\$ 7</b>	<b>\$ 7</b>	<b>\$ -</b>

Interest income for fiscal years 2008 and 2007 was minimal as the Company did not have surplus funds to invest.

### Foreign Exchange

In thousands of U.S. dollars	2008	2007	2008 to 2007
<b>Foreign exchange loss</b>	<b>\$ 31</b>	<b>\$ 316</b>	<b>\$ 285</b>

The Company's Canadian subsidiaries, whose functional currency is the Canadian dollar, are exposed to foreign exchange gain and loss due to exchange rate movements of the U.S. dollar, the Australian dollar and the UK pound. The Company minimized the exposure to foreign exchange fluctuations through the use of foreign exchange forward contracts.

### Technology Partnerships Canada

In thousands of U.S. dollars	2008	2007	2008 to 2007
<b>Royalty</b>	<b>\$ 532</b>	<b>\$ 471</b>	<b>\$ 61</b>

The company entered into two agreements with Technology Partnerships Canada ("TPC") whereby TPC granted financial assistance for the purpose of funding research and development activities which were completed on March 31, 2007. The contributions we received were based on the eligible expenditures incurred.

As part of the agreement entered into on November 15, 1999 with TPC, we are required to pay a royalty of 3% on annual gross revenue in our subsidiary, Offshore Systems Ltd., for the period December 1, 1999 to November 30, 2008. In addition, as part of the agreement entered into on April 26, 2004, we are required to pay a royalty of 1.4% on annual gross revenue in our subsidiary, Offshore Systems Ltd., for

## OSI Geospatial Inc.

Management's Discussion and Analysis  
Year ended November 30, 2008 and 2007  
(expressed in U.S. dollars)

the period January 1, 2006 to December 31, 2008 and a royalty of 2.5% on annual gross revenue for the period January 1, 2009 to December 31, 2013.

Although we believe that our submissions for TPC funding meet the terms and conditions of the TPC agreements, the final determination is subject to audit by government authorities in the ordinary course of business.

### Income Taxes

In thousands of U.S. dollars	2008	2007	2008 to 2007
Future income tax (recovery)	\$ (661)	\$ (298)	\$ 363
Current income tax (recovery) expense	(236)	358	594
	<u>\$ (897)</u>	<u>\$ 60</u>	<u>\$ 957</u>

Based on the information available at the time of the issue of the audited annual financial statements for the year ended November 30, 2008, we estimated that we would not have sufficient taxable earnings in Canada in future periods to utilize a portion of our \$2.7 million Canadian non-capital losses carried forward, \$10.6 million scientific research and experimental development costs and other Canadian tax balances.

We have recognized a future income tax recovery in the year ended November 30, 2008 related to temporary timing differences between accounting income and income for tax purposes in our U.S. subsidiaries as we believe that it is more likely than not that these differences will be realized in future fiscal years. In accordance with Canadian GAAP, we have provided a valuation allowance against future tax assets where realization did not meet the requirements of "more likely than not" under the liability method of tax allocation. We continue to evaluate our taxable position quarterly and consider factors such as estimated taxable income, the history of losses for tax purposes, and the growth of the Company, among others.

### LIQUIDITY AND CAPITAL RESOURCES - November 30 2008 compared to November 30, 2007

In thousands of U.S. dollars	2008	2007	2008 to 2007
Current assets	10,763	14,905	(4,142)
Current liabilities	5,599	7,087	(1,488)
Working capital <sup>(1)</sup>	5,164	7,818	(2,654)

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

We strive to maintain cash-contributing profitable operations that provide an adequate liquidity and capital resource base for growth. We believe that cash flow from operating activities, together with lines of credit borrowings of Canadian \$3.0 million and U.S. \$1.2 million available under our revolving credit facilities, will be sufficient to fund currently anticipated working capital, planned capital spending, and debt service requirements for the next 12 months.

At November 30, 2008, our current assets decreased primarily due to a decrease in accounts receivable. Our working capital has decreased mainly due to the decrease in accounts receivable offset by a decrease in accounts payable and accrued liabilities. Accounts receivable decreased mainly due to collection of significant receivables. Accounts payable and accrued liabilities decreased due to one-time costs which were incurred in the fourth quarter ending November 30, 2007 including severance costs due to reorganization and an accrual of estimated settlement costs relating to the lawsuit with Triathlon Ltd.

## OSI Geospatial Inc.

Management's Discussion and Analysis  
Year ended November 30, 2008 and 2007  
(expressed in U.S. dollars)

We have credit facilities consisting of an operating line, standby letters of credit, and forward exchange contract facilities. The credit facilities permit us to borrow funds directly for general corporate purposes, including acquisitions, at floating rates. At November 30, 2008, we had borrowings of \$1.6 million against our operating lines. We have operating lines of Canadian \$3.0 million available with a Canadian chartered bank collateralized by accounts receivable and U.S. \$1.2 million with a U.S. chartered bank. During fiscal 2008, we utilized the facility which increased interest expense for the year. We utilize our forward exchange contract facility to reduce our exposure to exchange rate movements.

In December 2007, we declared and paid the semi-annual dividends earned in November 2007 in the amount of Canadian \$1.75 per share to the Class B Series 2 preference shareholders. In July 2008, we declared and paid partial semi-annual dividends in the amount of Canadian \$0.0175 per share to the Class B Series 2 preference shareholders during the year ended November 30, 2008. On December 1, 2008, the Board of Directors declared partial semi-annual dividend in the amount of Canadian \$0.0175 per share on the Class B Series 2 preference shareholders. The partial dividends were paid in accordance with the Company's Articles of Incorporation and to preserve our financial resources in light of the current market conditions. The Company will be assessing its financial resources on a regular basis to determine when we can increase or reinstate the dividends.

We are required to meet certain covenants as outlined in our credit facilities agreement with a major Canadian chartered bank. Compliance with these covenants is measured on a quarterly basis. For the periods ending May 31, 2008, August 31, 2008 and November 30, 2008, we did not meet the interest coverage ratio covenant. For the periods ended May 31, 2008 and August 31, 2008 we received a waiver from the bank. We expect to receive a waiver from the bank for the period ended November 30, 2008. We expect our operating performance in 2009 will allow us to remedy this deficiency.

### Cash Flows

In thousands of U.S. dollars	2008	2007	2008 to 2007
<b>Cash flows provided by (used in):</b>			
Operating activities	\$ 25	\$ (1,456)	\$ 1,481
Investing activities	(579)	(1,432)	853
Financing activities	587	2,905	(2,318)
Effect of foreign exchange on cash	(33)	(17)	16

Cash flows provided by operating activities for the year ended November 30, 2008 was the result of the net loss for the year ended November 30, 2008 which was reduced by amortization and stock-based compensation and a decrease in accounts receivable offset by a decrease in accounts payable and accrued liabilities.

