



MANAGEMENT'S DISCUSSION AND ANALYSIS

for the three months ended February 28, 2006

Offshore Systems International Ltd.

107 – 930 West 1st Street
North Vancouver, BC V7P 3N4

Tel: 604.904.4600

Fax: 604.987.2555

www.osil.com

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 Offshore Systems International Ltd. ("OSI") for the quarter ended February 28, 2006 in comparison with those for the quarter ended February 28, 2005. The following discussion should be read in conjunction with our audited annual consolidated financial statements for the year ended November 30, 2005 prepared in accordance with United States generally accepted accounting principles ("U.S. GAAP").

Effective December 1, 2004, we elected to report our consolidated financial statements in accordance with U.S. GAAP as permitted by Canadian regulators. All references in this report to financial information concerning OSI are in accordance with U.S. GAAP and all dollar amounts are in Canadian dollars unless otherwise indicated. A reconciliation of our results to Canadian generally accepted accounting principles ("Canadian GAAP") is provided in note 21 of the notes to the interim consolidated financial statements.

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

Additional information relating to OSI, including our Annual Information Form, is filed on SEDAR at www.sedar.com and is available on the company's investor web site at www.osil.com.

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

OVERVIEW

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

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

Our Common Operational Picture product line (COP PL) is a command and control application that addresses the needs of the Navy, Army, Air Force, Special Forces and joint forces operations. In fiscal 2005 we launched two new Common Operational Picture products: Common Operational Picture – Tactical Display Server (COP-TDS™) and Common Operational Picture – Web Display Server (COP-WDS™).

In April 2005, we completed a private placement in the aggregate amount of \$19.5 million through the sale of 19,500 units, with each unit comprised of 20 voting class B preference shares series 2 ("Preference Shares") and 588 share purchase warrants. The issue price was \$1,000.01 per unit. Compensation in consideration of the provision of advisory services totalling \$815,908 and an additional 350,000 warrants was paid in connection with this private placement to E. Brinton Coxe, a director of the company. The cash compensation of \$815,908 paid to Mr. Coxe includes an adjustment in the amount of \$15,908 to reflect exchange rate changes between the U.S. dollar and Canadian dollar. Finder's fees of \$1.0 million and an additional 579,064 warrants were paid to the investment bankers, C.E. Unterberg, Towbin. The Preference Shares entitle the holders to receive a fixed preferential cumulative 7% dividend payable semi-annually. During fiscal 2005, we declared and paid \$840,781 of dividends on the Preference Shares. Each Preference Share is convertible at the option of the holder at any time into 58.8235 of our common shares, calculated by dividing the issue price of \$50.00 for each Preference Share by the conversion price of \$0.85. Each warrant entitles the holder to purchase one of our common shares at the exercise price of \$0.85 for a period of five years.

The proceeds of the private placement financing were used to pursue acquisitions, to increase available cash for operations, and to repurchase 57,711 issued and outstanding class B preference shares series 1 held by two institutional investors at a cost of \$2.9 million.

During fiscal 2005, seven holders of the Preference Shares converted 48,760 preference shares into 2.9 million common shares which is equivalent to 9.4% of our outstanding common shares as at November 30, 2005. In the fourth quarter of 2005, 27,400 Preference Shares were converted into 1.7 million common shares which is equivalent to 5.3% of our outstanding common shares as at November 30, 2005. During the first quarter of fiscal 2006, no holders of Preference Shares converted.

In April 2005, we completed the acquisition of all the outstanding shares of Mapcon Mapping Consultants Inc. ("Mapcon Mapping") of Salt Lake City, Utah for \$1.3 million. Mapcon Mapping is a land mapping company in the U.S. digital map production market.

On December 14, 2005, we completed the acquisition of CHI Systems Inc., a United States defense contracting company. CHI Systems has multiple offices in the United States, and is a supplier of technology and services to all of the U.S. military services and key defense prime contractors. Under the

terms of the agreement, we paid approximately \$10.3 million (approximately US \$9.0 million) for 100% of the outstanding shares of CHI Systems, of which approximately \$9.4 million (approximately US\$8.1 million) was paid in cash and the balance paid by the issuance of 1.1 million common shares of the company. The results of CHI Systems have been included in the consolidated financial statements commencing December 14, 2005, as our U.S. operations. On February 27, 2006, we filed the related Business Acquisition Report on SEDAR and EDGAR.

