



# MANAGEMENT'S DISCUSSION AND ANALYSIS

for the three and six months ended May 31, 2011

**OSI Geospatial Inc.**

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## **OSI Geospatial Inc.**

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### **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion and analysis provides a review of activities, results of operations, and financial condition of OSI Geospatial Inc. for the three and six months ended May 31, 2011, in comparison with those for the three and six months ended May 31, 2010. References to "OSI Geospatial", "the Company", "we", "us", and "our" refer to OSI Geospatial Inc. and its subsidiaries, as applicable. The following discussion should be read in conjunction with our unaudited consolidated interim financial statements, including the notes thereto, for the three and six months ended May 31, 2011, and the audited annual consolidated financial statements for the year ended November 30, 2010, prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP"). The following discussion should also be read in conjunction with Management's Discussion and Analysis prepared for the year ended November 30, 2010.

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

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

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

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

This management's discussion and analysis is dated July 11, 2011.

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## OVERVIEW

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

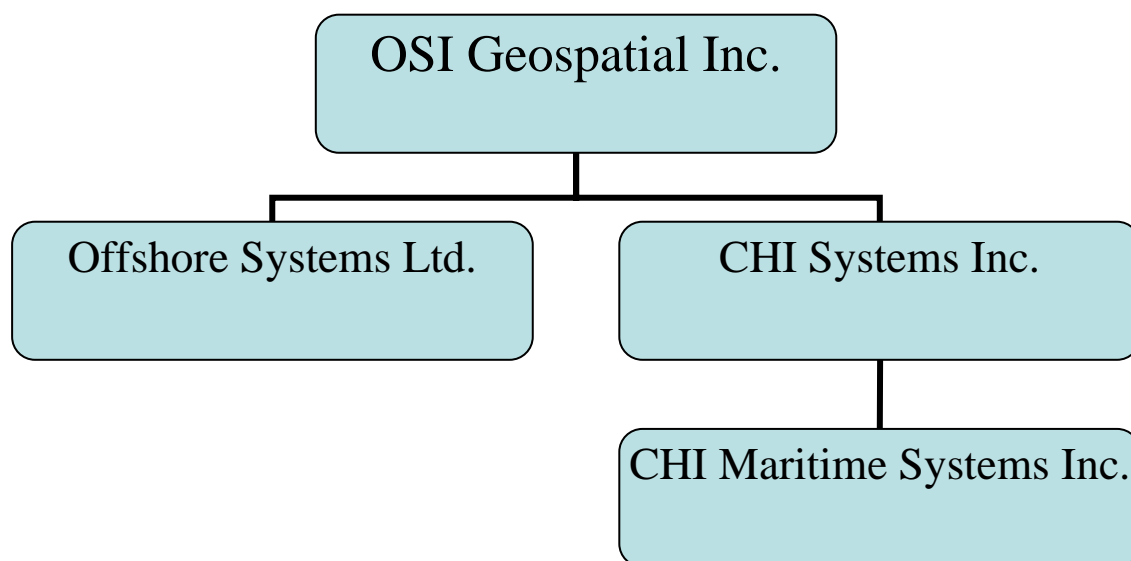
Headquartered in Burnaby, British Columbia, the Company is a globally-focused organization with offices across North America and a sales and support office in the United Kingdom. The Company became a public company in 1990, and is currently listed on the TSX Venture Exchange (symbol: OSI).

On January 31, 2011, the Company closed the sale of the Mapping division for a selling price of \$1,400,000 which included a working capital adjustment of \$250,000. As such, this division has been considered as an operation held for sale and presented as discontinued operations. Assets and liabilities have been reclassified as assets held for sale and liabilities related to assets held for sale; and revenues and expenses related have been reclassified from continuing operations to discontinued operations for all reporting years. The Mapping division included the operations of Mapcon Mapping Ltd. and Mapcon Mapping Inc.

