



offshore

systems international Ltd.

2005

2nd Quarter Financial Statements



Offshore Systems International Ltd.

MANAGEMENT'S DISCUSSION AND ANALYSIS

For the six months ended May 31, 2005

Forward-Looking Statements

Statements in this Management's Discussion and Analysis, or any document filed by Offshore Systems International Ltd. (the "Company") with the different governing authorities, or in any other written or oral communication by or on behalf of the Company, to the extent not directly and exclusively based on historical events, constitute 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, with respect to achieving corporate objectives, developing additional project interests, the Company's analysis of opportunities in the acquisition and development of various project interests and other matters. These statements are made under the 'safe harbour' provisions of the Private Securities Litigation Reform Act of 1995 and, as such, involve known and unknown risks and uncertainties and other factors that may cause the actual results to be materially different from the results implied herein. Although the Company believes the expectations reflected in such forward-looking statements are based on reasonable assumptions, it can give no assurances that its expectations will be achieved. Factors that could cause actual results to differ from expectations include the effects of general economic conditions, changing foreign exchange rates, actions by government authorities, uncertainties associated with contract negotiations, and industry supply.

The Company disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Overview

Effective December 1, 2004, the Company elected to report its consolidated financial statements in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") as now allowed by Canadian regulators. The Company's functional currency is Canadian dollars and therefore the Company's financial statements are presented in Canadian dollars unless otherwise noted. All references in this report to financial information concerning the Company refer to such information in accordance with U.S. GAAP and all dollar amounts in this Management's Discussion and Analysis are in Canadian dollars unless otherwise indicated.

The following discussion and analysis provides a review of activities, results of operations and financial condition of the Company for the six months ended May 31, 2005 in comparison with those for the six months ended May 31, 2004 and for the three months ended May 31, 2005 in comparison with those for the three months ended May 31, 2004. This discussion should be read in conjunction with the Company's unaudited interim consolidated financial statements for the three and six months ending May 31, 2005 and its 2004 Audited Consolidated Financial Statements, both prepared in accordance with U.S. GAAP, and the Company's Management Discussion and Analysis for the year ended November 30, 2004.

Founded in 1977, the Company designs, develops and markets the proprietary ECPINS® line of electronic chart navigation systems for commercial and military customers. ECPINS® helps to reduce the risk of navigation-related incidents by giving bridge crews a precise, real-time display of their position, course and speed, against a background of fixed obstacles and other navigational hazards. The Company has developed a strong market position in military navigation, and has ECPINS® systems deployed with the Canadian and United States Coast Guards, the Canadian Navy, the Royal New Zealand Navy, the Royal Danish Navy, the Royal Australian Navy, the Royal Navy of the United Kingdom and the United States Navy. For the six months ended May 31, 2005, the Company has also delivered software and system products to the Portuguese Navy, the Royal New Zealand Navy, commercial shipping fleets serving the Great Lakes region of North America, and Teekay Shipping Corporation, the leading provider of international commercial tanker transportation services.

In 2002, the Company expanded the business scope of its wholly-owned subsidiary Offshore Charts Ltd. beyond production of electronic navigation charts to include production of land-based mapping products. The Offshore Charts Ltd. subsidiary was also renamed OSI Geomatics Ltd. to better reflect its business expansion. The Company's U.S. subsidiary – Offshore Systems International Inc. was renamed OSI Geomatics Inc. and reactivated to enter the U.S. mapping market. Collectively, the two subsidiaries form the Company's new business unit – OSI Geomatics.

In February 2003, the Company announced the launch of a new product, Common Operational Picture - Image Display Server ("COP-IDS[®]"), a client server application that allows customers to integrate the Company's mapping and imagery display technology into existing Command and Control ("C2") systems rapidly and cost effectively. COP-IDS[®] facilitates the integration of information from multiple geo-spatial sources – such as land maps, nautical charts, aerial and space photo imagery and special military information – into a single fused display. COP-IDS[®] is designed to meet the emerging requirements of international fleets to be able to operate from and share common tactical data in the field. COP-IDS[®] allows the Company's customers to share data across C2 systems, regardless of which C2 applications systems are in use. COP-IDS[®] is a C2 product that addresses the needs of not only Navy applications but also Army, Air Force, Special Forces and joint forces operations.

To capitalize on the potential of the new COP-IDS[®] product, the Company added a new line of business – OSI Applications starting in fiscal 2004. OSI Applications develops software applications and tools for situational awareness. OSI Applications is a division of the Company's subsidiary Offshore Systems Ltd. and provides products and services to military forces, government agencies and systems integrators to enable improved situational awareness.

The Company plans 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, the Company may pursue strategic alliances, investments and acquisitions that are complimentary to its existing lines of business.

In April 2005, the Company completed a private placement in the aggregate amount of \$19,500,195 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 (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 \$1,001,362 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. Each Preference share is convertible at the option of the holder at any time into 58.82 of the Company's 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 the Company's common shares at the exercise price of \$0.85 for a period of five years.

The proceeds of the private placement financing will be 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 approximately \$2,900,000.

In April 2005, the Company completed the acquisition of all the outstanding shares of Mapcon Mapping Consultants Inc. (Mapcon) of Salt Lake City, Utah for U.S.\$1,000,000, subject to final

closing adjustments. Mapcon is a land mapping company in the U.S. geomatics (digital map and electronic chart data production) market.

Overall Performance

Earnings/Loss

For the six months ended May 31, 2005, the Company had a loss of \$1,917,358. Earnings available to common shareholders for the six months ended May 31, 2005 was a loss of \$7,133,165 or \$0.26 per share on a basic and diluted basis. For the three months ended May 31, 2005, the Company had loss of \$1,697,767. Earnings available to common shareholders for the three months ended May 31, 2005 was a loss of \$6,880,135 or \$0.25 per share on a basic and diluted basis.

The Company's results for the three and six months ended May 31, 2005 were largely driven by lower revenues that resulted from timing of new contracts awarded to the Company and the delivery schedules of existing contracts and increased regulatory compliance costs offset by the financial assistance received from Technology Partnerships Canada ("TPC").

Backlog

Total backlog as at May 31, 2005 is \$20.2 million compared to \$21.1 million at November 30, 2004 and \$22.6 million at May 31, 2004. Total backlog is the total of the firm and option backlogs. Firm backlog consists of firm, fixed, signed orders issued to the Company and executable by the Company subsequent to the balance sheet date. Firm backlog as at May 31, 2005 was at \$7.5 million compared to \$8.4 million at November 30, 2004 and \$8.7 million at May 31, 2004. Option backlog consists of unexercised contract options at the balance sheet date and indefinite-quantity contracts executable by the Company subsequent to the balance sheet date. Option backlog as at May 31, 2005 was at \$12.7 million compared to \$12.7 million at November 30, 2004 and \$13.9 million at May 31, 2004. There is no guarantee or certainty that the Company's customers will elect to exercise their contract option backlog. Should the Company's 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. Total backlog, firm backlog and option backlog are non-GAAP measures that do not have a standardized meaning and are likely not comparable to similar measures presented by other issuers. These measures also do not have a comparable GAAP measure.

The timing of the awarding of major contracts to the Company can significantly impact the Company's total backlog position and revenue for the period. Historically, major contracts that have been awarded to the Company have taken up to three years to finalize with the contracting process involving lengthy discussions and negotiations with several groups of people within the prospective customer's organization. The Company has continually pursued, and will continue to pursue, major contracts with a lengthy sales cycle and, as a result, there could be large variations in its total backlog position and revenue from one fiscal quarter to another.

Because governments approve budget expenditures on an annual basis, multi-year contracts with government agencies have a termination-for-convenience clause that 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 Company customer. The Company has included the full value of these government contracts in total backlog.

Risks and Uncertainties

Certain statements made in this report by the Company 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, its financial condition or results of operations.

The Company depends heavily on its 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 the Company's 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 the Company's operations. Also, the Company cannot give assurance that it would be able to procure new government contracts to offset the revenues lost as a result of any termination of its contracts. As the Company's revenues are dependent on its procurement, performance and payment under its contracts, the loss of one or more critical contracts could have a negative impact on the Company's financial condition.

In addition, sales to the governments the Company works 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 the Company's control, could also negatively impact its financial condition.

The Company derives a significant amount of revenue from only a few customers. The Company depends on national and international governments for a significant portion of its sales, and the loss of any of these relationships or a shift in any of these governments' funding could have severe consequences on the Company's financial condition.

Approximately 59% of the Company's revenue for the six months ended May 31, 2005 was from the Royal Navy of the United Kingdom, the Royal New Zealand Navy and the Royal Australian Navy. For the six months ended May 31, 2004 approximately 75% of the Company's revenue was from the U.S. Coast Guard, the Royal Navy of the United Kingdom and the Royal Australian Navy. Approximately 70% of the Company's revenue for the three months ended May 31, 2005 was from national and international governments compared to 91% for the three months ended May 31, 2004. Therefore, any significant disruption or deterioration of any of the Company's relationships with these entities' governments would significantly reduce its 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 the Company is not involved could have severe consequences for its results of operations.

The Company's product lines are not broadly diversified.

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

The Company derives a significant portion of its revenues from international sales and is subject to the risks of doing business in foreign countries.

In the six months ended May 31, 2005, approximately 86% of the Company's revenues were from international customers, including governmental customers: 20% from the U.S. and 66% from other international countries. The Company has focussed its expansion efforts for the future on the American, European and Australasian markets. As a result, the Company expects that international sales will continue to account for a significant portion of its revenues for the foreseeable future. As a result, the Company is 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 the Company's operations in the future.

The Company's revenues and costs are affected by fluctuations in the rate of exchange between the Canadian dollar, which is its reporting currency, the U.S. dollar, the Australian dollar and the Euro.

Exposure to exchange rate fluctuations exists because a significant portion of the Company's trade receivable and revenue transactions are in U.S. dollars, Australian dollars and Euros. In addition, certain of the Company's subcontract payable and direct cost transactions are in U.S. dollars. For the six months ended May 31, 2005, approximately 28% of the Company's revenue and 11% of its expenses were transacted in U.S. dollars. During the same period, approximately 8% and 1% of the Company's revenue was transacted in Australian dollars and Euros respectively. For the six months ended May 31, 2004, approximately 63% of the Company's revenues and 12% of its expenses were transacted in U.S. dollars. During the same period, the Company did not have material transactions in Australian dollars or Euros. The Company expects that U.S. dollar, Australian dollar and Euro sales will continue to account for a material portion of its revenues for the foreseeable future. As a result, exchange rate fluctuations may affect the Company's revenue and earnings growth materially in the future. In order to reduce the impact of U.S. to Canadian dollar, Australian to Canadian dollar and Euro to Canadian dollar exchange rate fluctuations, the Company utilizes its foreign exchange forward contract facility. As at May 31, 2005, the Company had entered into foreign exchange forward contracts in the amount of U.S. \$0, Australian \$ 1,605,038 and €0.

The Company has established teaming relationships and strategic partnerships with international corporations to pursue major international government procurements, and its reputation and results of operations could be adversely affected by the Company's inability to control their operations.

The Company relies on agreements with international corporations to assist it in pursuing contracts for major government procurements. These international corporations often assist the Company with systems integration, complimentary products and services, and local domain knowledge necessary to successfully pursue major government procurements. The Company does 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 the Company's products in their business priorities.

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

The Company may lose sales, or sales may be delayed, because of the long sales and implementation cycles for its products and services.

The Company's customers have typically invested substantial time, money and other resources and have many people involved in the decision to license the Company's software products and purchase its hardware products and services. As a result, the Company 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 the Company's 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 the Company's products varies significantly from one customer to the next. Implementing the Company's products can sometimes take several months or even a few years depending on the customer's needs. It may be difficult to deploy the Company's products if the customer has complicated deployment requirements. If a customer utilizes a third party to deploy the Company's products, we cannot guarantee that the Company's products will be deployed successfully.

As a result, the Company's revenue could decrease and its business and operating results would be adversely affected.

Competition within the Company's markets may reduce its ability to procure future contracts and sales.

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

The Company's 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, the Company's revenue could decrease and its business and operating results would be adversely affected.

The Company's future success will depend on its ability to develop new technologies that achieve market acceptance.

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

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

The Company believes that, in order to remain competitive in the future, it 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 the Company's products will develop or continue to expand as the Company currently anticipates. The failure of the Company's technology to gain market acceptance could significantly reduce its revenues and harm its business. Furthermore, the Company cannot be sure that its competitors will not develop competing technology, which gains market acceptance in advance of the Company's products. The possibility that the Company's competitors might develop new technology or products might cause the Company's existing technology and products to become obsolete. If the Company fails in its new product development efforts or its products fail to achieve market acceptance more rapidly than the Company's competitors, its revenues will decline and its business, financial condition and results of operations will be negatively affected.

The Company depends on the recruitment and retention of qualified personnel, and its failure to attract and retain such personnel could seriously harm its business.

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

The Company does not have fixed-term employment agreements with its officers and key employees and the loss of any officer or key employee could seriously harm the Company's business.

The Company has not entered into fixed-term employment agreements with its officers and key employees. The Company's success depends upon the abilities and experience of its 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 the Company's operations and impair its ability to compete.

The Company depends on offshore sub-contract labour in its geomatics operations to maintain a competitive position in the geomatics marketplace.

The Company's geomatics operations are dependent upon labour resources located outside North America. While the Company enters into sub-contract agreements with these suppliers, it cannot be sure that the labour resources will be available when required and at the levels

required. Accordingly, maintaining the Company's 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 the Company's geomatics operations in the future.

The Company may be unable to adequately protect its intellectual property rights, which could affect its ability to compete.