We employ a common distribution strategy for all of our markets which relies on a combination of direct sales and indirect sales through teaming relationships, strategic partnerships, and distributorships to obtain major orders from both new and existing customers. This strategy has resulted in the company leading the industry with the most ships under contract as the supplier to eight NATO and allied fleets.

Our long-term goal is to become the leading provider of software and systems for enhancing situational awareness in command, control, and intelligence applications. We plan to grow through internal growth, focused on new and existing customers in the military agencies of Canada, U.S., European NATO and other allies of Canada, and national and international commercial marine transportation companies. In addition, we are pursuing strategic alliances, investments, and acquisitions that are complementary to our existing lines of business.

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

SELECTED ANNUAL INFORMATION

Operations:

<i>Three months ended February 28</i>	2006	2005
Revenue	\$ 4,222,618	\$ 2,259,863
Gross profit	1,387,187	1,232,108
Gross profit percentage	32.9%	54.5%
Net loss	<u>\$ (1,494,320)</u>	<u>\$ (219,591)</u>
Net loss attributable to common shareholders	<u>\$ (1,696,825)</u>	<u>\$ (296,313)</u>
Basic loss per share	<u>\$ (0.05)</u>	<u>\$ (0.01)</u>
Diluted loss per share	<u>\$ (0.05)</u>	<u>\$ (0.01)</u>
Weighted average common shares outstanding - basic	<u>31,269,155</u>	<u>27,488,074</u>
Weighted average common shares outstanding - diluted	<u>31,269,155</u>	<u>27,488,074</u>

Financial Position:

	<i>At February 28</i> 2006	<i>At November 30</i> 2005
Cash	\$ 1,332,750	\$ 9,599,801
Working capital ⁽¹⁾	8,174,768	17,808,110
Current assets	11,780,950	22,542,798
Total assets	23,244,430	24,771,781
Current liabilities	3,606,182	4,734,688
Total liabilities	4,012,346	4,965,494
Stockholders' equity	19,232,084	19,806,287
Dividends declared in quarter:		
Common shares	\$ -	\$ -
Class A preference shares	\$ -	\$ -
Class B preference shares	\$ -	\$ -

⁽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.

For the three months ended February 28, 2006, we have delivered engineering services, software and system products to the U.S. Air Force, U.S. Army, U.S. Navy's Naval Aviation, Royal Australian Navy through Nautronix Ltd., and the Canadian Navy.

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

The increase in revenue for the first quarter of 2006 as compared to the first quarter of 2005 is largely due to the addition of \$2.1 million in land and air systems revenue gained through our recent U.S. acquisition. Our revenue is influenced by the timing of new contracts that are awarded, and the delivery schedules of existing contracts.

Fluctuations in gross profit are influenced by the proportion of engineering labor, third-party systems or third-party labor or portions of all three required for a project, and a high proportion of these factors can result in increased cost of sales. Certain contracts awarded may require the inclusion of engineering

labor, third-party systems or third-party labor. In order to maintain competitiveness on these contracts, we may elect to reduce our usual margins on the third-party components. In addition, the product mix of services revenue, software, mapping, and systems and systems components in any given period may impact the gross profit for the period.

The lower gross profit percentage for the three months ended February 28, 2006 as compared to three months ended February 28, 2005 is the result of lower software revenue and the addition of engineering services revenue generated in our acquired operations. Software revenue generates more favorable margins than our other revenue streams and services revenue generates less favorable margins than other revenue streams.