Cash flows used in investing activities for the year ended November 30, 2008 was primarily reflective of the acquisitions of equipment, furnishings and intangibles commensurate with our plans to obtain additional systems and facilities to accommodate our current and future anticipated growth.

Cash flows provided by financing activities for the year ended November 30, 2008 was the result of an increase in the operating line of credit offset by the payment of the semi-annual dividends on our class B Preference shares.

As a result of the above mentioned changes, the line of credit utilization increased by \$974,000 for the year ended November 30, 2008.

In order to reduce the impact of exchange rate fluctuations, we use the forward exchange contract facility to mitigate any foreign exchange gain or loss that might occur. We use the forward exchange contract

## OSI Geospatial Inc.

Management's Discussion and Analysis  
Year ended November 30, 2008 and 2007  
(expressed in U.S. dollars)

facility only for known or reasonably certain future foreign currency transactions. As at November 30, 2008, we had entered into foreign exchange forward contracts in the amount of U.S. \$570,000, £460,000, and AUD \$580,000.

### Capital Resources

At November 30, 2008, we had a short-term credit facility of CAD \$3.0 million with a major Canadian chartered bank that bears interest at the chartered bank's prime lending rate plus 1.0% and a short-term credit facility of \$1.2 million with a U.S. chartered bank which bears interest at the bank's prime lending rate plus 0.5%. There can be no assurance that we will have adequate financial resources, financing, or cash flows to support the Company into the future.

### CONTRACTUAL OBLIGATIONS

The following table provides a summary of the contractual obligations and the payments due for each of the next five years and thereafter.

Payments due by period	Total	Less than 1 year	1 to 3 years	4 to 5 years	After 5 years
In thousands of U.S. dollars					
Facility leases	\$ 3,431	\$ 731	\$ 1,231	\$ 807	\$ 662
Capital equipment leases	230	89	109	32	-
Operating equipment leases	82	35	42	5	-
<b>Total contractual obligations</b>	<b>\$ 3,743</b>	<b>\$ 855</b>	<b>\$ 1,382</b>	<b>\$ 844</b>	<b>\$ 662</b>

### OFF BALANCE SHEET ARRANGEMENTS

#### Guarantees

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 \$1,200,000. At November 30, 2008, the carrying amount of the liability was \$691,000 (2007 - \$520,000).

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.

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

## **OSI Geospatial Inc.**

Management's Discussion and Analysis  
Year ended November 30, 2008 and 2007  
(expressed in U.S. dollars)

### **TRANSACTIONS WITH RELATED PARTIES**

There were no related party transactions for the fiscal years ending November 30, 2008 and 2007.

Related party transactions, when they occur, are conducted at market value prices and are approved by the board of directors.

### **CRITICAL ACCOUNTING ESTIMATES**

The preparation of financial statements in conformity with Canadian GAAP requires the Company's 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. Significant areas requiring the use of estimates include valuation of goodwill and intangible assets, future income tax assets, and revenue recognition. Management reviews its estimates based on management's best knowledge of current events and actions that the Company may undertake in the future. Actual results could differ from these estimates.

The Company's critical accounting policies are those that it believes are the most important in determining its financial condition and results, and requires significant subjective judgement by management. The Company considers an accounting estimate to be critical if the estimate requires management to make assumptions about matters that were highly uncertain at the time the estimate was made, if different estimates could have been reasonably used or if changes in the estimate would have a material impact on the Company's financial condition or results of operations are likely to occur from period to period.

#### *Valuation of goodwill and intangible assets impairment*

In November 2008 and 2007, the Company performed impairment tests for goodwill and intangible assets with indefinite useful lives, and determined that these assets were not impaired. The impairment test involves considerable use of judgment, and requires management to make estimates and assumptions. The fair values of the reporting units are derived from certain valuation models, which consider various factors such as cost of capital, discount rates, the Company's stock price, future earnings and earnings multiples. Changes in estimates and assumptions can affect the reported value of goodwill and intangible assets with indefinite useful lives.

#### *Future income tax assets*

The Company is required to determine if the "more likely than not" test under the liability method of accounting for income taxes is met in order to include in income the potential tax benefits relating to increases in future income tax assets. The valuation of income tax assets involves considerable use of judgment and requires management to make estimates and assumptions. Estimates and assumptions include projected earnings, projected growth, projected taxable income and tax planning strategies. Changes in estimates and assumptions can affect the reported value of net future tax assets.

#### *Revenue recognition*

The Company generates a portion of International Systems revenues from long-term fixed fee contracts to render specific consulting and software modification services. Revenues from long-term contracts are recognized using the percentage of completion method based on labour costs incurred relative to total estimated labour costs. The long-term nature of contracts involves considerable use of judgment and estimates in determining total revenues, total labour costs and percentage of completion. There are numerous factors to consider, including variances in the contract deliverables, scheduling, labour costs

## OSI Geospatial Inc.

Management's Discussion and Analysis  
Year ended November 30, 2008 and 2007  
(expressed in U.S. dollars)

and productivity. The Company has developed methods and systems to provide dependable expenditure estimates for its long-term contracts.

### REVIEW OF THE FOURTH QUARTER ENDING NOVEMBER 30, 2008

In thousands of U.S. dollars	2008	% of total revenue	2007	% of total revenue
<b>Revenue</b>				
Marine systems	\$ 3,409	49	3,952	48
Land and air systems	2,576	37	3,409	41
Mapping	933	14	915	11
	<u>6,918</u>	<u>100</u>	<u>8,276</u>	<u>100</u>
Cost of sales	4,121	60	4,683	57
Gross profit	<u>2,797</u>	<u>40</u>	<u>3,593</u>	<u>43</u>
<b>Expenses</b>				
General and administrative	1,096	16	1,925	23
Sales and marketing	943	13	1,607	19
Engineering	277	4	260	3
Technology Partnerships Canada royalty	151	2	195	2
Depreciation and amortization	104	2	106	1
Interest expense	29	-	22	-
Interest income	(5)	-	-	-
Foreign exchange (gain) loss	(38)	-	251	2
Loss on sale of fixed assets	-	-	9	-
	<u>2,557</u>	<u>37</u>	<u>4,375</u>	<u>52</u>
Income gain (loss) before income taxes	240	3	(782)	(9)
Income tax (recovery) expense	(541)	(8)	16	-
Net income (loss)	<u>\$ 781</u>	<u>11</u>	<u>\$ (798)</u>	<u>(9)</u>
Net income (loss) available to common shareholders	<u>\$ 692</u>		<u>\$ (960)</u>	
Earnings (loss) per share				
Basic	\$ 0.01		\$ (0.02)	
Diluted	\$ 0.01		\$ (0.02)	

### Overall Performance

For the three months ended November 30, 2008, we reported a net gain of \$782,000 compared to a net loss of \$798,000 for the three months ended November 30, 2007. The net gain attributable to common shareholders was \$656,000 compared to a net loss of \$960,000 for the three months ended November 30, 2007.