Protecting the Company's intellectual property rights is critical to its ability to compete and succeed as a company. The Company has trademark and copyright registrations, which are necessary and contribute significantly to the preservation of its 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, the Company may not be able to obtain necessary licenses on commercially reasonable terms. The Company enters into confidentiality and invention assignment agreements with its employees, and enters into nondisclosure agreements with its suppliers and customers, as appropriate, so as to limit access to and disclosure of the Company's proprietary information. These measures may not suffice to deter misappropriation or independent third party development of similar technologies.

The Company's operations depend on component availability and its key suppliers to manufacture and deliver its products and services.

The Company's operations are highly dependent on the timely delivery of materials by outside suppliers. While the Company enters into purchase agreements with a few of its suppliers, the Company 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 the Company's needs, it may not have readily available alternatives. The Company's inability to fill its supply needs would jeopardize its ability to satisfactorily complete the Company's obligations under its 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 to the Company's reputation and relationships with its customers. All of these events could have a negative effect on the Company's financial condition.

The unpredictability of the Company's results may harm or contribute to the volatility of the trading price of its common stock.

The Company's operating results may vary significantly over time for a variety of reasons, many of which are outside its control and any of which may harm its business. The value of the Company's 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 the Company's working capital position;
- the Company's ability and the ability of its key suppliers to respond to changes in customer orders;

- the timing of the Company's new product introductions and its 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.

The Company may pursue strategic relationships, investments and acquisitions. The Company may not be able to successfully manage its operations if it fails to successfully integrate the acquired technologies and/or businesses.

As part of the Company's business strategy, it may expand its product offerings to include application software products that are complementary to the Company's 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 the Company may encounter in acquiring or licensing technology from third parties include the following:

- difficulty in integrating the third party product with its 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 the Company's 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.

The Company may require additional capital, in which case it may need to raise additional funds from lenders and equity markets in the future.

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

The Company's business could be adversely affected if it fails to manage its growth effectively.

If the Company fails to manage its growth effectively, the Company's business and operating results could be adversely affected. The Company expects to continue to grow its operations domestically and internationally, and to hire additional employees. The growth in the Company's

operations and staff has placed, and will continue to place, a significant strain on its management systems and resources. If the Company fails to manage its future anticipated growth, the Company 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 the Company must, among other things, continue to:

- improve its financial and management controls, reporting systems and procedures;
- add and integrate new senior management personnel;
- improve its licensing models and procedures;
- hire, train and retain qualified employees;
- maintain sufficient working capital;
- control expenses;
- diversify channel sales strategies; and
- invest in its internal networking infrastructure and facilities.

The Company has committed funds to obtaining additional systems and facilities to accommodate its current and future anticipated growth. To the extent that this anticipated growth does not occur or occurs more slowly than the Company anticipates, it may not be able to reduce expenses to the same degree. If the Company incurs operating expenses out of proportion to revenue in any given quarter, its operating results may be adversely impacted.

Third parties may claim that the Company infringes their proprietary rights.

The Company potentially may receive claims that it has 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, the Company may become increasingly subject to infringement claims, including patent, trademark and copyright infringement claims. In addition, former employers of the Company's 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 the Company's core business, require it to stop selling or delay shipping, or cause the redesign of its product or products. In addition, the Company 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 its customers.

The Company licenses and uses software from third parties in its 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 the Company's ability to continue licensing this software. The Company's inability to use any of this third party software could result in shipment delays or other disruptions in its business, which could materially and adversely affect the Company's operating results.

The Company may not be able to protect its proprietary information.

The Company relies on a combination of copyright, trademark and trade secret laws, confidentiality procedures, contractual provisions and other measures to protect its 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 the Company's technology. Despite the Company's efforts to protect its proprietary rights, unauthorized parties may attempt to copy the Company's products or to obtain or use information that the Company regards as proprietary.

The Company's 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 the Company's efforts to test its products, the Company might experience significant errors or failures in its 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 the Company's products. Customers use the Company's 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. The Company's customers may claim that the Company is responsible for damages to the extent they are harmed by the failure of any of the Company's products. If the Company 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, the Company could lose revenue or be subject to liability for service or warranty costs. Should this occur, the Company's business and operating results could be adversely affected.

The Company's products depend on third party software products and its reputation and results of operations could be adversely affected by the Company's inability to control their operations.

The Company's products incorporate and use software products developed by other entities. The Company does not have assurance that such third parties will:

- remain in business;
- support the Company's 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 the Company's business, results of operation, cash flows and financial condition.

The Company's products may not be compatible with various operating systems and therefore the Company may not be able to sell its products to potential customers.

The Company's products are used in combination with various operating systems. The Company's future success depends on our ability to continue to support widely-used operating systems. The Company's applications run on Microsoft operating systems. Therefore, the Company's ability to increase sales depends on the continued acceptance of Microsoft operating system products. If the Company is 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, its business and operating results could be adversely affected.

Selected Information

Statement of Earnings Information

	For the six months ended May 31		For the years ended November 30		
	2005 \$	2004 \$	2004 \$	2003 \$	2002 \$
Revenue	4,141,542	6,803,595	13,451,303	11,520,793	13,814,133
Gross profit	1,602,460	4,343,776	7,781,979	6,361,725	6,713,382
Gross profit percentage	38.7%	63.8%	57.9%	55.2%	48.6%
Net earnings (loss) for the period	(1,917,358)	931,879	248,017	352,016	1,694,126
Basic earnings per share	(0.26)	0.03	0.00	(0.02)	0.07
Diluted earnings per share	(0.26)	0.01	(0.01)	(0.02)	0.06

Balance Sheet Information

	As at May 31 (Unaudited)		As at November 30 (Audited)		
	2005 \$	2004 \$	2004 \$	2003 \$	2002 \$
Cash	13,580,479	1,017,005	251,037	3,837,555	3,244,048
Working capital*	19,485,967	8,977,443	8,287,798	8,071,926	4,449,492
Current assets	23,170,056	11,532,250	10,964,025	10,377,836	8,810,568
Total assets	25,464,611	12,965,217	12,310,738	11,728,257	10,766,438
Current liabilities	3,684,089	2,554,807	2,676,227	2,305,910	4,361,076
Long term liabilities	77,887	93,694	-	187,384	372,717
Total liabilities	3,761,976	2,648,501	2,676,227	2,493,294	4,733,793
Shareholders' equity	21,702,635	10,316,716	9,634,511	9,234,963	6,032,645

Balance Sheet Information

	As at		As at November 30		
	May 31, 2005 \$	May 31, 2004 \$	2004 \$	2003 \$	2002 \$
Dividends declared per share					
Common shares	-	-	-	-	-
Class A preference shares	-	-	-	-	-
Class B preference shares – series 1	1.26	1.50	3.00	2.37	-
Class B preference shares – series 2	0.46	-	-	-	-

* Working Capital is a non-GAAP measure that does not have a standardized meaning and may not be comparable to similar measures presented by other issuers. This measure does not have a comparable GAAP measure. Working Capital is defined as current assets less current liabilities.

The Company's annual and quarterly results are primarily affected by the level, timing and duration of customer orders and customer product delivery requirements. The Company depends heavily on government contracts and derives a significant amount of revenue from a few customers, which may result in varying revenue, gross profit and earnings.

The lower revenue for the six months ended May 31, 2005 as compared to the six months ended May 31, 2004 is attributable to the timing of new contracts that are awarded to the Company, the delivery schedules of existing contracts and the Company experiencing continuing difficulties in penetrating the U.S. markets for its products and services. The Company is addressing these issues by acquiring Mapcon Mapping Consultants Inc. of Salt Lake City, Utah and having completed a private placement of preference shares and warrants of \$19.5 million - part of the proceeds of which will be used to pursue additional acquisitions. Mapcon's acquisition will increase the Company's geomatics revenue in the U.S. market and the private placement will allow the Company to pursue primarily U.S. acquisitions which will provide the Company with U.S. sales channels for its Navigation Systems and Applications products and services.

The lower revenue in fiscal 2003 as compared to fiscal 2002 was largely attributable to the substantial completion in fiscal 2002 of the Canadian Department of National Defence contract awarded to the Company in fiscal 2001, the Marinette Marine Corp. contracts to provide ECDIS systems for the U.S. Coast Guard Juniper class buoy tenders, and the substantial completion of the Danish Navy contract in early fiscal 2003. The increase in revenue in fiscal 2004 over fiscal 2003 was the result of contracts from the Royal Navy of the United Kingdom and the Royal Australian Navy that were awarded to the Company in late fiscal 2003 and early fiscal 2004. The Company was not awarded contracts of this magnitude in the first or second quarters of fiscal 2005.

The fluctuations in gross profit year over year are impacted negatively by projects that include a large proportion of third-party systems or labour resulting in higher cost of sales. Certain contracts awarded to the Company may require the Company to include third-party systems or labour. In order to maintain competitiveness on these contracts, the Company may elect to reduce its usual margins on the third party components. In addition, the product mix of Software, Geomatics, Systems and systems components in any given period may impact the gross profit for the period.

The lower gross margin percentage for the six months ended May 31, 2005 as compared to the six months ended May 31, 2004 is the result of the Company realizing higher software sales in the six months ended May 31, 2004 when compared to the six months ended May 31, 2005. Software revenue generates more favourable margins than the Company's other revenue streams.

During the first six months of fiscal 2004, the Company's gross profit percentage increased because of an increase in software revenue. During the last six months of fiscal 2004, the Company's gross profit percentage was lower when compared to the first six months as the Software revenue decreased and Systems and systems components revenue increased. During the six months ended May 31, 2005, the Company's gross profit percentage decreased as a result of decreased software revenue when compared to the same period last year.

Results of Operations

The table below presents, for the periods indicated, selected financial data of the Company expressed as a percentage of total revenues:

	<u>Three months ended May 31</u>		<u>Six months ended May 31</u>	
	<u>2005</u> %	<u>2004</u> %	<u>2005</u> %	<u>2004</u> %
Revenue				
Software	15.0%	50.4%	42.8%	64.5%
Geomatics	48.1%	36.0%	29.3%	25.2%
Systems and system components	29.5%	8.2%	23.2%	6.2%
Other	7.4%	5.4%	4.7%	4.1%
	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>
Direct costs	<u>80.3%</u>	<u>36.0%</u>	<u>61.3%</u>	<u>36.2%</u>
Gross profit	<u>19.7%</u>	<u>64.0%</u>	<u>38.7%</u>	<u>63.8%</u>
Expenses				
General and administrative	53.1%	33.3%	49.2%	24.3%
Research and development	24.5%	21.0%	18.9%	15.4%
Sales and marketing	35.8%	26.5%	29.6%	22.5%
Amortization	4.2%	2.0%	3.2%	1.6%
Interest	0.5%	0.0%	0.5%	0.0%
Foreign exchange loss (gain)	2.7%	0.3%	(0.5%)	(0.2%)
Technology Partnerships Canada royalty	2.0%	0.3%	2.2%	0.8%
Technology Partnerships Canada contribution	(25.0%)	(30.7%)	(17.8%)	(12.5%)
	<u>97.8%</u>	<u>52.7%</u>	<u>85.3%</u>	<u>51.9%</u>
Earnings before income taxes	(78.1%)	11.3%	(46.6%)	11.9%
Income tax (recovery)	<u>12.0%</u>	<u>(2.5%)</u>	<u>(0.3%)</u>	<u>(1.7%)</u>
Net earnings for the period	<u>(90.1%)</u>	<u>13.8%</u>	<u>(46.3%)</u>	<u>13.6%</u>

Revenues

The Company's core revenue stream is derived from four sources: Software, Systems and system components, Geomatics, and Other which includes system repairs and servicing, training and consulting. The Company's principal developed and manufactured product, the Electronic Chart Precise Integrated Navigation System ("ECPINS®"), delivers the majority of the revenue. The Company also derives revenue from the delivery of the ECPINS® software component of its system product. Combined, ECPINS® systems and software delivered 67.0% of the Company revenue for the six months ended May 31, 2005 and 70.6% for the six months ended May 31, 2004.

Consolidated revenue for the three months ended May 31, 2005 was \$1,881,685 compared with \$2,773,835 for the three months ended May 31, 2004, resulting in a decrease of 32%. Consolidated revenue for the six months ended May 31, 2005 was \$4,141,542 compared with \$6,803,595 for the six months ended May 29, 2004, resulting in a decrease of 39%. The decrease is attributable to the timing that new contracts are awarded to the Company, the delivery schedules of existing contracts, continuing difficulties in penetrating the U.S. markets for its products and services, and the lengthy sales cycle in the international market. Revenue from the Royal Navy and the Royal Australian Navy in the first six months of fiscal 2004 amounted to approximately \$4.2 million. Contracts with revenue of this magnitude did not occur in the first or second quarters of fiscal 2005. Subsequent to May 31, 2005, the Company announced two new contracts for its technology – a \$1.7 million contract to supply an integrated submarine navigation and weapons management system for the Canadian Navy's Victoria Class submarines and a \$3.8 million contract for additional software and long term support to the Royal Navy.

The main customers for the Company's products and services for the three months ended May 31, 2005 were the Royal Navy of the United Kingdom through Lockheed-Martin UK, the Royal New Zealand Navy through Air Affairs Ltd., and the Royal Australian Navy through Nautronix Ltd. Revenue from these customers accounted for 37% of the consolidated revenue. For the three months ended May 31, 2004, the main customers for the Company's products and services were the Royal Navy of the United Kingdom through Lockheed-Martin UK, the U.S. Coast Guard and the Royal Australian Navy through Nautronix Ltd. Revenue from these customers accounted for 60% of the consolidated revenue for the three months ended May 31, 2004.