RESULTS OF OPERATIONS

Overall Performance

<i>Three months ended February 28</i>	2006	2005	2006 to 2005
Loss before income taxes	\$ (1,505,847)	\$ (457,956)	\$ (1,047,510)
Net loss	\$ (1,494,320)	\$ (219,591)	\$ (1,274,729)
Net loss attributable to common shareholders	\$ (1,696,825)	\$ (296,313)	\$ (1,400,512)
Loss per share:			
Basic	\$ (0.05)	\$ (0.01)	\$ —
Diluted	\$ (0.05)	\$ (0.01)	\$ —

The net loss reported in the three months ended February 28, 2006 was largely driven by lower gross profit percentage driven by the mix of contracts executed in the period and higher operating expenses due to the addition of costs from our acquired operations, product launch activities, an increase in staff to support our growth plans, and a negative foreign exchange impact.

Backlog

Total backlog is the sum of the firm and option backlogs. As at February 28, 2006, total backlog was \$31.3 million compared to \$19.8 million at February 28, 2005.

Firm backlog consists of firm, fixed, or signed orders issued and executable subsequent to the balance sheet date. Firm backlog as at February 28, 2006 was at \$13.9 million compared to \$7.0 million at February 28, 2005.

Option backlog consists of unexercised contract options at the balance sheet date and indefinite-quantity contracts executable subsequent to the balance sheet date. Option backlog as at February 28, 2006 was at \$17.4 million compared to \$12.7 million at February 28, 2005.

There is no guarantee or certainty that our customers will elect to exercise their contract option backlog. Should our customers elect to exercise contract options or place orders against indefinite-quantity contracts, the option backlog converts to firm backlog, which then may convert to revenue as contract execution occurs. Backlog metrics are non-GAAP measures. These measures do not have a standardized meaning or comparable GAAP measure and are likely not comparable to similar measures presented by other companies.

The timing of major contracts award can significantly impact our total backlog position and revenue. Historically, major contracts awarded have taken up to three years to finalize. The contracting process

involves lengthy discussions and negotiations with several groups of people within the prospective customer's organization. We have continually pursued, and will continue to pursue, major contracts with lengthy sales cycles, and as a result, there could be large variations in our total backlog and revenue from quarter to quarter.

Multi-year contracts with government agencies have a termination-for-convenience clause because governments approve budget expenditures on an annual basis. This allows contracts to be terminated by the contracting government agency should future budget funding not be approved. Historically, the termination-for-convenience clause has not been exercised by any of our customers. We have included the full value of these government contracts in total backlog.

Revenue

<i>Three months ended February 28</i>	2006	% of total revenue	2005	% of total revenue	2006 to 2005
Marine systems	\$ 1,478,943	35.0	\$ 1,952,277	86.4	\$ (473,090)
Land and air systems	2,126,731	50.4	—	—	2,126,731
Mapping	616,944	14.6	307,586	13.6	309,358
	\$ 4,222,618	100.0	\$ 2,259,863	100.0	\$ 1,962,999

Our core revenue stream is derived from three sources: marine systems, land and air systems, and mapping. Our land and air systems through our U.S. operations deliver 50.4% of our revenue for the three months ended February 28, 2006. Our principal developed and manufactured product, ECPINS, delivers the majority of the marine systems revenue. We also derive revenue from the delivery of the ECPINS software component of our system product. Combined, ECPINS systems and software delivered 35.0% and 84.0% in the three months ended February 28, 2006 and 2005, respectively.

Our results are primarily affected by the level, timing, and duration of customer orders and customer product delivery requirements. The main customers for our products and services in the first quarter of fiscal 2006 were U.S. Air Force, U.S. Army, U.S. Navy's Naval Aviation, the Royal Australian Navy through Nautronix, and the Canadian Navy. Revenue from these customers accounted for 68.5% of the consolidated revenue. In the first quarter of fiscal 2005, the main customers for our products and services, accounting for 77% of the consolidated revenue, were the U.S. Coast Guard, the Royal Australian Navy through Nautronix, and the Royal Navy of the United Kingdom through Lockheed Martin UK.