Our results for the three months ended November 30, 2008 are primarily influenced by the level, timing, and duration of customer orders, and customer product delivery requirements. We depend heavily on government contracts and derive a significant amount of revenue from a few customers, which may result in varying revenue, gross profit, and earnings. Some of our government customers have cyclical purchasing patterns which can also impact our quarterly and year-to-date results.

The lower gross profit percentage for the three months ended November 30, 2008 as compared to the three months ended November 30, 2007 is largely due to the mix of revenue. The decrease in the gross

## OSI Geospatial Inc.

Management's Discussion and Analysis  
Year ended November 30, 2008 and 2007  
(expressed in U.S. dollars)

profit percentage is due to a decrease in higher margin software revenue and an increase in lower margin hardware and systems revenue generated by International Systems operations.

Fluctuations in gross profit are influenced by the proportion of engineering labour, third-party systems or third-party labour or portions of all three required for a project, and a high proportion of these factors can result in increased cost of sales and therefore lower gross profit. Certain contracts awarded may require the inclusion of engineering labour, third-party systems or third-party labour. In order to maintain competitiveness on these contracts, we may elect to reduce our usual margins on the third-party components.

G&A decreased by 43% for the three months ended November 30, 2008 compared to the three months ended November 30, 2007. G&A expenses for the three months ended November 30, 2007 included a one-time accrual of estimated settlement costs relating to the lawsuit with Triathlon Ltd., severance costs associated with restructuring in the fourth quarter of 2007 as well as costs associated with the relocation of corporate headquarters to Ottawa, Ontario.

S&M expenses decreased by 41% for the three months ended November 30, 2008 compared to the three months ended November 30, 2007. S&M expenses for the three months ended November 30, 2007 included one-time costs including severance costs due to reorganization and costs associated with the relocation of sales and marketing personnel to the new headquarters in Ottawa, Ontario.

### SELECTED QUARTERLY DATA (UNAUDITED)

In thousands of U.S. dollars

For the three months ended	November 30 2008	August 31 2008	May 31 2008	February 29 2008
Revenue	\$ 6,918	\$ 6,243	\$ 6,529	\$ 5,808
Gross profit	2,797	2,204	2,019	2,188
Gross profit percentage	40%	35%	31%	38%
Net earnings (loss)	781	(691)	(1,141)	(533)
Net earnings (loss) available to common shareholders	692	(847)	(1,296)	(692)
Loss per share – basic	0.01	(0.02)	(0.03)	(0.01)
Loss per share – diluted	0.01	(0.02)	(0.03)	(0.01)

For the three months ended	November 30 2007	August 31 2007	May 31 2007	February 28 2007
Revenue	\$ 8,275	\$ 7,342	\$ 6,138	\$ 3,571
Gross profit	3,594	3,048	2,455	669
Gross profit percentage	43%	42%	40%	19%
Net (loss) earnings	(798)	279	(366)	(1,989)
Net (loss) earnings available to common shareholders	(960)	109	(557)	(2,180)
Loss per share – basic and diluted	(0.02)	0.00	(0.02)	(0.06)
Loss per share – basic and diluted	(0.02)	0.00	(0.02)	(0.06)

### CRITICAL ACCOUNTING POLICIES

Financial statement preparation requires that we use estimates and assumptions that affect the reported amount of assets, liabilities, revenue and expenses, and the related disclosure of contingent liabilities.

## **OSI Geospatial Inc.**

Management's Discussion and Analysis  
Year ended November 30, 2008 and 2007  
(expressed in U.S. dollars)

Our accounting policies are described in note 4 to our audited consolidated financial statements. The following critical accounting policies affect our more significant estimates and assumptions used in preparing our consolidated financial statements:

### **Revenue**

#### ***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. Anticipated losses on these contracts are expensed when identified.

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 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.

## **OSI Geospatial Inc.**

Management's Discussion and Analysis  
Year ended November 30, 2008 and 2007  
(expressed in U.S. dollars)

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 is 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.

### **Income Taxes**

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

### **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

## **OSI Geospatial Inc.**

Management's Discussion and Analysis  
Year ended November 30, 2008 and 2007  
(expressed in U.S. dollars)

goodwill and other intangible assets related to the CHI Systems Inc. acquisition as of November 30 of each year. Based on testing performed as of November 30, 2008 and 2007, there was no impairment.

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

We have 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 fair value of the stock options is estimated using the Black-Scholes option pricing model, using weighted-average assumptions for the following: dividend yield, volatility rate, risk-free interest rate, and expected average life. 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. Upon the exercise of stock options, share capital is increased by the amount paid by the employees as well as the amounts previously added to contributed surplus when compensation costs were charged to earnings.

### **Accounts Receivable**

We maintain an allowance for doubtful accounts for estimated losses that may arise if any of our 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 uncollectibility of our accounts receivable. If we determine that the financial condition of any of our customers deteriorates, increases in the allowance may be made. We review the unbilled revenue balance on a regular basis to assess our fair market value and provide an allowance against any amounts that are impaired.

### **Inventory**

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

### **RECENT ACCOUNTING PRONOUNCEMENTS**

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

The CICA has issued CICA Handbook section 3031, *Inventories*, which replaces CICA Handbook section 3030, *Inventories*. This section will result in 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. Accordingly, the Company will adopt the new section for its fiscal year beginning December 1, 2008. The Company does not expect that the adoption of this new Section will have a material impact on its consolidated financial statements.

The CICA has issued CICA Handbook section 3064, *Goodwill and Intangible Assets*, which replaces CICA Handbook section 3062, *Goodwill and Other Intangibles*, and CICA Handbook 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

## **OSI Geospatial Inc.**

Management's Discussion and Analysis  
Year ended November 30, 2008 and 2007  
(expressed in U.S. dollars)

trademarks. This section applies to annual and interim financial statements relating to fiscal years beginning on or after October 1, 2008. Accordingly, the Company will adopt the new section for its fiscal year beginning December 1, 2008. The Company does not expect that the adoption of this new Section will have a material impact on its consolidated financial statements.

The CICA has issued CICA Handbook section 1582, *Business Combinations*, which replaces CICA Handbook section 1581, *Business Combinations*. This section establishes standards for the recognition, measurement, presentation and disclosure of business combinations. This section applies to annual and interim financial statements relating to fiscal years beginning on or after January 1, 2011. Accordingly, the Company will adopt the new section for its fiscal year beginning December 1, 2011. The Company does not expect that the adoption of this new Section will have a material impact on its consolidated financial statements.