The main customers for the Company's products and services for the six months ended May 31, 2005 were the Royal Navy of the United Kingdom through Lockheed-Martin UK, the Royal New Zealand Navy through Air Affairs Ltd, and the Royal Australian Navy through Nautronix Ltd. Revenue from these customers accounted for 59% of the consolidated revenue. For the six months ended May 31, 2004, the main customers for the Company's products and services were the Royal Navy of the United Kingdom through Lockheed-Martin UK, the U.S. Coast Guard and the Royal Australian Navy through Nautronix Ltd. Revenue from these customers accounted for 75% of the consolidated revenue for the six months ended May 31, 2004.

Segment Results

Revenue from the Navigation Systems business unit for the three months ended May 31, 2005 was \$956,378 compared to \$1,691,056 for the same period last year, a decrease of \$734,678 or 43%. Revenue for the six months ended May 31, 2005 was \$2,897,155 compared to \$4,971,154 for the six months ended May 31, 2004, a decrease of \$2,073,999 or 42%. The decrease is attributable to the timing that new contracts are awarded to the Company, the delivery schedules of existing contracts and the Company having realized higher software sales in the first and second quarter of 2004 when compared to the same period in the current year.

Revenue from the Geomatics business unit for the three months ended May 31, 2005 was \$905,895 compared to \$1,042,793 for the three months ended May 31, 2004, a decrease of \$136,898 or 13%. Revenue for the six months ended May 31, 2005 was \$1,213,475 compared to \$1,764,137 for the same period last year, a decrease of \$550,662 or 31%. The decrease is primarily the result of the Company experiencing increased difficulty in penetrating the U.S. geomatics market. The Company is implementing changes in the strategies to improve its market position in the U.S. through the acquisition of Mapcon Mapping Consultants Inc., a U.S. land mapping company based in Salt Lake City, Utah. For the three and six months ended May 31, 2005, revenue increased approximately \$285,000 as a result of the acquisition.

Revenue from the Applications business unit for the three months ended May 31, 2005 was \$19,412 compared to \$39,986 for the three months ended May 31, 2004, a decrease of \$20,574 or 51%. Revenue for the six months ended May 31, 2005 was \$30,912 compared to \$68,304 for the same period last year, a decrease of \$37,392 or 55%. The Applications business unit

develops software applications and tools for situational awareness and provides products and services to military forces, government agencies and systems integrators to enable improved situational awareness. The sales cycle with government customers for Applications products can be upwards of three years. The business unit's initial product is Common Operational Picture – Image Display Server (COP- IDS®). This Applications business unit commenced operations in fiscal 2004.

In all three business units, the Company continues to invest significant corporate, sales and marketing resources in identifying and pursuing new opportunities and contracts, both in its existing customer base and with new prospective customers.

Gross Profit

The Company's gross profit decreased \$1,404,652 to \$370,351 for the three months ended May 31, 2005 from \$1,775,003 for the same period last year. Gross profit percentage decreased to 19.8% for the three months ended May 31, 2005 from 64.0% for the three months ended May 31, 2004. For the six months ended May 31, 2005, the Company's gross profit decreased \$2,741,316 to \$1,602,460 from \$4,343,776 for the six months ended May 31, 2004. Gross profit percentage decreased to 38.6% from 63.8% period over period. The lower gross margin percentage is the result of the Company realizing lower software sales in the three and six months ended May 31, 2005 when compared to same periods last year and the lower revenues in general that could not adequately offset the fixed costs in cost of sales.

Segment Results

Gross profit from the Navigation Systems business unit for the three months ended May 31, 2005 was \$105,823 compared to \$1,252,341 for the same period last year, a decrease of \$1,146,518. Gross profit percentage decreased to 11.1% from 74.1% period over period. Gross profit from the Navigation Systems business unit for the six months ended May 31, 2005 was \$1,303,913 compared to \$3,648,387 for the same period last year, a decrease of \$2,344,474 or 64.3%. Gross profit percentage decreased to 45.0% from 73.4% period over period. The decrease was attributable to a decreased percentage of the Company's revenue being attributable to Software revenue and an increased percentage being attributable to Systems and system components revenue when compared to the same three and six month periods last year and the lower revenues in general that could not adequately offset the fixed costs in cost of sales.

Gross profit from the Geomatics business unit for the three months ended May 31, 2005 was \$247,082 compared to \$492,963 for the same period last year, a decrease of \$245,881 or 49.9%. Gross profit percentage decreased to 27.3% from 47.3% period over period. Gross profit from the Geomatics business unit for the six months ended May 31, 2005 was \$271,090 compared to \$646,722 for the six months ended May 31, 2004, a decrease of \$375,632 or 58.1%. Gross profit percentage decreased to 22.3% from 36.7% period over period. The decrease is the result of the competitive nature of the geomatics market where customers are very price sensitive and the increasing protectionism the Geomatics business unit has encountered entering the U.S. geomatics market. As stated above, the Company is implementing changes in the strategies to improve its market position in the U.S. through the acquisition of Mapcon Mapping Consultants Inc., of Salt Lake City, Utah.

Gross profit from the Company's new business unit – Applications for the three months ended May 31, 2005 was \$17,446 compared to \$29,699 for the same period last year, a decrease of \$12,253 or 41.3%. Gross profit percentage increased to 89.9% from 74.3% period over period. Gross profit from the Applications business unit for the six months ended May 31, 2005 was \$27,457 compared to \$48,667 for the six months ended May 31, 2004, a decrease of \$21,210 or 43.6%. The gross profit percentage for the six months ended May 31, 2005 of 88.8% reflected the contract mix that included more applications software contracts than applications systems contracts.

General and Administrative Expenses

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, interest and other income. G&A increased \$74,833 for the three months ended May 31, 2005 to \$999,877 from \$925,044 for the same period last year. As a percentage of revenue, G&A increased to 53.1% from 33.3% period over period. For the six months ended May 31, 2005, G&A increased \$380,844 to \$2,035,961 from \$1,655,117 for the six months ended May 31, 2004. As a percentage of revenue, G&A increased to 49.2% from 24.3% period over period. The increase is the result of increased salaries and internal re-alignment of sales staff to G&A activities, professional fees, directors' fees and directors and officers insurance. The Company anticipates that as a result of recently introduced reporting regulations in Canada and the U.S., the Company will continue to experience increases in costs primarily relating to professional fees and increased infrastructure costs to meet the increased reporting obligations. The Company estimates that the direct and incremental costs of being a publicly company for the six months ended May 31, 2005 are in excess of \$660,000.

Research and Development Expenses

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. The Company expenses research and development costs in the period incurred.

The Company believes that in order to maintain its technological capabilities, it must continue to develop existing products and introduce new high quality products that challenge and redefine the industry standards. R&D costs decreased \$121,425 to \$461,926 or 24.5% of revenue for the three months ended May 31, 2005, compared to \$583,351 or 21.0% of revenue in the same period last year. For the six months ended May 31, 2005, R&D costs decreased \$265,417 to \$781,158 or 18.9% of revenue, compared to \$1,046,575 or 15.4% of revenue for the six months ended May 31, 2004. The decrease is largely the result of approximately \$345,000 in engineering labour costs charged to cost of sales from R&D for the six months ended May 31, 2005 compared to approximately \$167,000 for the six months ended May 31, 2004, an increase of approximately \$178,000. These costs are to support the software customization required to meet the needs of specific customers.

In November of 1999, the Company announced an agreement with Technology Partnerships Canada whereby TPC granted financial assistance to the Company to fund research and development activities to March 31, 2003. As at November 30, 2003, the Company had received the maximum eligible contribution of \$4,000,177. Under the terms of the agreement, the Company is required to pay TPC a royalty based on the revenue of its subsidiary Offshore Systems Ltd. To May 31, 2005, the Company had paid royalties of \$1,242,022 and accrued for future payment an additional \$92,559. 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 April of 2004, TPC announced an agreement with the Company whereby TPC granted financial assistance to the Company to fund research and development activities to March 31, 2007. The maximum eligible contribution is \$3,768,391. As at May 31, 2005, the Company had claimed for \$2,207,559 of eligible assistance under the TPC program which includes a receivable of \$470,628. The Company will receive the remaining contributions over the remaining term. Also, under the terms of the agreement, the Company is required to pay TPC a royalty based on the revenue of its subsidiary Offshore Systems Ltd. commencing January 2006. 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. There were no royalties paid or payable in connection with this agreement for the six months ended May 31, 2005.

Although the Company believes that its 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. During the year ended November 30, 2004, the Company was subject to an audit by government authorities. The results of the audit have not been communicated to the Company however the Company has no reason to believe that the audit will have a material impact on the Company's financial results. If the Company causes an event of default, as defined in the agreement, TPC can suspend or terminate any obligation.

Sales and Marketing Expenses

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 the Company's products and services. S&M expenses decreased \$60,979, or 8.3%, for the three months ended May 31, 2005 to \$674,562 (35.8% of revenue) from \$735,541 (26.5% of revenue) for the same period last year. For the six months ended May 31, 2005, S&M expenses decreased \$302,000, or 19.8%, to \$1,226,818 (29.6% of revenue) from \$1,528,818 (22.5% of revenue) for the six months ended May 31, 2004. The reduction is primarily the result of a decrease of approximately \$130,000 in expenses relating to the internal re-alignment of sales staff to G&A activities to support corporate and operations initiatives, a decrease of approximately \$72,000 in travel costs because of more efficient travel planning and a decrease of approximately \$52,000 in sales commissions as the result of lower sales achievements for the quarter. The Company's current level of S&M staff continues to allow the Company to pursue business development activity relating to its expansion efforts into American, European and Australasian markets. The expansion effort targets 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 to increase the profile of the Company and its products through the establishment of marketing agreements with companies local to the targeted regions and to broaden the Company's customer base thereby reducing its dependence on the current few international customers. 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

Total depreciation and amortization increased slightly to \$118,184 for the three months ended May 31, 2005 from \$83,802 for the three months ended May 31, 2004, and to \$202,854 for the six months ended May 31, 2005 from \$161,849 for the six months ended May 31, 2004. The increase reflects the acquisitions in the period and mix of plant and equipment in the Company at May 31, 2005 and the amortization of intangibles related to the acquisition of Mapcon Mapping Inc. For the three months ended May 31, 2005 and 2004, depreciation of \$39,213 and \$27,824, respectively was included in cost of sales. For the six months ended May 31, 2005 and 2004, depreciation of \$70,137 and \$53,805, respectively was included in cost of sales.

Interest

Interest expense increased to \$8,687 for the three months ended May 31, 2005 from \$103 for the three months ended May 31, 2004 and to \$21,403 for the six months ended May 31, 2005 from \$371 for the six months ended May 31, 2004. The increases in interest expense are the result of the Company having utilized a portion of its operating line credit facility of \$2,000,000 during the six months ended May 31, 2005. The Company did not utilize its operating line credit facility during Fiscal 2004.

Foreign exchange

Foreign exchange loss increased to \$50,912 for the three months ended May 31, 2005 from \$8,101 for the three months ended May 31, 2004 and the foreign exchange gain increased to \$22,232 for the six months ended May 31, 2005 from \$16,640 for the six months ended May 31, 2004. The changes were the result of exchange rate movements of the Australian dollar and the Company's reduced U.S. dollar exposure at May 31, 2005 when compared to May 31, 2004.

Technology Partnerships Canada royalty

The Company is required to pay a royalty of 3% on annual gross revenue for the Navigation Systems and Applications business units for the period December 1, 1999 to November 30, 2008. Royalty expense increased to \$37,867 for the three months ended May 31, 2005 from \$7,708 for the same period last year. Royalty expense increased to \$92,558 for the six months ended May 31, 2005 from \$56,634 for the same period last year.

Income Taxes

Based on the information available at the time of the issue of the unaudited interim consolidated financial statements for the three and six months ended May 31, 2005, the Company estimated that it will have sufficient taxable earnings in future periods from the Navigation Systems and Geomatics business units to utilize a portion of the Company's \$2,820,108 Canadian and \$250,358 U.S. non-capital losses carried forward and other tax balances. As a result of this assessment, the Company has recognized deferred tax expense amount of \$143,189 for the three months ended May 31, 2005 and a deferred tax recovery amount of \$95,176 for the six months ended May 31, 2005 compared to deferred tax recovery amounts of \$217,363 and \$496,266 for the same periods the previous year. The recovery amounts for the three and six months ended May 31, 2005 were calculated by using the projected effective tax rate for the fiscal year. The recovery is expected to reverse as the Company generates profitable results for the remainder of the fiscal year. In accordance with U.S. GAAP, the Company provided a valuation allowance against the total deferred tax asset as it is not considered "more likely than not" that the remaining deferred tax asset will be recovered. The Company continues to evaluate its taxable position quarterly and considers factors such as estimated taxable income, the history of losses for tax purposes and the growth of the Company, among others. For the three months ended May 31, 2005, the Company recorded a current tax expense of \$82,756, compared to a current tax expense for the same period last year of \$147,994. For the six months ended May 31, 2005, the Company recorded a current tax expense of \$82,756, compared to a current tax expense for the same period last year of \$380,786.

Earnings/Loss

As a result of the above factors, the Company had a loss for the three months ended May 31, 2005 of \$1,697,767 or 90.1% of revenue, compared to earnings of \$380,088 for the three months ended May 31, 2004, or 13.8% of revenue. The loss for the six months ended May 31, 2005 was \$1,917,358, or 46.3% of revenue, compared to earnings of \$931,879 for the six months ended May 31, 2004, or 13.6% of revenue.