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

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

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



Our mission is to provide integrated navigational and tactical solutions that enhance the operational capabilities, security, and safety for our customers. Our customers include the United States Navy, Army,

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Coast Guard, and Department of Homeland Security; the Canadian Navy and Coast Guard; the UK Royal Navy; and other NATO allies around the world. The Company is leveraging its world-leading technologies, such as ECPINS® and iGEN™, to grow its market share, expand its customer base, and enter into adjacent markets. We will also continue to partner with the world's largest defence and security contractors, such as Lockheed Martin, BAE Systems, Northrop Grumman, L-3 Communications, General Dynamics, and Raytheon. As we successfully integrate our technology into the solution provided by the large defence systems integrators, we will significantly increase our reach into the defence and security markets around the world.

Our Company delivers integrated navigational and tactical solutions that meet naval and maritime security operational requirements. These solutions include our Warship Electronic Chart Display and Information System (ECPINS®-W/S), Tactical Asset Control and Tracking System (TACTS), Integrated Navigation and Tactical System (INTS), and security risk assessment consulting services. In addition, the Company provides advanced technology research and development engineering services in support of the military and security requirements.

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

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### SELECTED DATA

The following tables contain financial information that is derived from the unaudited interim consolidated financial statements for the six months ended May 31, 2011 and 2010.

<b>Operations:</b>	<b>For the six months ended May 31,</b>	
	<b>2011</b>	<b>2010*</b>
In thousands of Canadian dollars, except per share related data		
	<b>\$</b>	<b>\$</b>
Revenue	6,698	6,082
Gross profit	3,382	2,271
Gross profit percentage	50%	37%
Net (loss) income from continuing operations	(72)	1,253
Net (loss) income from discontinued operations	(67)	79
Net (loss) income	(139)	1,332
Net (loss) income available to common shareholders	(259)	1,113
Basic and diluted earnings (loss) per share		
Continuing operations	-	\$0.02
Discontinued operations	-	-
Net income (loss)	-	\$0.02
Weighted average common shares outstanding		
Basic	53,033,446	50,183,685
Diluted	53,033,446	50,294,988
<u>Dividends declared per share</u>		
Class A Preference Shares – Series A	-	-
Class B Preference Shares – Series 2	-	\$0.04
Common Shares	-	-

*\*Prior year comparatives have been restated for discontinued operations.*

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

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

The increase in revenue for the six months ended May 31, 2011 as compared to the six months ended May 31, 2010 is largely due to the timing of new contracts that are awarded and the delivery schedules of existing contracts.

The higher gross profit in the six months ended May 31, 2011 as compared to the six months ended May 31, 2010 is due to the increase in revenue in International Systems operations; and the mix of revenue and the level of fixed costs included in cost of sales across all operating units.

The higher gross profit percentage in the six months ended May 31, 2011 as compared to the six months ended May 31, 2010 is the result of less revenue derived from projects that included third party systems and

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labour as well as large software only sales that carry little costs. Projects that included third party systems and labour have less favourable margins that those that do not.

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

The Company's sales strategy focuses on markets such a military command and control, homeland security, and maritime defence that to date experienced curtailments in budgets and delays in spending. These changes have impacted the Company's customers and, as a result, the Company experienced delays in the execution of current projects, awarding of new contracts and releasing of competitive requests for proposals, and reductions in the value of some sales opportunities which the Company has been pursuing.

<b>Financial Position:</b>	<b>At May 31, 2011</b>	<b>At November 30, 2010</b>
In thousands of Canadian dollars		
	\$	\$
Working capital <sup>(1)</sup>	3,347	4,096
Current assets	6,996	9,050
Long term assets	6,590	6,273
Total assets	13,586	15,323
Current liabilities	3,649	4,954
Long term liabilities	526	546
Total liabilities	4,175	5,500
Shareholders' equity	9,412	9,823

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

On February 1, 2010, the Company's U.S. Systems Operations signed a contract valued at USD \$6.5 million with Harris Corporation ("Harris"). Under the terms of this contract, the Company sold all of its rights to its soldier systems intellectual property and transferred its San Diego-based employees, office and associated equipment, furniture and fixtures to Harris. The net cash proceeds after corporate income taxes were approximately USD \$5.5 million. The net proceeds provided additional working capital for the Company.