The CICA has issued CICA Handbook section 1601, *Consolidated Financial Statements*, and CICA Handbook section 1602, *Non-controlling Interests*, which replace CICA Handbook section 1600, *Consolidated Financial Statements*. CICA Handbook section 1601 establishes standards for the preparation of consolidated financial statements and CICA Handbook section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements. These sections apply to annual and interim financial statements relating to fiscal years beginning on or after January 1, 2011. Accordingly, the Company will adopt the new section for its fiscal year beginning December 1, 2011. The Company does not expect that the adoption of this new Section will have a material impact on its consolidated financial statements.

The Canadian Accounting Standards Board has confirmed that the use of International Financial Reporting Standards ("IFRS") will be required commencing 2011 for publicly accountable, profit oriented enterprises. IFRS will be replacing current Canadian GAAP followed by the Company. The Company will be required to begin reporting under IFRS for its fiscal year ended November 30, 2012 and will be required to provide information that conforms to IFRS for the comparative periods presented.

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

### **CHANGES IN ACCOUNTING POLICIES**

#### **a) Changes in accounting policies**

Effective December 1, 2007 the Company adopted the following new accounting standards.

##### **Capital Management**

The Canadian Institute of Chartered Accountants ("CICA") Handbook section 1535, *Capital Disclosures*, requires the Company to disclose information about the Company's objectives, policies and processes for the management of its capital. The impact of this new accounting standard on the Company's interim and annual financial statements is limited to providing additional disclosure requirements.

##### **Financial Instruments – Recognition and Measurement**

CICA Handbook section 3862, *Financial Instruments – Disclosures*, and CICA Handbook section 3863, *Financial Instruments- Presentation*, replace CICA Handbook section 3861, *Financial Instruments – Disclosure and Presentation*. These sections require the disclosure of information with regard to the significance of financial instruments for the Company's financial position and performance, and the nature and extent of risk arising from financial instruments to which the Company is exposed during the period and at the balance sheet date, and how the Company manages those risks. The impact of this new accounting standard on the Company's interim and annual financial statements is limited to providing additional disclosure requirements.

## OSI Geospatial Inc.

Management's Discussion and Analysis  
Year ended November 30, 2008 and 2007  
(expressed in U.S. dollars)

Financial instrument classification is as follows:

- |  |                       |
|--|-----------------------|
| • Cash and bank indebtedness               | Held for trading      |
| • Accounts receivable                      | Loans and receivables |
| • Derivative assets and liabilities        | Held for trading      |
| • Accounts payable and accrued liabilities | Other liabilities     |
| • Long-term liabilities                    | Other liabilities     |

### Held for trading

Held for trading financial assets and liabilities are typically acquired for resale. These financial assets and liabilities are measured at fair value with changes in fair value flowing through the statement of operations.

### Loans and receivables

Loans and receivables are recorded initially at fair value and are then accounted for at amortized cost using the effective interest method.

### Other liabilities

Other liabilities are recorded initially at fair value and are then accounted for at amortized cost using the effective interest method. Other liabilities include all financial liabilities, other than derivative instruments.

### Embedded derivatives

Derivatives embedded in other financial instruments or contracts are separated from their host contract and accounted for as derivatives when: (a) their economic characteristics and risks are not closely related to those of the host contract; (b) the terms of the embedded derivative are the same as those of a free standing derivative; and (c) the combined instrument or contract is not measured at fair value with changes in fair value recognized in other income. As at November 30, 2008 and 2007, the Company does not have any outstanding contracts or financial instruments with embedded derivatives.

## FINANCIAL INSTRUMENTS AND OTHER INSTRUMENTS

The Company has exposure to the following risks from its use of financial instruments: credit risks, market, and liquidity risk. The Company reviews its risk management framework on a quarterly basis and makes adjustments as necessary.

### Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations. Credit risk arises principally from the Company's accounts receivable and its foreign exchange contracts. The Company provides credit to its customers in the normal course of its operations. The Company's credit risk review includes performing credit evaluations of the financial condition of significant customers. The Company's customers are, for the most part, national and international government clients and large public customers. A significant portion of the Company's accounts receivable is from long-time customers and at November 30, 2008, 48% (2007 – 71%) of its accounts receivable was with national and international government clients and 39% (2007 – 7%) of its accounts receivable was with large international public companies. Due to the low risk nature of the government clients and large international public companies and a history of excellent collections, provisions for doubtful accounts are made on a customer by customer basis, based on ongoing customer discussions. The carrying amount of financial assets represents the maximum credit exposure. The maximum exposure to credit risk at November 30, 2008 was \$9,038,000 (2007 –

## **OSI Geospatial Inc.**

Management's Discussion and Analysis  
Year ended November 30, 2008 and 2007  
(expressed in U.S. dollars)

\$13,055,000). The Company is exposed to non-performance by counterparties to foreign currency forward contracts. These counterparties are major financial institutions and to date, no such counterparty has failed to meet its financial obligations to the Company. Management does not believe there is a significant risk of non-performance by these counterparties because the positions with and the credit rating of these counterparties are monitored.

### **Market risk**

Market risk is the risk that changes in market prices, such as foreign exchange rates and interest rates will affect the Company's income or the value of its holding of financial instruments.

#### *Foreign exchange risk*

The Company operates internationally, giving rise to exposure to market risks from changes in foreign exchange rates. The Company is exposed to foreign currency fluctuations mainly on its accounts receivable and future cash flows related to contracts denominated in a foreign currency. The Company's foreign exchange risk management includes the use of foreign currency forward contracts to fix the exchange rates on certain foreign currency exposures. The Company's objective is to manage and control exposures and secure the Company's profitability on existing contracts and therefore, the Company's policy is to hedge the majority of its foreign currency exposure. The Company does not utilize derivative financial instruments for trading or speculative purposes. The Company formally documents all relationships between derivative financial instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives to specific firm contractually related commitments on projects.

The Company did not designate its foreign exchange forward contracts as a hedge of underlying assets, liabilities, firm commitments or anticipated transactions in accordance with CICA Handbook Section 3865, *Hedges*, and accordingly did not use hedge accounting. As a result of this, the foreign exchange forward contracts are recorded on the consolidated balance sheet at fair value in other receivables when the contracts are in a gain position and in other accrued liabilities when the contracts are in a loss position. The fair value of the foreign exchange forward contracts was a recorded liability in accounts payable and accrued liabilities of \$24,000 at November 30, 2008 (2007 – \$142,000). Changes in fair value of these contracts are recognized as gains or losses in the consolidated statement of operations.