Revenue by Segment

<i>Three months ended February 28</i>	2006	% of total revenue	2005	% of total revenue	2006 to 2005
International Systems operations	\$ 1,478,943	35.0	\$ 1,952,277	86.4	\$ (473,334)
U.S. Systems operations	2,126,731	50.4	—	—	2,126,731
Mapping	616,944	14.6	307,586	13.6	309,358
	\$ 4,222,618	100.0	\$ 2,259,863	100.0	\$ 1,962,999

Revenue from our International Systems operations for the three months ended February 28, 2006 decreased 24.2% due to the timing of new contracts awarded, the delivery schedules of existing contracts and the mix of products and services delivered.

Revenue from the U.S. Systems operations has no comparatives as this revenue comes from CHI Systems Inc., which was acquired December 14, 2005.

Revenue from the Mapping segment increased 100.6% for the three months ended February 28, 2006 in comparison to the three months ended February 28, 2005. The increase is primarily the result of changes

in our strategy implemented to improve our market position in the U.S. through the acquisition of a U.S. land mapping company based in Salt Lake City, Utah.

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

Gross Profit

<i>Three months ended February 28</i>	2006	2005	2006 to 2005
Gross profit	\$ 1,387,431	\$ 1,232,108	\$ 155,323
Gross profit percentage	32.9%	54.5%	(21.6)%

Gross profit decreased by 12.6% in the three months ended February 28, 2006 compared to the three months ended February 28, 2005 while the gross profit percentage was 21.6% lower year-over-year. The reduced gross profit percentage compared to the prior year is due to lower software sales realized in the first quarter of fiscal 2006 and the addition of lower margin revenue in our acquired operations.

Gross Profit by Segment

<i>Three months ended February 28</i>	2006	2005	2006 to 2005
Gross profit:			
International Systems operations	\$ 783,143	\$ 1,208,100	\$ (424,957)
U.S. Systems operations	486,560	–	486,560
Mapping	117,484	24,008	93,476
	\$ 1,387,187	\$ 1,232,108	\$ 155,079
Gross profit percentage:			
International Systems operations	53.0%	61.9%	(8.9)%
U.S. Systems operations	22.9%	–	22.9%
Mapping	19.0%	7.8%	11.2%
	32.9%	54.5%	(21.6)%

Gross profit from the International Systems operations decreased 35.2% and gross profit percentage was 8.9% lower period over period. The decreases are the result of lower revenues in the International Systems operations in first quarter of fiscal 2006 and a reduction in our high margin software revenue compared to the first quarter of fiscal 2005.

Gross profit from the U.S. Systems operations did not exist for the three months ended February 28, 2005 as CHI Systems was acquired in the current period.

Gross profit from the Mapping segment in the three months ended February 28, 2006 increased 389.4% compared to the same period last year. The increase is the result of our successful entrance into the U.S. mapping market through our U.S. mapping acquisition. Gross profit percentage increased 11.2% period over period consistent with the mix of contracts in the period.

Operating Expenses

<i>Three months ended February 28</i>	2006	% of total revenue	2005	% of total revenue	2006 to 2005
General and administrative	\$ 1,552,085	36.8	\$ 1,036,193	45.8	\$ 515,892
Research and development	625,921	14.8	319,232	14.1	306,689
Sales and marketing	636,438	15.1	552,256	24.4	84,182

General and administrative (“G&A”) expenses consist mainly of salaries and benefits of management and administrative personnel, professional fees, public company expenses, related facility costs, and other general administrative expenses, and other income. G&A increased by 49.8% for three months ended February 28 2006 compared to the same period last year as a result of the addition of our U.S. operations and the increase of staff to support our growth plans.

Research and development (“R&D”) expenses consist mainly of salaries and benefits of software and hardware engineering personnel, sub-contractor costs, facilities expenses, and related expenses. We expense research and development costs in the period incurred.

R&D costs increased by 96.1% in the three months ended February 28 2006 compared to the same period last year. The increase is related to increased staff levels and expenses for new product activities for the three months ended February 28, 2006 and approximately \$223,000 in engineering labor costs charged to cost of sales from R&D for the three months ended February 28, 2005 compared to the three months ended February 28, 2006, where there were no costs similarly charged. These engineering labor costs are to support the needs of specific customer orders. We believe that in order to maintain our technological leadership, we must continue to develop existing products and introduce innovative new products that challenge and redefine the industry standards.