Summary of Quarterly Results

For the three months ended (unaudited)	Revenue \$	Gross Profit \$	Net Earnings/ (Loss) \$	Basic Earnings (Loss) per Share \$	Diluted Earnings (Loss) per Share \$
May 31, 2005	1,881,685	370,351	(1,697,767)	(0.25)	(0.25)
February 28, 2005	2,259,863	1,232,108	(219,591)	(0.01)	(0.01)
November 30, 2004	3,696,137	1,968,649	(227,940)	(0.01)	(0.02)
August 31, 2004	2,951,571	1,469,554	(455,922)	(0.02)	(0.03)
May 31, 2004	2,773,835	1,775,003	380,088	0.01	(0.01)
February 29, 2004	4,029,760	2,568,773	551,791	0.02	0.00
November 30, 2003	2,724,439	1,630,782	315,417	0.01	0.01
August 31, 2003	2,275,152	1,176,210	(347,135)	(0.01)	(0.01)

For a discussion on the factors that affect the quarterly results, please refer to the section **Selected Information**.

Liquidity and Capital Resources

The Company strives to maintain cash-contributing profitable operations that provide an adequate liquidity and capital resource base for growth. Every business endeavour the Company develops or acquires targets a positive cash flow from the outset.

The Company believes that cash flow from operating activities, together with line of credit borrowings of \$2,000,000 available under its revolving credit facilities, will be sufficient to fund currently anticipated working capital, planned capital spending and debt service requirements for the next 12 months. The Company expects cash flow from operations will continue 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. There can be no assurance that these resources will be adequate or that additional financing will be available to the Company.

At May 31, 2005, the Company had current assets of \$23,170,056, current liabilities of \$3,684,089. Working capital increased \$11,198,169 to \$19,485,967 at May 31, 2005 from \$8,287,798 at November 30, 2004 primarily due to the increases in cash resulting from the private placement issuance of Class B preference shares, and a decrease in cash resulting from the net loss for the six months ended May 31, 2005, offset by an increase in accounts payable, a decrease in accounts receivable and the acquisition of Mapcon Mapping Inc..

The Company has credit facilities consisting of an operating line, standby letters of credit and forward exchange contract facilities. The credit facilities permit the Company to borrow funds directly for general corporate purposes (including acquisitions) at floating rates. At May 31, 2005 the Company had \$193,301 borrowings against its U.S. dollar operating line. The Company has an operating line of \$2,000,000 available with a Canadian chartered bank collateralized by accounts receivable. The Company has issued a standby letter of credit totalling Australian \$283,886. The Company has utilized the standby letter of credit to support certain performance

obligations to our customers. At May 31, 2005, the Company had entered into foreign exchange forward contracts in the amount of Australian \$1,605,038. The Company utilizes its forward exchange contract facility to reduce its exposure to exchange rate movements.

Cash flows from operating activities for the three months ended May 31, 2005, were a contribution of \$1,411,462, compared with a usage of \$742,355 for the three months ended May 31, 2004, an increase of \$2,153,817. Cash flows from operating activities for the six months ended May 31, 2005, were a contribution of \$739,604, compared with a usage of \$2,779,590 for the six months ended May 31, 2004, an increase of \$3,519,194. The main changes were the increase in the deferred income taxes balance offset by the increases in the net earnings for the periods, accounts receivable, accounts payable and accrued liabilities.

Net cash provided by financing activities for the three months ended May 31, 2005 amounted to \$14,029,337 compared to net cash provided of \$244,124 for the same period in 2004. The Company raised \$17,081,832 net of issuance costs as a result of the private placement of Class B Preference shares Series 2 and warrants. This was offset by the repurchase of Series 1 Class B Preference shares in the amount of \$2,885,550, and by Class B preference shares dividends declared and paid, in the amount of \$166,945.

Net cash provided by financing activities for the six months ended May 31, 2005 amounted to \$13,942,771 compared to net cash provided of \$203,435 for the same period in 2004. The Company raised \$17,081,832 net of issuance costs as a result of the private placement of Class B Preference shares Series 2 and warrants. This was offset by the repurchase of Series 1 Class B Preference shares in the amount of \$2,885,550, and by Class B preference shares dividends declared and paid, in the amount of \$253,511.

Cash used in investing activities totalled \$1,887,370 for the three months ended May 31, 2005 and \$1,379,983 for the six months ended May 31, 2005, compared with \$201,759 and \$244,395 for the same periods in 2004. The increases are reflective of the acquisition of Mapcon Mapping Consultants Inc., the acquisitions of property, plant and equipment commensurate with the Company's plans to obtain additional systems and facilities to accommodate its current and future anticipated growth and the restriction in usage of \$220,000 in cash.

As a result of the above mentioned changes and a translation adjustment of \$27,050, a net increase in cash amounted to \$13,580,479 for the three months ended May 31, 2005 compared to a decrease of \$699,190 for the three months ended May 31, 2004 and a net increase of \$13,329,442 for the six months ended May 31, 2005 compared to a decrease of \$2,820,550 for the six months ended May 31, 2004.

As at May 31, 2005, the Company estimates that a U.S. \$0.01 increase in the exchange rate of the U.S. dollar relative to the Canadian dollar would have an annualized impact of reducing earnings before income taxes by approximately \$2,000. As at May 31, 2005, the Company estimates that an Australian \$0.01 increase in the exchange rate of the Australian dollar relative to the Canadian dollar would have an annualized impact of reducing earnings before income taxes by approximately \$3,000. As at May 31, 2005, the Company does not expect to have a material number of Euro transactions and therefore does not expect earnings to be impacted by changes in the exchange rate of the Euro relative to the Canadian dollar.

In order to reduce the impact of U.S. to Canadian dollar, Australian to Canadian dollar and Euro to Canadian dollar exchange rate fluctuations, the Company has used the forward exchange contract facility described above. The Company used the forward exchange contract facility to set the exchange rate between the U.S. and Canadian dollar, the Australian to Canadian dollar and the Euro to Canadian dollar for specific transactions at a specific agreed upon rate, thereby mitigating any foreign exchange gain or loss that might occur on those transactions. The Company uses the forward exchange contract facility only for known or reasonably certain future U.S., Australian dollar and Euro transactions.

Contractual Obligations

	Payments due by period				
	Total	Less than 1 year	1 to 3 years	4 to 5 years	After 5 years
Facility leases	558,851	259,362	299,489	-	-
Equipment leases	25,931	12,737	13,194	-	-
Total contractual obligations	584,782	272,099	312,683	-	-

Off-Balance Sheet Arrangements

Guarantees

The Company has issued a standby letter of credit totalling Australian \$283,886. The standby letter of credit is repayable on demand after certain conditions have been met. The Company utilizes standby letters of credit to support certain performance obligations to its customers.

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

Transactions with Related Parties

During the last two fiscal years ended 2004 and 2003, the Company did not enter into any transactions with its management, members of its Board of Directors or major shareholders. In the second quarter of 2005, E. Brinton Coxe, a member of the Company's Board of Directors, became a related party by virtue of the fact that the Company has 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 April 8, 2005. The cash compensation of \$815,908 paid to Mr. Coxe included an adjustment in the amount of \$15,908 to reflect exchange rate changes between the U.S. dollar and Canadian Dollar. Mr. Coxe has also participated in the financing by purchasing 100 units personally. Also subsequent to the 2004 fiscal year end, Gerald J. Shields, elected to the Company's Board of Directors on April 8, 2005, became a related party by virtue of the provision of legal services to the Company by a law firm in which Mr. Shields has an interest. During FY2004 fees billed to the Company by this firm were under \$60,000. It is anticipated that fees billed to the Company by this firm will exceed \$60,000 for FY2005.

Proposed Transactions

The Company announced on July 11, 2005 that it has signed a non-binding letter of intent to acquire a United States defense contracting company. The acquisition is expected to approximately double OSI's revenue and employee base. The target company, with multiple offices in the United States, is a supplier of technology and services to the U.S. Department of Defense and key defense prime contractors.

Critical Accounting Policies

The Company prepares its consolidated financial statements in accordance with United States generally accepted accounting principles, and makes estimates and assumptions that affect its reported amounts of assets, liabilities, revenue and expenses, and the related disclosure of contingent liabilities. The Company bases its estimates on historical experience and other assumptions that it believes are reasonable in the circumstances. Actual results may differ from these estimates.

The following critical accounting policies affect the Company's more significant estimates and assumptions used in preparing its consolidated financial statements:

Revenue

The Company is required to estimate the costs to complete certain systems and geomatics services 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. The Company may need to adjust the estimated costs to complete for these projects, if the actual results differ from the Company's estimates. If the Company anticipates that a contract or a contract segment will generate a loss, the Company estimates that loss and records the total expected loss on the contract or contract segment. When revenues exceed amounts invoiced under a contract, the difference is recorded as unbilled revenue. The Company believes that unbilled revenue will be invoiced and collected. Billings in excess of revenues are amounts that have been billed to the customer but have not been recognized in revenue.

Income Taxes

The Company is required to estimate its income taxes in each of the jurisdictions in which it operates. This process involves estimating the Company's 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 the Company's consolidated balance sheet. The Company recognizes 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 the Company's estimates of taxable income by jurisdiction in which it operates and the period over which its deferred tax assets will be recoverable. In the event that actual results differ from these estimates, or the Company adjusts these estimates in future periods, the Company may need to adjust the valuation allowance. Although we believe that our tax estimates are reasonable, the ultimate tax determination involves significant judgement that is subject to audit by tax authorities in the ordinary course of business.

Stock-based Compensation and Other Stock-based Payments

The Company has established three stock option plans under which 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 Company recognizes 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 was 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, stock option and stock awards granted to non-employees are also accounted for in accordance with the intrinsic method of accounting for stock-based compensation.

Accounts Receivable

The Company maintains an allowance for doubtful accounts for estimated losses that may arise if any of its customers are unable to make required payments. Management specifically analyses the age of outstanding customer balances, historical bad debts, customer credit-worthiness and changes in customer payment terms when making estimates of the uncollectability of the Company's accounts receivable. If the Company determines that the financial condition of any of its customers deteriorates, increases in the allowance may be made. The Company reviews the unbilled revenue balance on a regular basis to assess its fair market value and provides 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 labour applied to the product and the applicable share of overhead. Finished goods are stated at the lower of cost and net realizable value. The Company assesses the need for inventory write-downs based on its assessment of estimated net realizable value using assumptions about future demand and market conditions. If market conditions differ from those originally estimated by the Company, an additional inventory write-down may be required.

Changes in Accounting Policies including Initial Adoption

Effective December 1, 2004, the Company elected to report its consolidated financial statements in accordance with U.S. GAAP. The Company prepares a reconciliation highlighting the material differences between its unaudited interim consolidated financial statements prepared in accordance with U.S. GAAP as compared to unaudited interim consolidated financial statements prepared under Canadian GAAP (see Note 16 to the unaudited interim consolidated financial statements). Additional disclosure with respect to the effects of the Company's election to report on its consolidated financial statements in accordance with U.S. GAAP is provided in Notes 1, 2 and 17 of the Company's unaudited interim consolidated financial statements.

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard No. 123R - Share-Based Payment ("SFAS 123R"), a revision to SFAS 123 "Accounting for Stock Based Compensation". SFAS 123R 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. Accordingly, from the date of adoption of the revised standard, the Company will be required to recognize compensation expense for all share-based payments based on grant-date fair value, including those granted, modified or settled prior to September 1, 2005, that were previously disclosed on a pro-forma basis. The Company is currently evaluating the impact of SFAS 123R in its consolidated financial statements.

Financial Instruments and Other Instruments

Foreign Exchange Forward Contracts

The Company uses foreign exchange forward contracts to hedge transactions denominated in U.S. dollars, Australian dollars and Euros. The purpose of the Company's hedging activities is to reduce the level of exposure to exchange rate movements. At May 31, 2005, the Company had foreign exchange forward contracts to sell Australian \$1,605,038. The exchange rates set in the foreign exchange forward contracts ranged between \$0.9486 to \$0.9578 for Australian \$1.00. The contracts mature between June 2005 and July 2005.

Derivative financial instruments are utilized by the Company in the management of its foreign currency exposure to reduce its exposure to fluctuations in foreign exchange on certain

committed and anticipated transactions. The Company formally documents the relationships between derivative financial instruments and hedged items, as well as the risk management objective and strategy. The Company assesses, on an ongoing basis, whether the derivative financial instruments continue to be effective in offsetting changes in fair values or cash flows of the hedged transactions.

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

Disclosure of Outstanding Share Data

As at June 30, 2005, the Company had issued and outstanding 27,488,074 common shares, and 2,448,947 outstanding stock options. As at June 30, 2005 the Company also had 30,262 issued and outstanding Class A preference shares and 390,000 issued and outstanding Class B preference shares series 2 convertible into common shares at conversion ratios of 1:1 and 1:58.82 respectively which represents 22,970,062 common shares. Also at June 30, 2005 the Company had outstanding 13,788,365 common share purchase warrants convertible to common shares at a conversion ratio of 1:1, representing 13,788,365 common shares.

Other MD&A Requirements

Additional information is also contained in the Company's Annual Report, including the financial statements, for the financial year ended November 30, 2004, the Company's Information Circular dated March 11, 2005 and in the Company's Annual Information Form dated March 17, 2005. The information contained in those documents is hereby incorporated by reference. This and other additional information relating to the Company may be found on SEDAR at www.sedar.com. Also, copies of these documents will be provided to any person, on request to the Secretary of the Corporation at 107-930 West 1st Street, North Vancouver, British Columbia, Canada, V7P 3N4, telephone (604) 904-4600, fax (604) 986-4454.