A 10% strengthening (weakening) of the Canadian dollar against each of the Great Britain pound, the United States dollar, the euro and the Australian Dollar would have decreased (increased) earnings from operations by a total of \$6,000 (2007 – \$4,000). A 10% strengthening (weakening) of the Canadian dollar against the U.S. dollar would have decreased (increased) the reporting currency earnings from Canadian operations by a total of \$175,000 (2007 - \$325,000). A 10% strengthening (weakening) of the Canadian dollar against the U.S. dollar would also impact the reporting currency balance sheet values with an offsetting adjustment of approximately \$473,000 (2007 – \$552,000) to other comprehensive income.

#### *Interest rate risk*

The Company is exposed to interest rate risk on its operating line of credit. A 1% increase (decrease) in the interest rate would have resulted in approximately \$13,000 (2007 – \$8,000) increase (decrease) in the loss of the Company.

### **Liquidity risk**

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company's approach to managing liquidity risk is to ensure, as far as possible, that it will always have sufficient liquidity to meet liabilities when due. The Company has operating lines of credit of CAD \$3.0 million and U.S. \$1.2 million. At November 30, 2008, the Company utilized CAD \$1.5 million (2007 -

## OSI Geospatial Inc.

Management's Discussion and Analysis  
Year ended November 30, 2008 and 2007  
(expressed in U.S. dollars)

CAD \$265,000) and U.S. \$691,000 (2007 – U.S. \$520,000) of its lines of credit. All of the Company's financial liabilities, other than capital lease obligations, have contractual maturities of less than 45 days.

### *Fair values*

The Company's financial instruments consist of bank indebtedness, accounts receivable, and accounts payable and accrued liabilities, capital lease obligations and foreign exchange contracts. The carrying value of bank indebtedness, accounts receivable and accounts payable and accrued liabilities approximates their fair value due to the immediate or short-term maturity of these financial instruments.

The fair values of the Company's forward foreign exchange contracts are based on the current market values of similar contracts with the same remaining duration as if the contracts had been entered into on November 30, 2008.

The carrying amounts of each of the financial instruments are:

In thousands of U.S. dollars

	2008	2007
Held for trading	\$ (1,629)	\$ (822)
Loans and receivables	5,583	7,570
Held for trading	(24)	(142)
Other liabilities	(3,847)	(5,831)

## DISCLOSURE OF OUTSTANDING SHARE DATA

As at February 19, 2009, we had 46,956,439 issued and outstanding common shares and 3,433,166 outstanding stock options. As at February 19, 2009, we also had 30,262 issued and outstanding class A preference shares and 178,530 issued and outstanding class B preference shares series 2 convertible into common shares at conversion ratios of 1:1 and 1:58.82353 respectively which represents 10,532,027 common shares. Also at February 19, 2009, we had 15,175,067 outstanding common share purchase warrants convertible to common shares at a conversion ratio of 1:1, representing 15,175,067 common shares.

## DISCLOSURE CONTROLS AND PROCEDURES

The Company maintained a set of disclosure controls and procedures during the year ended November 30, 2008 designed to ensure that information required to be disclosed is recorded, processed, summarized and reported within the time periods specified in Canadian securities legislations. The Chief Executive Officer and the Chief Financial Officer of the Company, after evaluating the effectiveness of the Company's disclosure controls and procedures as of November 30, 2008, have concluded that the Company's disclosure controls and procedures were adequate and effective.

## INTERNAL CONTROLS OVER FINANCIAL REPORTING

The Chief Executive Officer and the Chief Financial Officer of the Company are responsible for designing and maintaining internal controls over financial reporting. The Chief Executive Officer and the Chief Financial Officer have designed internal controls over financial reporting, or caused them to be designed under their supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP. The Company has not formally evaluated the operating effectiveness of internal controls over financial reporting.

## **OSI Geospatial Inc.**

Management's Discussion and Analysis  
Year ended November 30, 2008 and 2007  
(expressed in U.S. dollars)

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

## **RISKS AND UNCERTAINTIES**

Certain statements made in this report constitute forward-looking statements, and are subject to risks and uncertainties that may cause future results to differ materially from those expected. Factors that may cause such differences include, but are not limited to, the factors discussed below. If any of these events actually occur, they could have a materially adverse effect on the Company, our financial condition, or results of operations.

**We depend heavily on government contracts, which are only partially funded, subject to termination, heavily regulated, and audited. The termination of one or more of these contracts could have a negative impact on our operations. The contract termination clauses are generally in favour of the government agencies. Typically the termination clause for convenience is 30 days or less with the condition that all costs to that date are paid by the government agencies.**

The termination of funding for a government program would result in a loss of anticipated future revenues attributable to that program. That could have a negative impact on our operations. Also, we cannot give assurance that we would be able to procure new government contracts to offset the revenues lost as a result of any contract termination. As our revenues are dependent on the procurement, performance, and payment under these contracts, the loss of one or more critical contracts could have a negative impact on our financial condition.

In addition, sales to the governments we work with may be affected by:

- changes in procurement policies;
- changes in the structure and management of government departments;
- budget considerations;
- changing concepts of national defence;
- political developments domestically and abroad; and
- increased protectionism.

The influence of any of these factors, which are largely beyond our control, could also negatively impact our financial condition.

**We derive a significant amount of revenue from only a few customers. We depend on national and international governments for a significant portion of our sales, and the loss of any of these relationships or a shift in any of these governments' funding could have severe consequences on our financial condition.**

For the year ended November 30, 2008 approximately 35% of our revenue was from the Royal Australian Navy, the Royal Navy of the United Kingdom, and the U.S. Army. Approximately 41% of our revenue for the year ended November 30, 2007 was from the Royal Navy of the United Kingdom, the U.S. Army and the U.S. Navy. Therefore, any significant disruption or deterioration of any of our relationships with these entities' governments would significantly reduce our revenues. These governments may choose to use other competing corporations for their navigational equipment. In addition, a shift in government spending to other programs in which we are not involved could have severe consequences for our results of operations.

## **OSI Geospatial Inc.**

Management's Discussion and Analysis  
Year ended November 30, 2008 and 2007  
(expressed in U.S. dollars)

### **Our product lines are not broadly diversified.**

We derive and expect to derive a substantial majority of our revenue from navigational software, systems, and equipment sales. If customers do not purchase our products as a result of competition, technological change, budget constraints, or other factors, we do not have other product categories that it could rely on to make up any shortfall in sales. As a result, our revenue could decrease, and our business and operating results would be adversely affected.