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### RESULTS OF OPERATIONS – Three and six months ended May 31, 2011 as compared to three and six months ended May 31, 2010

#### Overall Performance

Three months ended	May 31, 2011	May 31, 2010	2011 to 2010
In thousands of Canadian dollars, except for share related data			
Net income (loss) before income taxes and discontinued operations	\$ 797	\$ (1,435)	\$ 2,232
Net income (loss)	\$ 1,145	\$ (750)	\$ 1,895
Net income (loss) attributable to common shareholders: Basic and diluted	\$ 1,092	\$ (838)	\$ 1,930
Net earnings (loss) per share: Basic and diluted	\$ 0.02	\$ (0.02)	\$ 0.04

Six months ended	May 31, 2011	May 31, 2010	2011 to 2010
In thousands of Canadian dollars, except for share related data			
Net income (loss) before income taxes and discontinued operations	\$ (456)	\$ 2,901	\$ (3,357)
Net income (loss)	\$ (139)	\$ 1,332	\$ (1,471)
Net income (loss) attributable to common shareholders: Basic and diluted	\$ (259)	\$ 1,113	\$ 1,372
Earnings (loss) per share: Basic and diluted	\$ -	\$ 0.02	\$ (0.02)

The higher net income for the three months ended May 31, 2011 was mainly due to large software only sales and a recovery of income tax. The lower net income reported for the six months ended May 31, 2011 was largely driven by gain on sale of intellectual property in the prior comparative period.

#### Backlog

Firm backlog consists of firm, fixed, or signed orders issued and executable subsequent to the balance sheet date. Firm backlog as at May 31, 2011, was \$30 million compared to \$28 million at November 30, 2010. Of the \$30 million firm backlog, \$3 million is expected to be executed in the remainder of fiscal 2011, and \$27 million is expected to be executed in fiscal year 2012 and beyond. The increase in backlog is as a result of new contracts awarded.

Firm backlog is a non-GAAP measure. This measure does not have a standardized meaning or comparable GAAP measure and is likely not comparable to similar measures presented by other companies and cannot be reconciled to any GAAP measurements. The Company discloses this non-GAAP measure as we believe it provides more insight into our performance, specifically regarding revenue available for periods subsequent to May 31, 2011.

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

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

### Revenue

Three months ended	May 31, 2011	% of total revenue	May 31, 2010	% of total revenue	2011 to 2010
In thousands of Canadian dollars					
<b>Maritime navigation and tactical solutions</b>	\$ 2,862	71%	\$ 1,092	40%	\$ 1,770
<b>Advanced technology research and development</b>	1,146	29%	1,660	60%	(514)
	<u>\$ 4,008</u>	<u>100%</u>	<u>\$ 2,752</u>	<u>100%</u>	<u>\$ 1,256</u>
Six months ended	May 31, 2011	% of total revenue	May 31, 2010	% of total revenue	2011 to 2010
In thousands of Canadian dollars					
<b>Maritime navigation and tactical solutions</b>	\$ 4,062	61%	\$ 2,498	41%	\$ 1,564
<b>Advanced technology research and development</b>	2,636	39%	3,584	59%	(948)
	<u>\$ 6,698</u>	<u>100%</u>	<u>\$ 6,082</u>	<u>100%</u>	<u>\$ 616</u>

Our core revenue stream is derived from two sources: maritime navigation and tactical solutions, and advanced technology research and development. In maritime navigation and tactical solutions, our principal-developed product line, ECPINS®, delivers the majority of the maritime navigation and tactical solutions revenue. We also derive revenue from the delivery of the ECPINS® software component of our system product.