Offshore Systems International Ltd.

Interim Consolidated Financial Statements (Unaudited)

Three and Six Months Ended May 31, 2005 and 2004

(expressed in Canadian dollars)

(Prepared in accordance with United States Generally Accepted Accounting Principles)

Offshore Systems International Ltd.

U.S. GAAP

Consolidated Balance Sheets (unaudited)

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

(expressed in Canadian dollars)

	As at	
	May 31, 2005	November 30, 2004
	\$	\$
Assets (note 10)		
Current assets		
Cash	13,580,479	251,037
Restricted cash (note 4)	220,000	-
Accounts receivable (note 5)	7,306,453	9,140,478
Inventory (note 6)	893,754	649,427
Prepaid expenses and deposits	325,229	142,752
Deferred income taxes	844,141	780,331
	<hr/>	<hr/>
	23,170,056	10,964,025
Deferred income taxes	31,366	-
Plant and equipment (note 7)	989,952	938,102
Intangible and other assets (note 8)	876,098	408,611
Goodwill (note 3)	397,139	-
	<hr/>	<hr/>
	25,464,611	12,310,738
Liabilities		
Current liabilities		
Bank indebtedness	193,301	-
Accounts payable and accrued liabilities (note 9)	3,139,283	2,596,362
Income taxes payable	209,650	-
Unearned revenue	98,088	79,865
Deferred income taxes	43,767	-
	<hr/>	<hr/>
	3,684,089	2,676,227
Deferred income taxes	77,887	-
	<hr/>	<hr/>
	3,761,976	2,676,227
Stockholders' Equity		
Capital stock		
Authorized (note 11(a))		
Issued and outstanding		
30,262 Class A preference shares – Series A (2004 – 30,262) (note 11(b))	30,262	30,262
390,000 Class B preference shares – Series 2 (2004 – nil) (note 11(c)(ii))	12,649,066	-
nil Class B preference shares – Series 1 (2004 – 57,711) (note 11(c)(i))	-	2,163,621
27,488,074 common shares (2004 - 27,488,074)	20,047,731	20,047,731
	<hr/>	<hr/>
	32,727,059	22,241,614
Warrants (note 11(c))	5,206,844	661,575
Additional Paid in Capital	5,071,694	928,169
Accumulated deficit	(21,330,012)	(14,196,847)
Accumulated other comprehensive income	27,050	-
	<hr/>	<hr/>
	21,702,635	9,634,511
	<hr/>	<hr/>
	25,464,611	12,310,738
Contingencies (note 14)		

The accompanying notes are an integral part of these unaudited interim consolidated financial statements.

Offshore Systems International Ltd.

U.S. GAAP

Consolidated Statement of Earnings (unaudited) (expressed in Canadian dollars)

	Three Months Ended May 31,		Six Months Ended May 31,	
	2005	2004	2005	2004
	\$	\$	\$	\$
Revenue				
Software	281,521	1,397,516	1,772,689	4,390,779
Geomatics	906,015	998,970	1,213,596	1,717,703
Systems and system components	555,079	227,344	960,808	414,238
Other	139,070	150,005	194,449	280,875
	<hr/>	<hr/>	<hr/>	<hr/>
	1,881,685	2,773,835	4,141,542	6,803,595
Cost of sales	<hr/>	<hr/>	<hr/>	<hr/>
	1,511,334	998,832	2,539,082	2,459,819
Gross profit	<hr/>	<hr/>	<hr/>	<hr/>
	370,351	1,775,003	1,602,460	4,343,776
Expenses				
General and administrative	999,877	925,044	2,035,961	1,655,117
Research and development	461,925	583,351	781,158	1,046,575
Sales and marketing	674,562	735,541	1,226,818	1,528,818
Depreciation and amortization	78,971	55,978	132,717	108,044
Interest	8,687	103	21,403	371
Foreign exchange loss (gain)	50,912	8,101	(22,232)	(16,640)
Technology Partnerships Canada royalty (note 12)	37,867	7,708	92,558	56,634
Technology Partnerships Canada contribution (note 12)	(470,628)	(851,542)	(736,145)	(851,542)
	<hr/>	<hr/>	<hr/>	<hr/>
	1,842,173	1,464,284	3,532,238	3,527,377
Net earnings (loss) before income taxes	<hr/>	<hr/>	<hr/>	<hr/>
	(1,471,822)	310,719	(1,929,778)	816,399
Income tax expense (recovery) (note 15)				
Deferred income tax expense (recovery)	143,189	(217,363)	(95,176)	(496,266)
Current income tax expense	82,756	147,994	82,756	380,786
	<hr/>	<hr/>	<hr/>	<hr/>
	225,945	(69,369)	(12,420)	(115,480)
Net earnings (loss)	<hr/>	<hr/>	<hr/>	<hr/>
	(1,697,767)	380,088	(1,917,358)	931,879
Foreign currency translation adjustment	27,050	-	27,050	-
Comprehensive income (loss)	<hr/>	<hr/>	<hr/>	<hr/>
	(1,670,717)	380,088	(1,890,308)	931,879
Net earnings (loss) available to common shareholders (note 11(e))	<hr/>	<hr/>	<hr/>	<hr/>
	(6,880,135)	303,366	(7,133,165)	778,435
Earnings per share (note 11(e))				
Basic earnings per share	(0.25)	0.01	(0.26)	0.03
Diluted earnings per share	(0.25)	(0.01)	(0.26)	0.01
Weighted average number of common shares outstanding (note 11(e))				
Basic	27,488,074	27,145,769	27,488,074	26,964,789
Diluted	27,488,074	29,771,620	27,488,074	32,525,826

The accompanying notes are an integral part of these unaudited interim consolidated financial statements.

Offshore Systems International Ltd.

U.S. GAAP

Consolidated Statements of Stockholders' Equity and Accumulated Deficit (unaudited)

For the six months ended May 31, 2005

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

(expressed in Canadian dollars)

	Class A Preference Shares		Class B Preference Shares		Common Shares		Warrants		Additional Paid In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income	Total Stockholders' Equity
	Number	Amount \$	Number	Amount \$	Number	Amount \$	Number	Amount \$				
Balance - November 30, 2004	30,262	30,262	57,711	2,163,621	27,488,074	20,047,731	1,393,301	661,575	928,169	(14,196,847)	-	9,634,511
Accretion of discount on Class B preference shares Series 1				33,439	-	-	-	-	-	(33,439)	-	-
Stock-based compensation	-	-	-	-	-	-	-	-	2,524	-	-	2,524
	30,262	30,262	57,711	2,197,060	27,488,074	20,047,731	1,393,301	661,575	930,693	(14,230,286)	-	9,637,035
Net loss for the period	-	-	-	-	-	-	-	-	-	(219,591)	-	(219,591)
Balance - February 28, 2005	30,262	30,262	57,711	2,197,060	27,488,074	20,047,731	1,393,301	661,575	930,693	(14,449,877)	-	9,417,444
Accretion of discount on Class B preference shares Series 1	-	-	-	390,672	-	-	-	-	-	(390,672)	-	-
Repurchase of Class B preference shares Series 1	-	-	(57,711)	(2,587,732)	-	-	-	-	(668,785)	370,967	-	(2,885,550)
Issue of Class B preference shares Series 2 and warrants, net of issue costs	-	-	390,000	12,536,563	-	-	12,395,064	4,545,269	-	-	-	17,081,832
Beneficial conversion feature on Class B preference shares Series 2	-	-	-	(4,796,649)	-	-	-	-	4,796,649	-	-	-
Accretion of discount on Class B preference shares Series 2	-	-	-	112,503	-	-	-	-	-	(112,503)	-	-
Accretion of beneficial conversion feature on Class B preference shares Series 2	-	-	-	4,796,649	-	-	-	-	-	(4,796,649)	-	-
Foreign currency translation adjustment	-	-	-	-	-	-	-	-	-	-	27,050	27,050
Dividends on Class B preference shares series 1	-	-	-	-	-	-	-	-	-	(62,785)	-	(72,785)
Dividends on Class B preference shares series 2	-	-	-	-	-	-	-	-	-	(190,726)	-	(180,726)
Stock-based compensation	-	-	-	-	-	-	-	-	13,137	-	-	13,137
	30,262	30,262	390,000	12,649,066	27,488,074	20,047,731	13,788,365	5,206,844	5,071,694	(19,632,245)	27,050	23,400,402
Net loss for the period	-	-	-	-	-	-	-	-	-	(1,697,767)	-	(1,697,767)
Balance - May 31, 2005	30,262	30,262	390,000	12,649,066	27,488,074	20,047,731	13,788,365	5,206,844	5,071,694	(21,330,012)	27,050	21,702,635

Offshore Systems International Ltd.

U.S. GAAP

Consolidated Statement of Cash Flows (unaudited)

Three and Six Months Ended May 31, 2005 and 2004

(expressed in Canadian dollars)

	Three Months Ended May 31		Six Months Ended May 31	
	2005 \$	2004 \$	2005 \$	2004 \$
Cash flows from (used in) operating activities				
Net earnings (loss) for the period	(1,697,767)	380,088	(1,917,358)	931,879
Items not affecting cash				
Depreciation and amortization	118,184	83,802	202,854	161,849
Stock based compensation	13,137	33,006	15,661	33,006
Deferred income taxes	143,189	(64,470)	(95,176)	(115,480)
Other	4,420	-	4,420	-
	<u>(1,418,837)</u>	<u>432,426</u>	<u>(1,789,599)</u>	<u>1,011,254</u>
Changes in non-cash working capital items				
Accounts receivable	1,403,092	(1,359,153)	2,383,378	(3,983,827)
Inventory	(31,200)	(81,880)	(244,327)	(51,644)
Prepaid expenses and deposits	114,844	91,029	(182,477)	175,987
Accounts payable and accrued liabilities	1,258,425	312,017	493,011	253,801
Income taxes payable	87,366	-	87,366	-
Unearned revenue	(2,228)	43,993	(7,748)	42,471
Rent payable	-	(133,942)	-	(133,942)
Accrued long term royalties	-	(46,845)	-	(93,690)
	<u>2,830,299</u>	<u>(1,174,781)</u>	<u>2,529,203</u>	<u>(3,790,844)</u>
	<u>1,411,462</u>	<u>(742,355)</u>	<u>739,604</u>	<u>(2,779,590)</u>
Cash flows from (used in) financing activities				
Issue of Common shares	-	264,239	-	315,416
Share issue cost – Class B preference shares – Series 1	-	(20,115)	-	(20,115)
Issue of Class B preference shares – Series 2 and warrants, net of issue costs	17,081,832	-	17,081,832	-
Repurchase of Class B preference shares – Series 1	(2,885,550)	-	(2,885,550)	-
Class B preference share dividends declared and paid	(166,945)	-	(253,511)	(91,866)
	<u>14,029,337</u>	<u>244,124</u>	<u>13,942,771</u>	<u>203,435</u>
Cash flows from (used in) investing activities				
Purchase of Mapcon Mapping Consultants Inc, net of cash acquired (note 3)	(1,176,241)	-	(1,176,241)	-
Advances from (payment to) operating line of credit	(355,093)	-	193,301	-
Increase in restricted cash	(220,000)	-	(220,000)	-
Additions to plant and equipment	(77,955)	(35,666)	(105,379)	(65,364)
Additions to intangibles	(58,081)	(166,093)	(71,664)	(179,031)
	<u>(1,887,370)</u>	<u>(201,759)</u>	<u>(1,379,983)</u>	<u>(244,395)</u>
Translation adjustment	<u>27,050</u>	<u>-</u>	<u>27,050</u>	<u>-</u>
Increase (decrease) in cash	<u>13,580,479</u>	<u>(699,190)</u>	<u>13,329,442</u>	<u>(2,820,550)</u>
Cash – Beginning of period	<u>-</u>	<u>1,716,195</u>	<u>251,037</u>	<u>3,837,555</u>
Cash – End of period	<u>13,580,479</u>	<u>1,017,005</u>	<u>13,580,479</u>	<u>1,017,005</u>

Offshore Systems International Ltd.

U.S. GAAP

Notes to the Consolidated Financial Statements (unaudited)
Three and Six Months Ended May 31, 2005 and 2004
(expressed in Canadian dollars)

1 Basis of presentation

These unaudited interim consolidated financial statements have been prepared by management and include the accounts of Offshore Systems International Ltd. and its subsidiaries, collectively referred to as the Company. These unaudited interim consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") and all amounts herein have been expressed in Canadian dollars unless otherwise noted. These unaudited interim consolidated financial statements do not include all the information and footnote disclosures required for compliance with U.S. GAAP for annual financial statements applied on a consistent basis. These unaudited interim consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and notes thereto. These unaudited interim consolidated financial statements conform in all material respects with Canadian generally accepted accounting principles ("Canadian GAAP"), except as disclosed in notes 19 and 20.

The preparation of these unaudited interim consolidated financial statements and the accompanying notes requires management to make estimates and assumptions that affect the amounts reported. In the opinion of management, these unaudited interim consolidated financial statements reflect all adjustments (which include only normal recurring adjustments) necessary to state fairly the results for the periods presented. Actual results could vary from these estimates and the operating results for the interim period presented are not necessarily indicative of the results expected for the full year.