### **We derive a significant portion of our revenues from international sales and are subject to the risks of doing business in foreign countries.**

In the year ended November 30, 2008, approximately 86% of our revenues were from international customers, including governmental customers: 47% from the U.S. and 39% from other international countries. We have focused our expansion efforts for the future on the American, European and Australasian markets. As a result, we expect that international sales will continue to account for a significant portion of our revenues for the foreseeable future. As a result, we are subject to the risks of doing business internationally, including those risks related to:

- changes in regulatory requirements;
- domestic and foreign government policies, including requirements to expend a portion of program funds locally and governmental industrial co-operation requirements;
- fluctuations in foreign currency exchange rates;
- the complexity and necessity of dealing with foreign representatives and consultants;
- imposition of tariffs or embargoes, export controls, and other trade restrictions; and
- compliance with a variety of foreign laws.

While the presence of these factors and the impact of these factors are difficult to predict, any one or more of them could adversely affect our operations in the future.

### **The Company derives significant revenue from contracts awarded through a competitive bidding process, which can impose substantial costs upon it, and the Company could fail to maintain its current and projected revenue if it fails to compete effectively.**

The Company derives significant revenue from government contracts, both domestic and international, that are awarded through a competitive bidding process. The Company expects that most of the government business it will seek in the foreseeable future will be awarded through competitive bidding. Competitive bidding imposes substantial costs and presents a number of risks. Such risks include, but are not limited to

- the need to bid on engagements in advance of the completion of their design, which may result in unforeseen difficulties in executing the engagement and cost overruns;
- the substantial cost and managerial time and effort that the Company spends to prepare bids and proposals for contracts that may not be awarded to them;
- the need to accurately estimate the resources and costs that will be required to service any contract the Company is awarded;
- the expense and delay that may arise if the Company's competitors protest or challenge contract awards made to them pursuant to competitive bidding, and the risk that any such protest or challenge could result in the resubmission of bids on modified specifications, or in termination, reduction, or modification of the awarded contract; and
- the opportunity lost of not bidding on and winning other contracts the Company might otherwise pursue.

To the extent the Company engages in competitive bidding and are unable to win particular contracts, it not only incur substantial costs in the bidding process that could negatively affect the

## **OSI Geospatial Inc.**

Management's Discussion and Analysis  
Year ended November 30, 2008 and 2007  
(expressed in U.S. dollars)

Company's operating results, but it may be precluded from operating in the market for services that are provided under those contracts for a number of years. Even if the Company wins a particular contract through competitive bidding, its profit margins may be depressed as a result of the costs incurred through the bidding process.

**Our revenues and costs are affected by fluctuations in the rate of exchange between the Canadian dollar, which is the functional currency for the Company, and the U.S. dollar, the British pound, the Australian dollar, the Danish kroner and the euro,**

Exposure to exchange rate fluctuations exists because a significant portion of our trade receivables and revenue transactions are in U.S. dollars, Australian dollars, British pounds and euros. For the year ended November 30, 2008, approximately 30% of the Company's revenues and 48% of our expenses were transacted in Canadian dollars. During the same period, approximately 8% and 6% of the Company's revenues were transacted in British pounds and Australian dollars, respectively. We expect that British pound and Australian dollar sales will continue to account for a material portion of our revenues for the foreseeable future. As a result, exchange rate fluctuations may affect our revenue and earnings growth materially in the future. In order to reduce the impact of foreign exchange volatility, we utilize our foreign exchange forward contract facility. As at November 30, 2008, we had entered into foreign exchange forward contracts in the amount of U.S. \$460,000, £570,000, and \$580,000 AUD.

**We have established teaming relationships and strategic partnerships with international corporations to pursue major international government procurements, and our reputation and results of operations could be adversely affected by our inability to control their operations.**

We rely on agreements with international corporations to assist us in pursuing contracts for major government procurements. These international corporations often assist us with systems integration, complimentary products and services, and local domain knowledge necessary to successfully pursue major government procurements. We do not have assurance that these third parties will:

- remain in business;
- maintain the financial stability required to fulfill the requirements of these international procurements; and
- continue to consider our products in their business priorities.

There can be no assurance that we would be able to pursue and secure major international government procurements without these third parties.

We may lose sales, or sales may be delayed, because of the long sales and implementation cycles for our products and services.

Our customers have typically invested substantial time, money, and other resources and have many people involved in the decision to license our software products and purchase our hardware products and services. As a result, we may wait up to two or three years after the first contact with a customer for that customer to enter into a purchase agreement while the customer seeks internal approvals for the purchase of our products and/or services. During this long sales cycle, events may occur that affect the size or timing of the purchase or even cause the order to be cancelled.

Even if a purchase agreement is signed, the time period required to deploy our products varies significantly from one customer to the next. Implementing our products can sometimes take several months or even a few years depending on the customer's needs. It may be difficult to deploy our products if the customer has complicated deployment requirements. If a customer utilizes a third party to deploy our products, we cannot guarantee that our products will be deployed successfully.

As a result, our revenue could decrease, and our business and operating results would be adversely affected.

## **OSI Geospatial Inc.**

Management's Discussion and Analysis  
Year ended November 30, 2008 and 2007  
(expressed in U.S. dollars)

### **Competition within our markets may reduce our ability to procure future contracts and sales.**

The defence industry in which we operate is highly competitive. Our competitors range from companies, which are primarily targeting the pleasure boat market, to diversified corporations in the radar and marine equipment segment of the industry. Some of our competitors may have more extensive or more specialized engineering, manufacturing, and marketing capabilities. There can be no assurance that we can continue to compete effectively with these companies.

### **Our ability to procure contracts and gain sales in foreign markets may be negatively impacted by increasing protectionism of foreign governments.**

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

### **Our future success will depend on our ability to develop new technologies that achieve market acceptance.**

The defence market is characterized by rapidly changing technologies and evolving industry standards. Accordingly, our future performance depends on a number of factors, including our ability to:

- identify emerging technological trends in our market;
- develop and maintain competitive products;
- enhance our products by adding innovative features that differentiate our products from those of our competitors; and
- manufacture and bring products to market quickly at cost-effective prices.

We believe that, in order to remain competitive in the future, we will need to continue to develop new products, which will require the investment of significant financial resources in new product development. In addition, there can be no assurance that the market for our products will develop or continue to expand as we currently anticipate. The failure of our technology to gain market acceptance could significantly reduce our revenues and harm our business. Furthermore, we cannot be sure that our competitors will not develop competing technology, which gains market acceptance in advance of our products. The possibility that our competitors might develop new technology or products might cause our existing technology and products to become obsolete. If we fail in our new product development efforts or our products fail to achieve market acceptance more rapidly than our competitors, our revenues will decline and our business, financial condition and results of operations will be negatively affected.