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

S&M expenses increased by 15.2% in the three months ended February 28, 2006 compared to the three months ended February 28, 2005. The increase in S&M expenses is primarily due to the addition of CHI Systems. We believe our current level of S&M staff continues to allow us to pursue business development activities relating to our expansion efforts targeting new and existing customers in the military agencies of Canada, the U.S., European NATO, and other allies of Canada, and national and international commercial marine transportation companies. To increase our profile and our products, and to broaden our customer base in international markets, we have established marketing agreements with companies local to the targeted regions. Some of these activities may not result in closing orders during the current year but may yield orders in subsequent fiscal years.

Depreciation and Amortization

<i>Three months ended February 28</i>	2006	2005	2006 to 2005
Depreciation and amortization	\$ 215,959	\$ 84,670	\$ 131,289

Total depreciation and amortization increased 155.1% in the three months ended February 28, 2006 over the three months ended February 28, 2005 reflecting our U.S. acquisition in the period, the mix of plant and equipment at February 28, 2006, and the amortization of intangibles related to our U.S. acquisitions. For the three months ended February 28, 2006 and 2005, a portion of the depreciation, \$65,612 and \$30,924 respectively, was included in cost of sales for equipment used in revenue-generating activities.

Interest expense

<i>Three months ended February 28</i>	2006	2005	2006 to 2005
Interest expense	\$ 6,952	\$ 12,716	\$ (5,764)

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

Interest income

<i>Three months ended February 28</i>	2006	2005	2006 to 2005
Interest income	\$ 14,841	\$ 109	\$ 14,732

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

Foreign Exchange

<i>Three months ended February 28</i>	2006	2005	2006 to 2005
Foreign exchange loss (gain)	\$ 111,888	\$ (73,144)	\$ 185,032

Foreign exchange loss is the result of exchange rate movements of the Australian dollar and our U.S. dollar exposure which were not in the company's favor during the three months ended February 28 2006, as compared to the three months ended February 28, 2005.

Technology Partnerships Canada

<i>Three months ended February 28</i>	2006	2005	2006 to 2005
Royalty	\$ 65,645	\$ 54,691	\$ 10,954
Contribution	(243,276)	(265,517)	22,241

On April 26, 2004, the we entered into an agreement with Technology Partnerships Canada ("TPC") whereby TPC granted financial assistance to the us for the purpose of funding research and development activities to be completed on or before March 31, 2007. The maximum eligible contribution by TPC is \$3,768,391. For the three months ended February 28, 2006, we have claimed \$257,862 under the agreement. Accounts receivable at February 28, 2006 include \$266,401 of amounts receivable from TPC in connection with these claims (November 2005 - \$729,909).

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. We have paid royalties of \$1,306,799 to February 28, 2006 (to November 30, 2005 - \$1,241,154) and has accrued royalties of \$47,067 for the three months ended February 28, 2006 (three months ended February 28, 2005 - \$53,823). Royalty payments will continue until the cumulative royalties paid or payable to November 30, 2008 are at least \$7,810,230 or until November 30, 2014.

In addition, we are required to pay a royalty of 1.4% on annual gross revenue in our subsidiary Offshore Systems Ltd. for the period January 1, 2006 to December 31, 2008 and a royalty of 2.5% on annual gross revenue for the period January 1, 2009 to December 31, 2013. We have accrued royalties of \$18,578 for the three months ended February 28, 2006 (three months ended February 28, 2005 - \$nil). Royalty payments will continue until the cumulative royalties paid or payable to December 31, 2013 are at least \$6,079,176 or until December 31, 2017.

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

During the year ended November 30, 2005, we were subject to three audits by government authorities. The results of the cost audit did not have a financial impact on our results. The results of the compliance audit required a repayment of contributions received of \$128,284 recognized in the year ended November

30, 2005 as a reduction in TPC contributions. The royalty audit is currently in process. We have no reason to believe that the audit will have a material impact on the Company's financial results.