2 Accounting changes

a) Changes in accounting policies relating to the adoption of U.S. GAAP

Effective December 1, 2004, the Company elected to report its consolidated financial statements in conformity with U.S. GAAP. The Company continues to report all amounts in Canadian dollars. All accounting policies are the same as described in note 2 to the Company's audited financial statements for the year ended November 30, 2004, which were prepared accordance with Canadian GAAP filed with the appropriate securities commissions except for the following which have been retroactively adopted to comply with U.S. GAAP:

Stock Based Compensation

The Company grants stock options to employees, officers, directors, and persons providing management or consulting services to the Company pursuant to the stock option plans described in note 11(d). As allowed by Statement of Financial Accounting Standard 123 Accounting for Stock Based Compensation, ("SFAS 123") as amended by Statement of Financial Accounting Standard 148, the Company followed the Accounting Principles Board Opinion 25, Accounting for Stock Issued to Employees, ("APB 25") and presented pro forma information that is required by SFAS 123. APB 25 requires compensation cost for stock-based employee compensation plans to be recognized over the vesting period based on the difference, if any, between the quoted market price of the Company's stock as of the grant date and the amount an employee must pay to acquire the stock.

For stock options granted to non-employees, the Company follows the requirements of SFAS 123 and related interpretations. Costs are measured at the estimated fair value of the consideration received or the estimated fair value of the options issued, whichever is more reliably measurable. The value of the options issued for consideration other than employee services is determined on the earlier of a performance commitment or completion of performance by the provider of goods or services.

Beneficial conversion feature and accretion of discount on preference shares issued with attached warrants

For U.S. GAAP purposes, during the fiscal year 2003 and the three months ended May 31, 2005 the Company recorded beneficial conversion features of \$668,785 and \$4,796,649 on the issuance of Class B preference shares Series 1 and 2, respectively, as a reduction to the net earnings available to common shareholders calculated on the effective conversion price of the preference shares to common shares based on the proceeds allocated to the preference shares. In both cases, the conversion feature of the preference shares vested immediately and the Company recorded the accretion of the full amount of

Offshore Systems International Ltd.

U.S. GAAP

Notes to the Consolidated Financial Statements (unaudited)

Three and Six Months Ended May 31, 2005 and 2004

(expressed in Canadian dollars)

the beneficial conversion feature. For both the Series 1 and Series 2 Class B preference shares, the discount on these shares that resulted from the allocation of the gross proceeds to the Class B preference shares and to the attached warrants is accreted over the five-year life of the warrants. This resulted in an accretion of \$503,175 and \$536,614 to Deficit for the three and six months ended May 31, 2005 respectively (\$33,439 and \$66,878 for the three and six months ended May 31, 2004 respectively).

Under Canadian GAAP, there is not a requirement to record the beneficial conversion feature and accretion of discount when preference shares are issued with attached warrants.

Derivative Financial Instruments

Under Canadian GAAP, there is a requirement for derivatives outside of hedging relationships to be recognized on the balance sheet at fair market value; however for derivatives in hedging relationships, Canadian GAAP does not specify how such derivatives should be recorded. As a result, under Canadian GAAP, in some instances derivatives may not be recorded on the balance sheet. Under U.S. GAAP it is required that all derivatives be recorded as assets or liabilities, measured at fair value. Derivatives that are not hedges are adjusted to fair value through income. 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 recognized in other comprehensive income until the hedged item is recognized in income. The ineffective portion of a derivative's change in fair value is immediately recognized into income.

b) Recent pronouncements

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard 123R, Share-Based Payment, ("SFAS 123R") a revision to SFAS 123. SFAS 123R 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. Accordingly, from the date of adoption, December 1, 2005, of the revised standard, the Company will be required to recognize compensation expense for all share-based payments based on grant-date fair value, including those granted, modified or settled prior to September 1, 2005, that were previously disclosed on a pro-forma basis. The Company is currently evaluating the impact of SFAS 123R on its consolidated financial statements.

In December 2004, the FASB issued SFAS No. 153, "Exchange of Nonmonetary Assets, an amendment of APB Opinion No. 29, Accounting for Nonmonetary Transactions" ("SFAS No. 153"). The amendments made by SFAS No. 153 are based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged. Further, the amendments eliminate the narrow exception for nonmonetary exchanges of similar productive assets and replace it with a broader exception for exchanges of nonmonetary assets that do not have commercial substance. SFAS No. 153 is to be applied prospectively and is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The Company is currently evaluating the impact of SFAS No. 153 on its consolidated financial statements.

3 Acquisition

On April 8, 2005, the Company acquired all of the issued and outstanding shares of Mapcon Mapping Consultants Inc. ("Mapcon") of Salt Lake City, Utah for \$1,347,382 (USD\$1,113,907). The acquisition was effective April 1, 2005. Mapcon is a privately held land mapping company in the U.S. geomatics (digital and electronic chart data production) market. The results of Mapcon's operations have been included in the consolidated financial statements commencing April 1, 2005.

The following table summarizes the fair value of the assets acquired and liabilities assumed by the Company at April 1, 2005, the date of acquisition. The acquisition was accounted for using the purchase method whereby assets acquired and liabilities assumed were recorded at their fair values at April 1, 2005. The excess of the purchase price over the fair market value was recorded as goodwill. The allocation of the purchase price is preliminary and the final allocation may be subject to refinement in the next 12 months. The purchase price is subject to certain adjustments related to working capital and the achievement of a minimum level of sales bookings against a specific contract.

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	\$
Assets	
Current assets	819,568
Equipment	208,791
Intangible assets	350,784
Goodwill	382,712
Total assets acquired	<u>1,761,855</u>
Liabilities	
Current liabilities not including deferred tax liabilities	198,165
Deferred tax liabilities – current	42,177
Deferred tax liabilities – long term	75,058
Total liabilities assumed	<u>315,400</u>
Net assets acquired (cash consideration)	1,347,382
Direct acquisition costs incurred by the Company	99,073
Cash of acquired operations	270,214

The following table presents details of the purchased intangible assets:

	Estimated useful life	Amount \$
Customer contract	16 months	157,248
Customer relationships	4 to 10 years	193,536

The pro forma Offshore Systems International Ltd. consolidated operating results assuming the acquisition of Mapcon had occurred as of December 1, 2004, are as follows:

	3 Months Ended May 31,		6 Months Ended May 31,	
	2005	2004	2005	2004
	\$	\$	\$	\$
Revenue	2,024,702	3,049,028	4,660,036	7,353,981
Earnings (loss)	(1,651,780)	417,492	(1,767,503)	1,006,686
Earnings (loss) per share – basic	(0.25)	0.01	(0.25)	0.03
Earnings (loss) per share – diluted	(0.25)	0.00	(0.25)	0.01

4 Restricted cash

Restricted cash consists of cash pledged with a bank as collateral for bid bonds.

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5 Accounts receivable

	May 31, 2005	November 30, 2004
	\$	\$
Trade	2,125,855	4,679,207
Unbilled revenue	4,636,448	4,116,828
Technology Partnerships Canada contribution (note 12)	470,628	257,266
Other	109,884	111,234
Allowance for doubtful accounts	(36,362)	(24,057)
	<u>7,306,453</u>	<u>9,140,478</u>

The Company has collateralized its accounts receivable as security against its operating line facility.

6 Inventory

	May 31, 2005	November 30, 2004
	\$	\$
Materials and components	714,429	638,127
Finished goods	165,451	11,300
Work in process	13,874	-
	<u>893,754</u>	<u>649,427</u>

7 Plant and equipment

	May 31, 2005		
	Cost	Accumulated Depreciation	Net
	\$	\$	\$
Equipment	4,044,913	3,126,015	918,898
Furniture and fixtures	138,283	103,088	35,195
Leasehold improvements	234,175	198,316	35,859
	<u>4,417,371</u>	<u>3,427,419</u>	<u>989,952</u>
	November 30, 2004		
	Cost	Accumulated Depreciation	Net
	\$	\$	\$
Equipment	3,910,980	3,038,921	872,059
Furniture and fixtures	131,095	94,705	36,390
Leasehold improvements	222,737	193,084	29,653
	<u>4,264,812</u>	<u>3,326,710</u>	<u>938,102</u>

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8 Intangible and other assets

	May 31, 2005		
	Cost \$	Accumulated Amortization \$	Net \$
Computer software	1,141,984	621,752	520,232
Customer contract	163,176	20,397	142,779
Customer relationships	200,832	5,029	195,803
Licenses and patents	57,267	39,983	17,284
	<u>1,563,259</u>	<u>687,161</u>	<u>876,098</u>

	November 30, 2004		
	Cost \$	Accumulated Amortization \$	Net \$
Computer software	\$ 936,591	\$ 546,190	\$ 390,401
Licenses and patents	57,267	39,057	18,210
	<u>\$ 993,858</u>	<u>\$ 585,247</u>	<u>\$ 408,611</u>

9 Accounts payable and accrued liabilities

	May 31, 2005 \$	November 30, 2004 \$
Trade	1,285,005	\$ 1,343,129
Accrued employee costs	637,425	572,589
Accrued liabilities	1,125,162	282,227
Accrued royalties (note 12)	91,691	311,851
Class B preference shares Series 1 dividends declared and unpaid	-	86,566
	<u>3,139,283</u>	<u>\$ 2,596,362</u>

10 Credit facilities

In February 2005, the Company renewed certain credit facilities with a Canadian chartered bank, which consist of an operating line, a foreign exchange forward contract facility and standby letters of credit. The operating line bears interest at the chartered bank's prime lending rate plus 0.5% with interest payable monthly. The prime lending rate at May 31, 2005 was 4.25% (2004 – 4.25%). The standby letters of credit are denominated in U.S. dollars and bear interest at the rate of 1.25% per annum. Funds drawn on the operating line and the standby letters of credit are repayable on demand. As of May 31, 2005, letters of credit, relating principally to customer contracts, amounting to U.S. \$nil (2004 – U.S. \$818,398) and Australian

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\$1,605,038 (2004 – Australian \$2,750,000) have been issued. The Company utilizes letters of credit to back certain performance obligations with its customers.

The maximum amount(s) available to the Company under the operating line is \$2,000,000 and under the foreign exchange forward contract facility are U.S. \$2,000,000 and Australian \$2,500,000. The credit facilities are collateralized by an assignment of accounts receivable, a general security agreement from the Company and its subsidiaries Offshore Systems Ltd., OSI Geomatics Ltd. and OSI Geomatics Inc. In addition, the Company is required to meet certain covenants as outlined in the credit facilities agreement. As at May 31, 2005, the Company had drawn on its foreign exchange contract facility in the amount of U.S. \$nil (2004 – U.S. \$818,398) and Australian \$1,605,038 (2004 – \$2,750,000).

11 Capital Stock

(a) Authorized

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

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

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

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

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

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

Unlimited common shares without par value

(b) Class A preference shares

The Company has 30,262 (November 30, 2004 - 30,262) Class A preference shares outstanding that have a carrying value of \$30,262 for financial statement purposes. These Class A preference shares are being held in escrow but are no longer subject to any escrow restrictions and may be converted at any time into common shares of the Company, by notice in writing from the holders.

(c) Class B preference shares

(i) Series 1

The Company completed a private placement on February 13, 2003 consisting of 61,244 units for total gross proceeds of \$3,004,200. Each unit consists of one Class B Series 1 preference share and 22.75 common share purchase warrants exercisable at \$1.10. The preference shares are voting convertible shares at a ratio of 1:45.5 and have a cumulative dividend of 6% per annum. The Company has the right to redeem the preference shares after five years. The share purchase warrants are convertible to common shares at a ratio of 1:1 and expire five years after issue. The private placement incurred share issue costs of \$297,320.

The gross proceeds of \$3,004,200 were allocated between the preference shares and warrants based on their relative fair value at the date of issuance. The \$2,342,625 fair value of the preference shares has been estimated based on the fair value of the underlying common shares. The \$661,575 fair value of the warrants has been estimated using the Black-Scholes option pricing model. Assumptions used in the pricing model included: (i) risk free interest rate of 2.7%, (ii) expected volatility of 66%, (iii) an estimated life of 5 years and (iv) an expected dividend rate of 0%. During the fiscal year 2003, the Company has recorded a beneficial conversion feature of \$668,785 in dividends calculated on the effective conversion price of the preference shares to common shares based on the proceeds allocated to the preference shares. The conversion feature of the preference shares vested immediately and the Company recorded the accretion of the full amount of the beneficial conversion feature. The preference share discount that resulted from the allocation of the gross proceeds is accreted over the five-year life of the warrants. This resulted in an accretion of \$390,672 and \$33,439

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to accumulated deficit for the three and six months ended May 31, 2005 respectively (\$33,439 and \$66,878 for the three and six months ended May 31, 2004 respectively). During fiscal 2004 3,533 Class B Series 1 preference shares were converted into common shares.

On April 11, 2005, 57,711 Class B Series 1 preference shares were repurchased by the Company at their par value of \$50 per share for aggregate cash consideration of \$2,885,550. The unamortized discount in the amount of \$390,672 as of the repurchase date was amortized and accreted to the Class B series 1 preference shares and the beneficial conversion feature of \$668,785 was deducted from additional paid in capital. The repurchase resulted in a decrease of \$370,967 to deficit.

(ii) Series 2

On April 11, 2005, the Company completed a private placement consisting of 19,500 units for total gross proceeds of \$19,500,195. The issue price was \$1,000.01 per unit. Each unit consist of 20 voting Class B preference shares Series 2 ("Preference Shares") and 588 share purchase warrants ("Warrants"). The Preference Shares entitle the holders to receive a fixed preferential cumulative 7% dividend payable semi-annually. Each Preference Share is convertible at the option of the holder at any time into 58.82 of the Company's 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 the Company's common shares at the exercise price of \$0.85 for a period of five years. Fees for advisory, investment banking and legal and other professional services in connection with this private placement were paid in the amount of \$2,418,363 and 929,064 warrants were issued to an investment bank and related party (note 13) in connection with the private placement. The fair value of the finder's fee warrants was estimated to be \$0.47 per warrant, using the Black-Scholes option pricing model, and has been recognized as a share issue cost.