### **We depend on the recruitment and retention of qualified personnel, and our failure to attract and retain such personnel could seriously harm our business.**

Due to the specialized nature of our business, our future performance is highly dependent upon the continued services of our key engineering personnel and executive officers. Our prospects depend upon our ability to attract and retain qualified engineering, manufacturing, marketing, sales, and management personnel for our operations. Competition for personnel is intense, and we may not be successful in attracting or retaining qualified personnel. Our failure to compete for these personnel could seriously harm our business, results of operations, and financial condition.

## **OSI Geospatial Inc.**

Management's Discussion and Analysis  
Year ended November 30, 2008 and 2007  
(expressed in U.S. dollars)

### **We do not have fixed-term employment agreements with our officers and key employees and the loss of any officer or key employee could seriously harm our business.**

We have not entered into fixed-term employment agreements with our officers and key employees. Our success depends upon the abilities and experience of our officers and key employees. Competition for highly skilled management, engineering, technical, and other key employees is intense. The loss of officers and key employees could seriously disrupt our operations and impair our ability to compete.

### **We depend on foreign sub-contract labour in our mapping operations to maintain a competitive position in the mapping marketplace.**

Our mapping operations are dependent upon labour resources located outside North America. While we enter into sub-contract agreements with these suppliers, we cannot be sure that the labour resources will be available when required and at the levels required. Accordingly, maintaining our competitiveness will depend upon a number of factors, including:

- the geopolitical uncertainties specific to the home country of each sub-contractor;
- the cultural compatibility between Canada and the home country of each sub-contractor;
- the English language proficiency of the labour resources made available to the Company;
- labour pool characteristics such as work ethic, education, skill level, and attrition; and
- the infrastructure of both the sub-contractor's home country and the sub-contractor.

While the presence of these factors and the impact of these factors are difficult to predict, any one or more of them could adversely affect our mapping operations in the future.

### **We may be unable to adequately protect our intellectual property rights, which could affect our ability to compete.**

Protecting our intellectual property rights is critical to our ability to compete and succeed as a company. We have trademark and copyright registrations, which are necessary and contribute significantly to the preservation of our competitive position in the market. There can be no assurance that any of the trademarks, copyrights, and other intellectual property will not be challenged, invalidated or circumvented by third parties. In the future, we may not be able to obtain necessary licenses on commercially reasonable terms. We enter into confidentiality and invention assignment agreements with our employees, and enter into nondisclosure agreements with our suppliers and customers, as appropriate, so as to limit access to and disclosure of our proprietary information. These measures may not suffice to deter misappropriation or independent third-party development of similar technologies.

### **Our operations depend on component availability and our key suppliers to manufacture and deliver our products and services.**

Our operations are highly dependent on the timely delivery of materials by outside suppliers. While we enter into purchase agreements with a few of our suppliers, we cannot be sure that materials, components, and subsystems will be available in the quantities required, if at all. If any of the suppliers fail to meet our needs, it may not have readily available alternatives. Our inability to fill our supply needs would jeopardize our ability to satisfactorily complete our obligations under our contracts on a timely basis. This might result in reduced sales, contractually imposed penalties for delay in delivery, termination of one or more of these contracts or damage our reputation and relationships with our customers. All of these events could have a negative effect on our financial condition.

### **The Company may not be able to meet the delivery terms or budgeted costs of its firm fixed price contracts.**

A majority of the Company's contracts are firm fixed price contracts. There is a risk in every firm fixed price contract that the Company will be unable to deliver to the customer within the time specified or at a

## **OSI Geospatial Inc.**

Management's Discussion and Analysis  
Year ended November 30, 2008 and 2007  
(expressed in U.S. dollars)

cost to the Company which is less than the contract price. In the absence of any amendments to the original firm fixed price contract to increase the price of the contract or extend the delivery times, customers may be in a position to terminate the contract, demand repayment or impose penalties on the Company. A significant cost overrun or delay in delivery to the customer could adversely affect the Company's business and operating results.

### **The unpredictability of our results may harm or contribute to the volatility of the trading price of our common stock.**

Our operating results may vary significantly over time for a variety of reasons, many of which are outside our control and any of which may harm our business. The value of our common stock may fluctuate as a result of considerations that are difficult to forecast, such as:

- the volume and timing of product orders received and delivered;
- levels of product demand;
- government and corporate spending patterns;
- the timing of contract receipt and funding and resulting impact on our working capital position;
- our ability and the ability of our key suppliers to respond to changes in customer orders;
- the timing of our new product introductions and our competitors' new product introductions;
- the cost and availability of components and subsystems;
- price erosion;
- the adoption of new technologies and industry standards;
- competitive factors, including pricing, availability, and demand for competing products;
- fluctuations in foreign currency exchange rates; and
- regulatory developments.

### **Sales of a significant number of shares of our common stock by existing shareholders could cause the market price of our common stock to decline.**

If the Company's shareholders sell substantial amounts of the Company's common stock, including shares issued upon the exercise of outstanding options, the market price of the Company's common stock may decline. These sales also might make it more difficult for the Company to sell equity or equity-related securities in the future at a time and price that the Company deems appropriate. The Company is unable to predict the effect that sales may have on then prevailing market price of its common stock.

### **U.S. investors may not be able to enforce their civil liabilities against the Company or its directors and officers.**

It may be difficult to bring and enforce suits against the Company which is incorporated in the Province of British Columbia, Canada. With the exception of one (1) director who is a resident of Australia, the directors of the Company are residents of Canada and the United States and the Company has a substantial portion of their assets located outside of the U.S. As a result, it may be difficult for U.S. shareholders of the Company to effect service of process on these persons within the U.S. or to enforce judgments obtained in the U.S. based on the civil liability provisions of the U.S. federal securities laws against the Company or its officers and directors. In addition, U.S. shareholders of the Company should not assume that the courts of Canada (i) would enforce judgments of U.S. courts obtained in actions against the Company, its officers or directors predicated upon the civil liability provisions of the U.S. federal securities laws or other laws of the U.S., or (ii) would enforce, in original actions, liabilities against the Company, its officers or directors predicated upon the U.S. federal securities laws or other laws of the US.

## **OSI Geospatial Inc.**

Management's Discussion and Analysis  
Year ended November 30, 2008 and 2007  
(expressed in U.S. dollars)

### **We may pursue strategic relationships, investment, and acquisitions. We may not be able to successfully manage our operations if it fails to successfully integrate the acquired technologies and/or businesses.**

As part of our business strategy, we may expand our product offerings to include application software products that are complementary to our existing products. This strategy may involve technology licensing agreements, joint development agreements, investments, or acquisitions of other businesses that offer complementary products. The risks that we may encounter in acquiring or licensing technology from third parties include the following:

- difficulty in integrating the third-party product with our products;
- undiscovered software errors in the third-party product;
- difficulties in selling the third-party product;
- difficulties in providing satisfactory support for the third-party product;
- potential infringement claims from the use of the third-party product; and
- discontinuation of third-party product lines.