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

Income Taxes

<i>Three months ended February 28</i>	2006	2005	2006 to 2005
Income tax recovery	\$ (11,527)	\$ (238,365)	226,838

Based on the information available at the time of the issue of the audited annual financial statements for the year ended November 30, 2005, we estimated that we would not have sufficient taxable earnings in Canada in future periods to utilize a portion of our \$5,084,445 Canadian non-capital losses carried forward and other Canadian tax balances. We have recognized deferred tax recovery in the three months ended February 28, 2006 related to year to date losses recognized in our US subsidiaries as we believe that it is more likely than not that these losses will be realized in the current fiscal year. In accordance with U.S. GAAP, we provided a valuation allowance against deferred tax assets where realization did not meet the requirements of "more likely than not" under the liability method of tax allocation. We continue to evaluate our taxable position quarterly and consider factors such as estimated taxable income, the history of losses for tax purposes, and the growth of the Company, among others.

LIQUIDITY AND CAPITAL RESOURCES

	February 28, 2006	November 30, 2005	2006 to 2005
Cash	\$ 1,332,750	\$ 9,599,801	(8,267,051)
Current assets	11,780,950	22,542,798	(10,761,848)
Current liabilities	3,606,182	4,734,688	(1,128,506)
Working capital ⁽¹⁾	8,174,768	17,808,110	(9,633,342)

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

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

At February 28, 2006 our current assets and working capital decreased primarily due to the acquisition of our U.S. operations.

We have credit facilities consisting of an operating line, standby letters of credit, and forward exchange contract facilities. The credit facilities permit us to borrow funds directly for general corporate purposes, including acquisitions, at floating rates. At February 28, 2006, we had no borrowings against our Canadian or U.S. dollar operating line. We have an operating line of \$2.0 million available with a Canadian chartered bank collateralized by accounts receivable. During fiscal 2005, we utilized the facility which increased interest expense for the year. There were no borrowings in the three months ended

February 28, 2006. We had issued a standby letter of credit totaling Australian \$283,886 during fiscal 2005. We had utilized the standby letter of credit to support certain performance obligations to our customers. This standby letter of credit has since been cancelled. We utilize our forward exchange contract facility to reduce our exposure to exchange rate movements.

Cash Flows

<i>Three months ended February 28</i>	2006	2005	2006 to 2005
Cash flows provided by (used in):			
Operating activities	\$ 998,402	\$ (671,858)	\$ 1,670,260
Investing activities	-	461,828	(461,828)
Financing activities	(9,311,551)	(41,007)	(9,270,544)
Exchange impact on acquired cash balances	46,098	-	46,098

Cash flows provided by operating activities for the three months ended February 28, 2006, were the result of the decrease in accounts receivable offset by the loss for the three months ended February 28, 2006 and a decrease in accounts payable and accrued liabilities.

There were no cash flows provided by financing activities for the three months ended February 28, 2006. Cash flows provided by financing activities for the three months ended February 28, 2005 were the net result the proceeds from the operating line of credit offset by Class B preference share dividends paid.

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

As a result of the above mentioned changes and a \$46,098 foreign exchange impact, cash decreased by \$8,267,051 for the three months ended February 28, 2006 compared to a decrease of \$251,037 for the three months ended February 28, 2005.

As at February 28, 2006, we estimate that a US\$0.01 increase (or decrease) in the exchange rate of the U.S. dollar relative to the Canadian dollar would have an annualized impact of reducing (or increasing) earnings before income taxes by approximately \$7,400. As at February 28, 2006, we estimate that an Australian \$0.01 increase (or decrease) in the exchange rate of the Australian dollar relative to the Canadian dollar would have an annualized impact of reducing (or increasing) earnings before income taxes by approximately \$1,300. As at February 28, 2006, we estimate that any fluctuation in the euro, the Danish kroner and the pound sterling relative to the Canadian dollar would not have a material annualized impact on the Company's earnings before income taxes.