Maritime navigation and tactical solutions delivered 71% and 40% of the revenue for the three months ending May 31, 2011, and 2010 respectively. Our advanced technology research and development through our U.S. Systems operations delivered 29% and 60% of the revenue for the three months ending May 31, 2011, and 2010 respectively.

While Maritime navigation and tactical solutions delivered 61% and 41% of the revenue for the six months ending May 31, 2011, and 2010 respectively. Our advanced technology research and development through our U.S. Systems operations delivered 39% and 59% of the revenue for the six months ending May 31, 2011, and 2010 respectively.

Our results are primarily affected by the level, timing, and duration of customer orders and customer product delivery requirements. The main customers for the quarter ended May 31, 2011, were the Royal Navy of the United Kingdom, the Royal Navy of New Zealand, the Royal Navy of Australia, the Office of Naval Research and the U.S. Army Research, Development and Engineering Command (RDECOM). Revenue from these

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customers accounted for 67% of the consolidated revenue. The main customers for the quarter ended May 31, 2010, were the Ontario Ministry of Natural Resources, the U.S. Army, and the U.S. Defence Advanced Research Projects Agency (DARPA). Revenue from these customers accounted for 46% of the consolidated revenue.

### Revenue by Segment

Three months ended	May 31, 2011	% of total revenue	May 31, 2010	% of total revenue	2011 to 2010
In thousands of Canadian dollars					
International Systems operations	\$ 2,770	69%	\$ 851	31%	\$ 1,919
U.S. Systems operations	1,238	31%	1,901	69%	(663)
	<u>\$ 4,008</u>	<u>100%</u>	<u>\$ 2,752</u>	<u>100%</u>	<u>\$ 1,256</u>

Six months ended	May 31, 2011	% of total revenue	May 31, 2010	% of total revenue	2011 to 2010
In thousands of Canadian dollars					
International Systems operations	\$ 3,866	58%	\$ 2,064	34%	\$ 1,802
U.S. Systems operations	2,832	42%	4,018	66%	(1,186)
	<u>\$ 6,698</u>	<u>100%</u>	<u>\$ 6,082</u>	<u>100%</u>	<u>\$ 616</u>

Revenue from the International Systems operations for the three and six months ended May 31, 2011 increased 225% and 87%, respectively, when compared to the same periods in the prior year due to the timing of new contracts awarded and the delivery schedules of existing contracts.

Revenue from the U.S. Systems operations for the three and six months ended May 31, 2011 decreased over the same periods from the prior year by 34% and 30%, respectively. The decrease is mainly due to a decrease of new contracts awarded and the delivery schedules of existing contracts.

### Gross Profit

Three months ended	May 31, 2011	May 31, 2010	2011 to 2010
In thousands of Canadian dollars			
Gross profit	\$ 2,483	\$ 1,078	\$ 1,405
Gross profit percentage	62%	39%	23%

Six months ended	May 31, 2011	May 31, 2010	2011 to 2010
In thousands of Canadian dollars			
Gross profit	\$ 3,382	\$ 2,271	\$ 1,111
Gross profit percentage	50%	37%	13%

Gross profit increased by 130% in the three months ended May 31, 2011 compared to the three months ended May 31, 2010 and the gross profit percentage is higher by 23% period-over-period. The primary reason was large software only sales that carry little cost.

Gross profit also increased by 49% in the six months ended May 31, 2011 compared to the six months ended May 31, 2010 and the gross profit percentage increased 13% period-over-period.

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The increased gross profit for the three and six months ended May 31, 2011 compared to prior year's periods is mainly due to increased revenue earned during the current period.

The increase in gross profit percentage for the three and six months ended May 31, 2011 compared to the prior year's periods is the result large software sales that have very little costs and as a result of less revenue derived from projects that included third party system and labour. Projects that include third party systems and labour have less favourable margins than those that do not.