The risks commonly encountered in the investment in or acquisition of businesses would accompany any future investments or acquisitions by the Company. Such risks may include the following:

- issues related to product transition (such as development, distribution and customer support);
- the substantial management time devoted to such activities;
- the potential disruption of our ongoing business;
- undisclosed liabilities;
- failure to realize anticipated benefits (such as synergies and cost savings);
- the difficulty of integrating previously distinct businesses into one business unit; and
- technological uncertainty regarding the current and future functionality of the product.

### **We may require additional capital, in which case we may need to raise additional funds from lenders and equity markets in the future.**

If our expenditures exceed our incoming cash flows, we may be required to raise additional capital. In addition, we may choose to pursue additional financing in order to capitalize on potential opportunities in the marketplace that may accelerate our growth objectives. Our ability to arrange such financing in the future will depend in part on the prevailing capital market conditions as well as on our business performance. There can be no assurance that we will be successful in our efforts to raise additional funds, if needed, on terms satisfactory to us. If additional capital is raised by the issuance of shares, shareholders may experience dilution to their equity interest in the Company.

### **Our business could be adversely affected if we fail to manage our growth effectively.**

If we fail to manage our growth effectively, our business and operating results could be adversely affected. We expect to continue to grow our operations domestically and internationally, and to hire additional employees. The growth in our operations and staff has placed, and will continue to place, a significant strain on our management systems and resources. If we fail to manage our future anticipated growth, we may experience higher operating expenses, and it may be unable to meet the expectations of investors with respect to future operating results. To manage this growth we must, among other things, continue to:

- improve our financial and management controls, reporting systems, and procedures;
- add and integrate new senior management personnel;
- improve our licensing models and procedures;
- hire, train, and retain qualified employees;
- maintain sufficient working capital;

## **OSI Geospatial Inc.**

Management's Discussion and Analysis  
Year ended November 30, 2008 and 2007  
(expressed in U.S. dollars)

- control expenses;
- diversify channel sales strategies; and
- invest in our internal networking infrastructure and facilities.

To the extent that this anticipated growth does not occur or occurs more slowly than we anticipate, we may not be able to reduce expenses to the same degree. If we incur operating expenses out of proportion to revenue in any given quarter, our operating results may be adversely impacted.

### **Third parties may claim that we infringe their proprietary rights.**

We potentially may receive claims that we have infringed the intellectual property rights of others. As the number of products in the software industry increases and the functionality of these products further overlap, we may become increasingly subject to infringement claims, including patent, trademark, and copyright infringement claims. In addition, former employers of our former, current, or future employees may assert claims that such employees have improperly disclosed to the Company the confidential or proprietary information of these former employers. Any such claim, with or without merit, could be time-consuming to defend, result in costly litigation, divert management's attention from our core business, require it to stop selling or delay shipping, or cause the redesign of our product or products. In addition, we may be required to pay monetary amounts as damages, for royalty or licensing arrangements, or to satisfy indemnification obligations that it has with some of our customers.

We license and use software from third parties in our business. These third-party software licenses may not continue to be available to the Company on acceptable terms. Also, these third parties may from time to time receive claims that they have infringed the intellectual property rights of others, including patent and copyright infringement claims, which may affect our ability to continue licensing this software. Our inability to use any of this third-party software could result in shipment delays or other disruptions in our business, which could materially and adversely affect our operating results.

### **We may not be able to protect our proprietary information.**

We rely on a combination of copyright, trademark, and trade secret laws; confidentiality procedures; contractual provisions; and other measures to protect our proprietary information. All of these measures afford only limited protection. These measures may be invalidated, circumvented or challenged, and others may develop technologies or processes that are similar or superior to our technology. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy our products or to obtain or use information that we regard as proprietary.

### **Our products may contain significant defects, which may result in liability and/or decreased sales.**

Software products frequently contain bugs, errors or failures, especially when first introduced or when new versions are released. Despite our efforts to test our products, we might experience significant errors or failures in our products, or they might not work with other hardware or software as expected. This could delay the development or release of new products or new versions of products, or could adversely affect market acceptance of our products. Customers use our products for applications that are critical to their businesses, and they have a greater sensitivity to product defects than the market for other software products generally. Our customers may claim that we are responsible for damages to the extent they are harmed by the failure of any of our products. If we were to experience significant delays in the release of new products or new versions of products, or if customers were dissatisfied with product functionality or performance, we could lose revenue or be subject to liability for service or warranty costs. Should this occur, our business and operating results could be adversely affected.

## **OSI Geospatial Inc.**

Management's Discussion and Analysis  
Year ended November 30, 2008 and 2007  
(expressed in U.S. dollars)

### **Our products depend on third-party software products and our reputation and results of operations could be adversely affected by our inability to control their operations.**

Our products incorporate and use software products developed by other entities. We do not have assurance that such third parties will:

- remain in business;
- support our product lines;
- maintain viable and functional product lines; and
- make their product lines available to the Company on commercially acceptable terms.

Any significant interruption in the supply of such third-party technology could have a materially adverse effect on our business, results of operation, cash flows, and financial condition.

Our products may not be compatible with various operating systems and therefore we may not be able to sell our products to potential customers.

Our products are used in combination with various operating systems. Our future success depends on our ability to continue to support widely-used operating systems. Our applications run on Microsoft operating systems. Therefore, our ability to increase sales depends on the continued acceptance of Microsoft operating system products. If we are unable to develop and market products that support Microsoft's operating platforms or develop and market products that support other operating systems on a timely and cost effective basis, our business and operating results could be adversely affected.

### **The Company is subject to various government audits, which may result in unfavourable assessments or penalties to the Company.**

The Company is occasionally subject to compliance audits from government bodies and agencies relating to its Technology Partnership Canada (TPC) funding agreements and the U.S. government defence contracts, corporate income tax filings or federal, state, provincial and municipal government contracts for the procurement of the Company's products and services. The Company was audited in 2005 by Industry Canada in relation to its TPC funding agreements and as part of a broader Industry Canada review of TPC funding agreements. This compliance audit was focused on ensuring the funding submissions by the Company meet the terms and conditions of its TPC funding agreement. 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 2008 and resulted in a requirement to pay an additional \$16,000. The U.S. government defence contracts are audited on an annual basis by the Defense Contract Auditing Agency for compliance with the U.S. Federal Acquisition Regulations. To date, there have been no audit exceptions or adjustments required.