In order to reduce the impact of U.S. to Canadian dollar, Australian to Canadian dollar, and euro to Canadian dollar exchange rate fluctuations, we have used the forward exchange contract facility described above. We use the forward exchange contract facility to set the exchange rate between the U.S. and Canadian dollar, the Australian and Canadian dollar and the euro and Canadian dollar for specific transactions at a specific agreed upon rate, thereby mitigating any foreign exchange gain or loss that might occur on those transactions. We use the forward exchange contract facility only for known or reasonably certain future U.S. and Australian dollar and euro transactions. At February 28, 2006, we did not utilize the forward exchange contract facility.

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

Contractual Obligations

	Total	Payments due by period			
		Less than 1 year	1 to 3 years	4 to 5 years	After 5 years
Facility leases	\$ 3,161,480	\$ 711,073	\$ 1,206,425	\$ 994,464	\$ 249,518
Equipment leases	93,653	56,550	34,555	2,549	—
Total contractual obligations	<u>\$ 3,255,133</u>	<u>\$ 767,623</u>	<u>\$ 1,240,980</u>	<u>\$ 997,013</u>	<u>\$ 249,518</u>

Off-Balance Sheet Arrangements

Guarantees

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

Transactions with Related Parties

In the second quarter of 2005, E. Brinton Coxe, a member of our Board of Directors, became a related party by virtue of the fact that we have paid him compensation of \$815,908 and 350,000 common share purchase warrants in consideration of the provision of advisory services in connection with the private placement completed on April 8, 2005. Mr. Coxe has also participated in the financing by purchasing 100 units personally. Mr. Coxe was paid an additional \$145,940 for professional services provided during the year and to be provided to April 2006. For the three months ended February 28, 2006, \$24,189 was charged to expenses.

On April 8, 2005, Gerald J. Shields was elected to our Board of Directors. Mr. Shields provides legal services to the company through a law firm in which he has an interest. During fiscal 2004, fees billed to the company by this firm were under \$60,000. The fees billed to the company by Mr. Shields' firm were \$116,160 in the three months ended February 28, 2006.

Proposed Transactions

We are not currently engaged in any proposed transactions.

SELECTED QUARTERLY DATA (UNAUDITED)

<i>For the three months ended</i>	February 28 2006	November 30 2005	August 31 2005	May 31 2005
Revenue	\$ 4,222,618	\$ 6,090,856	\$ 3,195,036	\$ 1,881,685
Gross profit	1,387,431	3,129,293	1,763,266	370,351
Gross profit percentage	32.9%	51.4%	55.2%	19.7%
Net loss	(1,494,320)	(1,054,840)	(438,996)	(1,697,767)
Net loss attributable to common shareholders	(1,696,825)	(1,800,609)	(1,316,207)	(6,880,135)
Loss per share				
Basic	(0.05)	(0.06)	(0.05)	(0.25)
Diluted	(0.05)	(0.10)	(0.10)	(0.25)

<i>For the three months ended</i>	February 28 2005	November 30 2004	August 31 2004	May 31 2004
Revenue	\$ 2,259,863	\$ 3,696,137	\$ 2,951,571	\$ 2,773,760
Gross profit	1,232,108	1,968,649	1,469,554	1,775,003
Gross profit percentage	54.5%	53.3%	49.8%	64.0%
Net earnings (loss)	(219,591)	(227,940)	(455,922)	380,088
Net earnings (loss) attributable to common shareholders	(253,030)	(304,663)	(532,644)	303,366
Earnings (loss) per share				
Basic	(0.01)	(0.01)	(0.02)	0.01
Diluted	(0.01)	(0.02)	(0.03)	(0.01)

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. Our accounting policies are described in note 2 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

We are required to estimate the costs to complete certain systems contracts. Revenues from these contracts are recognized on the percentage-of-completion method measured by the percentage of costs incurred to total estimated costs to complete each contract. We may need to adjust the estimated costs to complete for these projects, if the actual results differ from our estimates. If we anticipate that a contract or a contract segment will generate a loss, we estimate that loss and record the total expected loss on the contract or contract segment. Revenues from certain mapping contracts are recognized using the proportional performance method of accounting, whereby revenue and profit in the period are based on the output completed to total units of work 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.