### Gross Profit by Segment

Three months ended	May 31, 2011	May 31, 2010	2011 to 2010
In thousands of Canadian dollars			
<b>Gross profit:</b>			
International Systems operations	\$ 2,191	\$ 418	\$ 1,773
U.S. Systems operations	292	660	(368)
Consolidated operations	<u>\$ 2,483</u>	<u>\$ 1,078</u>	<u>\$ 1,405</u>
<b>Gross profit percentage:</b>			
International Systems operations	55%	15%	40%
U.S. Systems operations	7%	24%	(17%)
Consolidated operations	<u>62%</u>	<u>39%</u>	<u>23%</u>

Six months ended	May 31, 2011	May 31, 2010	2011 to 2010
In thousands of Canadian dollars			
<b>Gross profit:</b>			
International Systems operations	\$ 2,726	\$ 1,063	\$ 1,663
U.S. Systems operations	656	1,208	(552)
Consolidated operations	<u>\$ 3,382</u>	<u>\$ 2,271</u>	<u>\$ 1,111</u>
<b>Gross profit percentage:</b>			
International Systems operations	40%	17%	23%
U.S. Systems operations	10%	20%	(10%)
Consolidated operations	<u>50%</u>	<u>37%</u>	<u>13%</u>

Gross profit from the International Systems operations increased 424% and 156% for the three and six months ended May 31, 2011, respectively; and gross profit percentages were 40% and 23% higher for the three and six months ended May 31, 2011. The increases in gross profit are the results of higher revenues, particularly from higher margin software sales, in the International Systems operations.

Gross profit from the U.S. Systems operations decreased 56% and 46% for the three and six months ended May 31, 2011, respectively. Gross profit percentages were 17% and 10% lower for the three and six months ended May 31, 2011, respectively, when compared to the same periods in the prior year. The decrease in gross profit for the three and six months ended May 31, 2011 when compared to the same periods last year was primarily the result of decrease in current period's revenue as a result of US Defense budget delays and cuts.

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### Operating Expenses

	May 31, 2011	% of total revenue	May 31, 2010	% of total revenue	2011 to 2010
<b>Three months ended</b>					
In thousands of Canadian dollars					
<b>General and administrative</b>	\$ 886	22%	\$ 1,776	65%	\$ (890)
<b>Sales and marketing</b>	382	10%	559	20%	(177)
<b>Engineering</b>	214	5%	25	1%	189
<b>Six months ended</b>					
In thousands of Canadian dollars					
<b>General and administrative</b>	\$ 1,768	26%	\$ 2,915	48%	\$ (1,147)
<b>Sales and marketing</b>	727	11%	1,152	19%	(425)
<b>Engineering</b>	488	7%	201	3%	287

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

G&A decrease 50% and 39% for the three and six months ended May 31, 2011, respectively, compared to the previous year's periods. The lower G&A cost in the second quarter of 2011 is largely due to lower wages as the result of reduction in staff levels and lower professional fees.

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

S&M expenses decreased by 32% and 37% for three and six months ended May 31, 2011 compared to the three and six months ended May 31, 2010. The decrease is primarily due to staff reduction and a reduction in discretionary spending. We believe our current level of S&M staff continues to allow us to pursue business development activities relating to our expansion efforts targeting new and existing customers in the military agencies of Canada, the U.S., European NATO, and other allies of Canada, and national and international commercial marine transportation companies. To increase our profile and our products, and to broaden our customer base in international markets, we have established marketing agreements with companies local to the targeted regions. Some of these activities will not result in closing orders during the current year but may yield orders in subsequent fiscal years.

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

Engineering costs increased 756% and 143% for the three and six months ended May 31, 2011, compared to the three and six months ended May 31, 2010. The Company believes that in order to maintain our technological leadership, we must continue to develop existing products and introduce innovative new products that challenge and redefine the industry standards.