The gross proceeds of \$19,500,195 were allocated between the Preference Shares and Warrants based on their relative fair value at the date of issuance. The \$20,188,235 fair value of the preference shares has been estimated based on the fair value of the underlying common shares. The \$5,389,020 fair value of the warrants has been estimated using the Black-Scholes option pricing model. Assumptions used in the pricing model included: (i) risk free interest rate of 2.88%, (ii) expected volatility of 59%, (iii) an estimated life of 5 years and (iv) an expected dividend rate of 0%. The Company has recorded a beneficial conversion feature of \$4,796,649 as a reduction to the net earnings available to common shareholders calculated on the effective conversion price of the preference shares to common shares based on the proceeds allocated to the Preference Shares. The conversion feature of the Preference Shares vested immediately and the Company recorded the accretion of the full amount of the beneficial conversion feature. The Preference Share discount that resulted from the allocation of the gross proceeds is accreted over the five-year life of the Warrants. This resulted in an accretion of \$112,503 to accumulated deficit for the three and six months ended May 31, 2005.

Each Class B Series 2 Preference Share entitles the holder to one vote either in person or by proxy at any general meeting of the shareholders of the Company. The Company has the right to require the shareholders of the Preference Shares to convert each such share into 58.82 Common Shares if (i) at any time after 13 months following the issuance of the Preference Shares, the closing trade price of the Company's common shares exceeds \$2.13 for at least 20 consecutive trading days, or (ii) at any time, the Company completes a firm public underwritten offering of its common shares for more than \$40,000,000 at a price per common share greater than \$1.70. The Preference Shares are redeemable at the option of the Company at any time after the third anniversary of the issuance date for an amount equal to the original issuance price plus a premium of 20% of the original issue price. The Preference Shares are not subject to any right of redemption at the option of the holder.

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(d) Stock option plans

The Company has established three stock option plans under which options to purchase common shares may be granted to directors, officers and employees of the Company and to any other person or Company permitted by the applicable regulatory authorities to purchase unissued common shares. The number of common shares authorized for grant under the Company's stock option plans is 10,930,732, of which 4,375,494 are available for granting. The exercise price of options granted pursuant to the plans may not be less than the market price of the common shares at the time of grant. The plans provide that options may be granted with vesting periods and expiry dates at the discretion of the board of directors. Options granted to directors and executives vest over periods ranging from immediately to three years and options granted to employees vest one year after the date granted.

A summary of the Company's stock options outstanding and exercisable at May 31, 2005 is as follows:

Range of exercise prices \$	Number outstanding at May 31, 2005	Options outstanding		Options exercisable	
		Weighted average remaining contractual life (years)	Weighted average exercise price \$	Number exercisable at May 31, 2005	Weighted average exercise price \$
0.75 – 1.00	768,000	3.94	0.85	618,000	0.87
1.01 – 1.35	1,620,947	1.00	1.06	1,474,947	1.06
1.36 – 1.41	60,000	0.05	1.41	60,000	1.41
0.75 – 1.41	2,448,947	1.90	1.00	2,252,947	1.01

Stock-based compensation

For the three and six months ended May 31, 2005, the Company incurred non-cash stock-based compensation expense of \$13,137 and \$15,661 respectively, related to stock options granted to third parties (three and six month period ended May 31, 2004 - \$33,006). The expense was included in general and administrative costs and was recorded in additional paid-in capital.

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

	3 Months Ended May 31,		6 Months Ended May 31,	
	2005	2004	2005	2004
Risk-free interest rate	2.78%	2.21%	2.78%	2.20%
Volatility	41%	58%	41%	83%
Estimated average option lives	1.38 years	3.00 years	1.38 years	1.10 years
Dividend yield	0.00%	0.00%	0.00%	0.00%

Pro forma disclosure

The Company applies the intrinsic value method for employee stock options granted as prescribed in APB 25. Had compensation cost been determined using the fair value approach set forth in SFAS 123, the Company's earnings for the three and six months ended May 31, 2005 and 2004 and earnings (loss) per share would have been in accordance with the pro forma amounts indicated below:

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	For the three months ended		For the six months ended	
	May 31, 2005 \$	May 31, 2004 \$	May 31, 2005 \$	May 31, 2004 \$
Earnings (loss) as reported	(1,697,767)	380,088	(1,917,358)	931,879
Add: Stock-based compensation cost	13,137	33,006	15,661	33,006
Less: Pro forma stock-based compensation cost	(220,582)	(120,724)	(253,051)	(127,024)
Pro forma income (loss)	(1,905,212)	292,370	(2,154,748)	837,861
Pro forma basic earnings (loss) per share	(0.26)	0.01	(0.27)	0.03
Pro forma diluted earnings (loss) per share	(0.26)	(0.01)	(0.27)	0.01
Weighted average number of common shares outstanding – basic	27,488,074	27,145,769	27,488,074	26,964,789
Weighted average number of common shares outstanding – diluted	27,488,074	29,771,620	27,488,074	32,525,826

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

	3 Months Ended May 31,		6 Months Ended May 31,	
	2005	2004	2005	2004
Risk-free interest rate	2.85%	2.21%	2.85%	2.21%
Volatility	54%	58%	54%	58%
Estimated average option lives	4.06 years	3.00 years	4.06 years	3.00 years
Dividend yield	0.00%	0.00%	0.00%	0.00%

(e) Earnings per share

	Three Months Ended May 31		Six Months Ended May 31	
	2005 \$	2004 \$	2005 \$	2004 \$
Basic earnings (loss) per share				
Net earnings (loss)	(1,697,767)	380,088	(1,917,358)	931,879
Less: Accretion of discount on Class B preference shares Series 1	(390,672)	(33,439)	(424,111)	(66,878)
Accretion of beneficial conversion feature on Class B preference shares Series 2	(4,796,649)	-	(4,796,649)	-
Accretion of discount on Class B preference shares Series 2	(112,503)	-	(112,503)	-
Class B preference share dividends Series 1	(62,785)	(43,283)	(62,785)	(86,566)
Class B preference share dividends Series 2	(190,726)	-	(190,726)	-
Add: Excess of carrying value of Class B preference shares series 1 and beneficial conversion feature over repurchase consideration paid.	370,967	-	370,967	-
Net earnings (loss) available to common shareholders	(6,880,135)	303,366	(7,133,165)	778,435
Weighted average number of common shares outstanding	27,488,074	27,145,769	27,488,074	26,964,789
Basic earnings (loss) per share	(0.25)	0.01	(0.26)	0.03

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	Three Months Ended May 31		Six Months Ended May 31	
	2005	2004	2005	2004
	\$	\$	\$	\$
Diluted earnings (loss) per share				
Net earnings	(1,697,767)	380,088	(1,917,358)	931,879
Less: Accretion of discount on Class B preference shares Series 1	(390,672)	(531,638)	(424,111)	(565,078)
Accretion of beneficial conversion feature on Class B preference shares Series 2	(4,796,649)	-	(4,796,649)	-
Accretion of discount on Class B preference shares Series 2	(112,503)	-	(112,503)	-
Class B preference share dividends Series 1	(62,785)	-	(62,785)	-
Class B preference share dividends Series 2	(190,726)	-	(190,726)	-
Add: Excess of carrying value of Class B preference shares series 1 and beneficial conversion feature over repurchase consideration paid.	370,966	-	370,967	-
Net earnings (loss) available to common shareholders	<u>(6,880,135)</u>	<u>(151,550)</u>	<u>(7,133,165)</u>	<u>366,801</u>
Weighted average number of common shares outstanding	27,488,074	27,145,769	27,488,074	26,964,789
Dilutive effect of Class A preference shares – Series A (*1)	-	-	-	30,262
Dilutive effect of Class B preference shares – Series 1	-	2,625,851	-	2,625,851
Dilutive effect of Class B preference shares – Series 2 (*2)	-	-	-	-
Dilutive effect of warrants (*3)	-	-	-	1,393,301
Dilutive effect of stock options (*1)	-	-	-	1,511,623
Adjusted weighted average number of common shares outstanding	<u>27,488,074</u>	<u>29,771,620</u>	<u>27,488,074</u>	<u>32,525,826</u>
Diluted earnings (loss) per share	<u>(0.25)</u>	<u>(0.01)</u>	<u>(0.26)</u>	<u>0.01</u>

(*1) The Class A preference shares – Series A and stock options were anti-dilutive for the purposes of calculating diluted earnings per share for the three and six months ended May 31, 2005 and for the three months ended May 31, 2004.

(*2) The Class B preference shares – Series 2 were anti-dilutive for the purposes of calculating diluted earnings per share for the three and six months ended May 31, 2005.

(*3) For the three and six months ended May 31, 2005, the outstanding 13,788,365 warrants were not included in the diluted earnings per share calculation as they were anti-dilutive. For the three months ended May 31, 2004, the outstanding 1,393,301 warrants were not included in the diluted earnings per share calculation as they were anti-dilutive.

12 Technology Partnerships Canada

On April 26, 2004, the Company entered into an agreement with Technology Partnerships Canada (“TPC”) whereby TPC granted financial assistance to the Company for the purpose of funding research and development activities to be completed on or before March 31, 2007. The maximum eligible contribution by TPC is \$3,768,391. As at May 31, 2005, the Company has claimed \$2,207,559 of assistance under the agreement. Accounts receivable at May 31, 2005 includes \$470,628 of amounts receivable from TPC in connection with these claims (November 30, 2004 – \$257,266).

In addition, under the April 26, 2004 agreement, the Company is required to pay a royalty of 1.4% on annual gross Navigation Systems and Applications revenue for the period January 1, 2006 to December 31, 2008 and a royalty of 2.5% on

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annual gross Navigation Systems and Applications revenue for the period January 1, 2009 to December 31, 2013. 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. No amounts for royalty payments in connection with this agreement have been recorded in the financial statements.

On November 15, 1999, the Company entered into an agreement with TPC whereby TPC granted financial assistance to the Company for the purpose of funding research and development activities to be completed on or before March 31, 2003. Under the agreement with TPC, the Company was eligible to receive contributions to a maximum of \$4,000,177 over the period from December 23, 1998 to March 31, 2003. As of March 31, 2003, the Company had received the maximum allowed under the agreement. There are no amounts recorded in accounts receivable with respect to these claims.

In addition, under the November 15, 1999 agreement, the Company is required to pay a royalty of 3% on annual gross Navigation Systems and Applications business unit revenue for the period December 1, 1999 to November 30, 2008. The Company has paid royalties of \$1,242,022 to date (November 30, 2004 – \$929,303) and has accrued royalties of \$91,691 at May 31, 2005 (November 30, 2004 - \$311,851). 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.

Although the Company believes that its submissions for TPC funding meet the terms and conditions of the TPC agreements, the final determination may be subject to audit by government authorities in the ordinary course of business. During fiscal year 2004, the Company was subject to an audit by government authorities. The results of the audit have not been communicated to the Company. The Company has no reason to believe that the outcome of the audit will have a material impact on the Company's financial results.

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

13 Related party transactions

On April 11, 2005, Mr. E. Brinton Coxe, a director of the Company, assisted the Company in structuring and arranging the private placement financing (note 11(c)(ii)). In consideration for his services, the Company paid him compensation of \$815,908 and 350,000 common share purchase warrants. The cash compensation of \$815,908 paid to Mr. Coxe included an adjustment in the amount of \$15,908 to reflect exchange rate changes between the U.S. dollar and Canadian Dollar. Mr. Coxe has also participated in the financing by purchasing 100 units personally.

On April 8, 2005, Gerald J. Shields was elected to the Company's Board of Directors and became a related party as he provides legal services to the Company through a law firm in which he has an interest.

14 Contingencies

In July 2002, two of the Company's subsidiaries, Offshore Systems Ltd. and OSI Geomatics Ltd., and four employees became subject to a lawsuit for an undisclosed amount by Triathlon Ltd., a subsidiary of MacDonald, Dettwiler and Associates Ltd., related to use of confidential information and breach of fiduciary duty. No amount has been accrued at May 31, 2005 in respect of these claims because the potential liability for the claims and the amount of damages, if any, cannot be reasonably estimated. Management believe that the claims are without merit.

15 Income taxes

The Company is subject to income taxes in Canada and the United States and the use of estimates is required in determining the Company's provision for income taxes. Although the Company believes its tax estimates are reasonable, the ultimate tax determination involves significant judgement that could become subject to audit by tax authorities in the ordinary course of business. The effective rate used to record income tax expense for the three and six months ended May 31, 2005 differed

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from the Canadian federal and provincial combined statutory tax rate primarily due to the change in valuation allowance to reflect those future tax benefits that were more likely than not to be realized, future income tax payments that will result from the payment of Class B preference share dividends and, also, items not deductible for income tax purposes. The change in effective tax rate from 2004 to 2005 was due primarily to the effect of the change in valuation allowance.

At May 31, 2005, the Company adjusted its valuation allowance against deferred tax assets to reflect the amount of the future tax benefit that was more likely than not to be realized. A valuation allowance continues to be provided against those deferred tax assets for which there is uncertainty of future realization.

	For the three months ended		For the six months ended	
	May 31, 2005	May 31, 2004	May 31, 2005	May 31, 2004
	\$	\$	\$	\$
Deferred income tax expense (recovery)	143,189	(217,363)	(95,176)	(496,266)
Current income tax expense	82,756	147,994	82,756	380,786
Income tax expense (recovery)	<u>225,945</u>	<u>(69,369)</u>	<u>(12,420)</u>	<u>(115,480)</u>
Effective tax rate	(15%)	(22%)	(1%)	(14%)

16 Segmented information

The Company's reportable segments are as outlined below. Accounting policies used by these segments are the same as those described in the significant accounting policies as disclosed in note 2 of the Company's audited consolidated annual financial statements for the year ended November 30, 2004 prepared in accordance with U.S. GAAP. The Company defines reportable segments as components of the Company about which separate financial information is available and which is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance.