When revenues exceed amounts invoiced under a contract, the difference is recorded as unbilled revenue. We believe that unbilled revenue will be invoiced and collected. Deferred revenues are amounts that have been billed to the customer but have not been recognized in revenue. Unbilled revenue represents revenue recognized in accordance with our accounting policies and is not legally invoiced as at the balance sheet date.

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 provides 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.

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. We recognize compensation as stock options, which have been granted and vested to third parties under stock option plans with no cash settlement feature based on the fair value method. 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. Direct awards of stock to employees and stock option and stock awards granted to non-employees are accounted for in accordance with the fair value method of accounting for stock-based compensation.

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 uncollectability 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 a reserve 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 labor 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.

CHANGES IN ACCOUNTING POLICIES

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard 123R, Share-Based Payment, ("SFAS 123(R)") a revision to SFAS 123. SFAS 123(R) requires all share-based payments to be recognized in the financial statements based on their values using either a modified-prospective or modified-retrospective transition method. The standard no longer permits pro forma disclosure or prospective recognition.

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

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

As a result of adopting SFAS 123(R) on December 1, 2005, the company's loss from operations, loss before income taxes and net loss for the period ended February 28, 2006 increased by \$7,970.

FINANCIAL INSTRUMENTS AND OTHER INSTRUMENTS

Foreign Exchange Forward Contracts

We use foreign exchange forward contracts to hedge transactions denominated in U.S. dollars, Australian dollars, and euros. The purpose of our hedging activities is to reduce the level of exposure to exchange rate movements. At February 28 2006, we have not entered into any foreign exchange forward contracts.

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

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

DISCLOSURE OF OUTSTANDING SHARE DATA

As at February 28, 2006, we had 31.4 million issued and outstanding common shares and 3.5 million outstanding stock options. We also had 30,262 issued and outstanding class A preference shares and 341,240 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 20.1 million common shares. Also at February 28, 2006, we had 13.8 million outstanding common share purchase warrants convertible to common shares at a conversion ratio of 1:1, representing 13.8 million common shares.

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 favor 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 defense;
- 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.

Approximately 68.5% of our revenue for the three months ended February 28, 2006 was from the Canadian Department of Defense, the U.S. Army, the U.S. Airforce, the U.S. Navy's Naval Aviation and the Royal Australian Navy. For the three months ended February 28, 2005 approximately 77% of our revenue was from the U.S. Coast Guard, the Royal Navy of the United Kingdom, and the Royal Australian 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.

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 three months ended February 28, 2006, approximately 78% of our revenues were from international customers, including governmental customers: 63% from the U.S. and 15% 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.

Our revenues and costs are affected by fluctuations in the rate of exchange between the Canadian dollar, which is our reporting currency, the U.S. dollar, the Australian dollar, the Danish kroner and the euro.

Exposure to exchange rate fluctuations exists because a significant portion of our trade receivable and revenue transactions are in U.S. dollars, Australian dollars and euros. In addition, certain of our subcontract payables and direct cost transactions are in U.S. dollars. For the three months ended February 28, 2006 year, approximately 63% of the company's revenue and 48% of our expenses were transacted in U.S. dollars and approximately 4% of the company's revenue was transacted in Australian dollars. For the three months ended February 28, 2005, approximately 11% of the company's revenues and 4% of our expenses were transacted in U.S. dollars. During the same period, approximately 8% of the company's revenues were transacted in Australian dollars. We expect that U.S. dollar 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 U.S. to Canadian dollar and Australian to Canadian dollar, we utilize our foreign exchange forward contract facility. As at February 28, 2006, we had not entered into any foreign exchange forward contracts.

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, complementary 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.

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

The defense 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 defense 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.

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 labor in our mapping operations to maintain a competitive position in the mapping marketplace.

Our mapping operations are dependent upon labor resources located outside North America. While we enter into sub-contract agreements with these suppliers, it cannot be sure that the labor 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 labor resources made available to the company;
- labor 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 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.

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

We have committed funds to obtaining additional systems and facilities to accommodate our current and future anticipated growth. To the extent that this anticipated growth does not occur or occurs more slowly than we anticipate, it 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.

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.