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**Amortization**

<b>Three months ended</b>	<b>May 31, 2011</b>	<b>May 31, 2010</b>	<b>2011 to 2010</b>
<b>In thousands of Canadian dollars</b>			
<b>Amortization</b>	<b>\$ 75</b>	<b>\$ 75</b>	<b>\$ -</b>

<b>Six months ended</b>	<b>May 31, 2011</b>	<b>May 31, 2010</b>	<b>2011 to 2010</b>
<b>In thousands of Canadian dollars</b>			
<b>Amortization</b>	<b>\$ 152</b>	<b>\$ 154</b>	<b>\$ (2)</b>

Total amortization remained relatively consistent for three and six months ended May 31, 2011 as compared to the same periods in the prior year.

**Interest expense**

<b>Three months ended</b>	<b>May 31, 2011</b>	<b>May 31, 2010</b>	<b>2011 to 2010</b>
<b>In thousands of Canadian dollars</b>			
<b>Interest expense (income)</b>	<b>\$ (22)</b>	<b>\$ 5</b>	<b>\$ (27)</b>

<b>Six months ended</b>	<b>May 31, 2011</b>	<b>May 31, 2010</b>	<b>2011 to 2010</b>
<b>In thousands of Canadian dollars</b>			
<b>Interest expense (income)</b>	<b>\$ (12)</b>	<b>\$ 43</b>	<b>\$ (55)</b>

Interest expense decreased by \$27,000 and \$55,000 in the three and six months ended May 31, 2011 as compared to the three and six months ended May 31, 2010, respectively.

**Foreign exchange**

<b>Three months ended</b>	<b>May 31, 2011</b>	<b>May 31, 2010</b>	<b>2011 to 2010</b>
<b>In thousands of Canadian dollars</b>			
<b>Foreign exchange loss (gain)</b>	<b>\$ (2)</b>	<b>\$ 30</b>	<b>\$ (32)</b>

<b>Six months ended</b>	<b>May 31, 2011</b>	<b>May 31, 2010</b>	<b>2011 to 2010</b>
<b>In thousands of Canadian dollars</b>			
<b>Foreign exchange loss</b>	<b>\$ 16</b>	<b>\$ 20</b>	<b>\$ (4)</b>

The Company's Canadian subsidiaries, whose functional currency is the Canadian dollar, are exposed to foreign exchange gain and loss due to exchange rate movements of the U.S. dollar, the Australian dollar, the UK pound and the Euro. These fluctuations were in the Company's favour for the three and six months ended May 31, 2011 as compared to the three and six months ended May 31, 2010, respectively. The Company minimized the exposure to foreign exchange fluctuations through the use of foreign exchange forward contracts.

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**Technology Partnerships Canada royalty**

Three months ended	May 31, 2011	May 31, 2010	2011 to 2010
In thousands of Canadian dollars			
<b>Royalty</b>	<b>\$ 153</b>	<b>\$ 43</b>	<b>\$ 110</b>
Six months ended	May 31, 2011	May 31, 2010	2011 to 2010
In thousands of Canadian dollars			
<b>Royalty</b>	<b>\$ 213</b>	<b>\$ 112</b>	<b>\$ 101</b>

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

The Company is required to pay a royalty of 2.5% on annual gross revenue in Offshore Systems Ltd. for the period January 1, 2009 to December 31, 2013. If the total royalties paid and payable as at December 31, 2013 does not equal or exceed \$6.1 million, the Company will continue to pay royalties on gross revenue generated after December 31, 2013 until total cumulative royalties paid or payable reach \$6.1 million or until December 31, 2017, whichever comes first. The Company commenced payment of these royalties effective February 2007.

In addition, the Company is required to pay a royalty of 3% on annual gross revenue of its subsidiary, Offshore Systems Ltd., until total cumulative royalties paid or payable reach \$7.8 million or until November 30, 2014, whichever comes first. The Company commenced payment of these royalties effective June 2001.