	Three Months Ended May 31, 2005			
	Navigation Systems	Applications	Geomatics	Total
	\$	\$	\$	\$
Revenue	956,378	19,412	905,895	1,881,685
Gross profit	105,823	17,446	247,082	370,351
Technology Partnerships Canada - net	(432,761)	-	-	(432,761)
Interest expense	8,596	-	91	8,687
Income tax expense (recovery)	118,934	-	107,011	225,945
Net earnings (loss)	(999,747)	(211,722)	(486,298)	(1,697,767)
Property, plant and equipment expenditures	64,969	-	12,986	77,955
Intangible expenditures	5,519	-	52,562	58,081
Depreciation and amortization	52,003	1,074	65,107	118,184

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	Six Months Ended May 31, 2005			
	Navigation Systems	Applications	Geomatics	Total
	\$	\$	\$	\$
Revenue	2,897,155	30,912	1,213,475	4,141,542
Gross profit	1,303,913	27,457	271,090	1,602,460
Technology Partnerships Canada - net	(643,587)	-	-	(643,587)
Interest expense	19,827	-	1,576	21,403
Income tax expense (recovery)	(95,176)	-	82,756	(12,420)
Net earnings (loss)	(810,017)	(384,548)	(722,793)	(1,917,358)
Property, plant and equipment expenditures	92,393	-	12,986	105,379
Intangible expenditures	15,867	1,213	54,584	71,664
Depreciation and amortization	104,896	2,149	95,809	202,854

	Three Months Ended May 31, 2004			
	Navigation Systems	Applications	Geomatics	Total
	\$	\$	\$	\$
Revenue	1,691,056	39,986	1,042,793	2,773,835
Gross profit	1,252,341	29,699	492,963	1,775,003
Technology Partnerships Canada - net	(782,654)	(61,180)	-	(843,834)
Interest expense	37	-	66	103
Income tax recovery	(69,369)	-	-	(69,369)
Net earnings (loss)	446,985	(214,047)	147,150	380,088
Property, plant and equipment expenditures	23,737	11,929	-	35,666
Intangible expenditures	10,269	-	155,824	166,093
Depreciation and amortization	55,811	538	27,453	83,802

	Six Months Ended May 31, 2004			
	Navigation Systems	Applications	Geomatics	Total
	\$	\$	\$	\$
Revenue	4,971,154	68,304	1,764,137	6,803,595
Gross profit	3,648,387	48,667	646,722	4,343,776
Technology Partnerships Canada - net	(733,728)	(61,180)	-	(794,908)
Interest expense	228	-	143	371
Income tax recovery	(115,480)	-	-	(115,480)
Net earnings (loss)	1,417,635	(525,346)	39,590	931,879
Property, plant and equipment expenditures	50,955	14,409	-	65,364
Intangible expenditures	20,062	-	158,969	179,031
Depreciation and amortization	110,614	615	50,620	161,849

Total assets employed	Navigation Systems	Applications	Geomatics	Total
	\$	\$	\$	\$
As at May 31, 2005	22,491,606	16,421	2,956,584	25,464,611
As at November 30, 2004	10,562,064	17,357	1,731,317	12,310,738

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Geographically, revenues reported are based on the location of the Company's customers.

	For the three months ended		For the six months ended	
	May 31, 2005	May 31, 2004	May 31, 2005	May 31, 2004
	\$	\$	\$	\$
Europe	293,678	415,953	1,920,679	2,480,974
Australia/New Zealand	477,049	1,019,610	788,936	1,967,873
United States	631,572	832,518	832,285	1,728,111
Canada	479,386	505,754	599,642	626,637
Total	<u>1,881,685</u>	<u>2,773,835</u>	<u>4,141,542</u>	<u>6,803,595</u>

Geographically, plant and equipment and intangible and other assets are reported based on location. At May 31, 2005 and November 30, 2004, all of the Company's plant and equipment and intangible and other assets were located in Canada and the U.S. as follows:

	Canada		United States	
	May 31, 2005	November 30, 2004	May 31, 2005	November 30, 2004
	\$	\$	\$	\$
Plant and equipment	932,741	938,102	57,212	-
Intangible and other assets	359,599	408,611	913,636	-
Total	<u>1,292,340</u>	<u>1,346,713</u>	<u>970,848</u>	<u>-</u>

17 Financial instruments

Fluctuations in foreign currency exchange rates

The Company enters into transactions denominated in U.S. dollars, Australian dollars and Euros and as such its revenue, expenses, monetary assets and liabilities will be affected by fluctuations in the various currencies relative to its functional currency, the Canadian dollar.

The Company uses foreign exchange forward contracts to hedge transactions denominated in U.S. dollars, Australian dollars and Euros. The purpose of the Company's hedging activities is to reduce the level of exposure to exchange rate movements. At May 31, 2005, the Company had foreign exchange forward contracts maturing in the following periods to sell Australian \$1,605,038 (May 31, 2004 – \$2,750,000). As at May 31, 2005, the Company had drawn on its foreign exchange contract facility in the amount of U.S. \$nil (2004 – U.S. \$818,398) and Australian \$1,605,038 (2004 – \$2,750,000). The exchange rates set in the forward exchange contracts ranged between 0.9486 to 0.9578 for Australian \$1.00. The contracts mature between June and July 2005.

18 Financial guarantees

The Company utilizes letters of credit to back certain performance obligations with its customers. The standby letters of credit are repayable on demand after certain conditions have been met. As of May 31, 2005, one letter of credit, relating principally to a customer contract, had been issued for Australian \$283,886 (November 30, 2004 – Australian \$283,886).

19 Reconciliation of generally accepted accounting principles

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

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

(b) Under Canadian GAAP, there is not a requirement to record the beneficial conversion feature and accretion of discount when preference shares are issued with attached warrants. For U.S. GAAP purposes, during the fiscal year 2003 and the three and six months ended May 31, 2005 the Company recorded beneficial conversion features of \$668,785 and \$4,796,649 on the issuance of Class B preference shares Series 1 and 2, respectively as a reduction to the net earnings available to common shareholders calculated on the effective conversion price of the preference shares to common shares based on the proceeds allocated to the preference shares. In both cases, the conversion feature of the preference shares vested immediately and the Company recorded the accretion of the full amount of the beneficial conversion feature. For both the Series 1 and Series 2 Class B preference shares, the discount on these shares that resulted from the allocation of the gross proceeds to the Class B preference shares and to the attached warrants is accreted over the five-year life of the warrants. This resulted in an accretion of \$503,175 and 536,614 to deficit for the three and six months ended May 31, 2005, respectively (\$33,439 and \$66,878 for the three and six months ended May 31, 2004, respectively).

(c) Under Canadian GAAP, there is a requirement for derivatives outside of hedging relationships to be recognized on the balance sheet at fair market value, however for derivatives in hedging relationships, Canadian GAAP does not specify how such derivatives should be recorded. As a result, under Canadian GAAP in some instances derivatives may not be recorded on the balance sheet. Under U.S. GAAP it is required that all derivatives be recorded as assets or liabilities, measured at fair value. Derivatives that are not hedges are adjusted to fair value through income. 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 recognized in other comprehensive income until the hedged item is recognized in income. The ineffective portion of a derivative's change in fair value is immediately recognized into income. With respect to the ineffective portion of derivative's changes in fair value, the Company has recorded a foreign exchange loss amount of \$7,748 for the three and six months ended May 31, 2005 under U.S. GAAP which has not been recorded under Canadian GAAP.

(d) Under Canadian GAAP, the Company was not required to record stock based compensation for options granted to third parties prior to December 1, 2001. Under U.S. GAAP, the Company is required to record stock based compensation for options granted to third parties based on the fair value method as required by SFAS 123 retroactive for all prior periods. As a result, these stock based compensation transactions, result in differences when compared to the same balances as previously reported under Canadian GAAP.

(e) For Canadian GAAP financial statement purposes, the Company's 30,262 (November 30, 2004 - 30,262) Class A preference shares have been presented at a nominal value. For U.S. GAAP financial statement purposes, these shares have been presented at a value of \$30,362.

(f) For Canadian GAAP financial statement purposes, the Company has recorded a cumulative translation adjustment of \$23,091 which is a separate component of shareholders' equity. For U.S. GAAP purposes changes in the cumulative translation adjustment are included as a component of accumulated other comprehensive income.

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(g) If Canadian GAAP were followed:

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

	For the three months ended		For the six months ended	
	May 31, 2005 \$	May 31, 2004 \$	May 31, 2005 \$	May 31, 2004 \$
Earnings (loss) for the period, U.S. GAAP	(1,697,767)	380,088	(1,917,358)	931,879
Adjustment for stock based compensation (a),(d)	(201,145)	(81,418)	(224,790)	(81,418)
Adjustment for loss on derivative (c)	7,748	-	7,748	-
Earnings (loss) for the period, Canadian GAAP	(1,891,164)	298,670	(2,134,400)	850,461
Basic earnings (loss) per common share, Canadian GAAP	(0.08)	0.01	(0.09)	0.03
Diluted earnings (loss) per common share, Canadian GAAP	(0.08)	0.01	(0.09)	0.03
Weighted average number of common shares - basic, Canadian GAAP	27,488,074	27,023,112	27,488,074	27,023,112
Weighted average number of common shares - diluted, Canadian GAAP	27,488,074	27,802,463	27,488,074	27,802,463

ii) Balance Sheet items which would differ under Canadian GAAP are as follows:

	May 31, 2005 \$	November 30, 2004 \$
Common shares (d)	19,026,125	19,026,125
Class A preference shares – Series A (e)	-	-
Class B preference shares – Series 1 (b)	-	1,926,157
Class B preference shares – Series 2 (b)	17,081,637	-
Warrants (b)	661,770	661,575
Additional paid in capital (a), (d)	454,943	214,492
Accumulated Deficit (a), (b), (c), (d)	(12,495,870)	(12,193,838)
Cumulative translation adjustment (f)	27,050	-

(h) Pro forma information – Stock based compensation

The following pro forma financial information as required by The Canadian Institute of Chartered Accountants (“CICA”) Handbook section 3870, Stock-Based Compensation and Other Stock – based Payments, presents the earnings had the Company recognized stock-based compensation using a fair value method for all stock awards granted, modified or settled prior to December 1, 2003:

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	For the three months ended		For the six months ended	
	May 31, 2005	May 31, 2004	May 31, 2005	May 31, 2004
	\$	\$	\$	\$
Earnings (loss) for the period, Canadian GAAP	(1,891,164)	298,670	(2,134,400)	850,461
Add: Stock-based compensation cost	214,282	114,424	240,451	114,424
Less: Pro forma stock-based compensation cost	(220,582)	(120,724)	(253,051)	(127,024)
Pro forma income (loss)	(1,897,464)	292,370	(2,147,000)	837,861
Pro forma basic earnings (loss) per share	(0.08)	0.01	(0.09)	0.03
Pro forma diluted earnings (loss) per share	(0.08)	0.01	(0.09)	0.03
Weighted average number of common shares – basic	27,488,074	27,023,112	27,488,074	27,023,112
Weighted average number of common shares – diluted	27,488,074	27,802,463	27,488,074	27,802,463

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

	3 Months Ended May 31,		6 Months Ended May 31,	
	2005	2004	2005	2004
Risk-free interest rate	2.85%	2.21%	2.85%	2.21%
Volatility	54%	58%	54%	58%
Estimated average option lives	4.06 years	3.00 years	4.06 years	3.00 years
Dividend yield	0.00%	0.00%	0.00%	0.00%

20 Other Information

The following presents the conversion of the Company's comparative financial information from Canadian GAAP to U.S. GAAP and presents a comparison for amounts which differ between Canadian GAAP and U.S. GAAP:

(a) Balance sheet at November 30, 2004:

	As previously reported under Canadian GAAP	As currently reported under U.S. GAAP
	\$	\$
Shareholders' Equity		
Capital stock		
Issued and outstanding		
30,262 Class A preference shares – Series A	-	30,262
57,711 Class B preference shares – Series I	1,926,157	2,163,621
27,488,074 common shares	19,026,125	20,047,731
	20,952,282	22,241,614
Additional Paid in Capital	214,492	928,169
Accumulated Deficit	(12,193,838)	(14,196,847)

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(b) Statement of Earnings and Accumulated Deficit for the three months and six months ended May 31, 2004

	As previously reported under Canadian GAAP		As currently reported under U.S. GAAP	
	For the three months ended May 31, 2004 \$	For the six months ended May 31, 2004 \$	For the three months ended May 31, 2004 \$	For the six months ended May 31, 2004 \$
Accumulated Deficit – Beginning of period	(11,583,655)	(12,043,580)	(13,619,622)	(14,046,108)
Class B preference share dividend paid	86,567	178,433	86,567	178,433
Class B preference share dividend accreted	-	-	33,439	66,878
Accumulated Deficit – End of period	(11,371,552)	(11,371,552)	(12,933,054)	(12,933,054)

21 Subsequent event

On July 11, 2005, the Company announced that it has signed a non-binding letter of intent to acquire a United States defence contracting company. The acquisition is expected to approximately double the Company's revenue and employee base. The target company, with multiple offices in the United States, is a supplier of technology and services to the U.S. Department of Defence and key defence prime contractors.