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

**Gain on sale of intellectual property**

Three months ended	May 31, 2011	May 31, 2010	2011 to 2010
In thousands of Canadian dollars			
<b>Gain on sale of intellectual property</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>
Six months ended	May 31, 2011	May 31, 2010	2011 to 2010
In thousands of Canadian dollars			
<b>Gain on sale of intellectual property</b>	<b>\$ -</b>	<b>\$ 5,227</b>	<b>\$ (5,227)</b>

On February 1, 2010, the Company's U.S. Systems Operations signed a contract valued at U.S. \$6.5 million with Harris Corporation ("Harris"). Under the terms of this contract, OSI Geospatial sold all of its rights to its soldier systems intellectual property and transferred its San Diego-based employees, office and associated equipment, furniture and fixtures to Harris. This intellectual property is a non-core asset that is not aligned with the Company's maritime strategy. The net proceeds after corporate income taxes were approximately U.S. \$5.5 million.

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### Restructuring costs and other items

Three months ended	May 31, 2011	May 31, 2010	2011 to 2010
In thousands of Canadian dollars			
Restructuring costs	\$ -	\$ -	\$ -
Loss on lease termination	-	-	-
Loss on disposal of furniture and fixtures	-	-	-
Six months ended	May 31, 2011	May 31, 2010	2011 to 2010
In thousands of Canadian dollars			
Restructuring costs	\$ 410	\$ -	\$ 410
Loss on lease termination	56	-	56
Loss on disposal of furniture and fixtures	20	-	20

During the first quarter of 2011, the Chief Executive Officer resigned. The contractual severance obligation was \$450,000 though this was negotiated down to \$410,000. See subsequent event commentary on page 18 for further information.

In addition, the finance and administrative functions were relocated from Ottawa to Vancouver and the Ottawa office was closed and the lease was terminated. The lease termination costs related to the shutdown amounted to \$56,000. In conjunction with the lease termination, the Company also disposed of furniture and fixtures with a net book value of approximately \$20,000.

### Income taxes

Three months ended	May 31, 2011	May 31, 2010	2011 to 2010
In thousands of Canadian dollars			
Future income tax expense (recovery)	\$ (380)	\$ 101	\$ (481)
Current income tax expense (recovery)	32	(412)	444
	<u>(348)</u>	<u>(311)</u>	<u>(37)</u>
Six months ended	May 31, 2011	May 31, 2010	2011 to 2010
In thousands of Canadian dollars			
Future income tax expense (recovery)	\$ (371)	\$ 989	\$ (1,360)
Current income tax expense (recovery)	(13)	659	(672)
	<u>(384)</u>	<u>1,648</u>	<u>(2,032)</u>

Based on the information available at the time of the issue of the interim financial statements for the three and six months ended May 31, 2011, we estimated that we would not have sufficient taxable earnings in Canada in future periods to utilize a portion of our \$4.8 million Canadian non-capital losses carried forward, \$13.2 million scientific research and experimental development costs, and other Canadian tax balances.

We have recognized a future tax expense for the three and six months ended May 31, 2011, related to temporary timing differences between accounting income and income for tax purposes in our U.S. subsidiaries. The future tax expense is mainly a result of reversal of future tax assets recognized in prior period for timing differences as these differences were utilized in the current quarter resulting from the sale of intellectual property. At May 31, 2011, we have current future tax asset of \$nil and non-current future tax asset of \$582,000 as we believe that it is more likely than not that these differences will be realized in future

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fiscal years. In accordance with Canadian GAAP, we have provided a valuation allowance against future tax assets where realization did not meet the requirements of "more likely than not" under the liability method of tax allocation. We continue to evaluate our taxable position quarterly and consider factors such as estimated taxable income, the history of losses for tax purposes, and the growth of the Company, among others.

### RESULTS OF DISCONTINUED OPERATIONS (Mapping Operations) – Three and six months ended May 31, 2011 and 2010

In thousands of Canadian dollars	Six months ended May 31,	
	2011	2010
Sales	\$ 344	\$ 2,472
Gross profit (loss)	101	541
Net loss from discontinued operations	(67)	79
Basic and diluted net loss from discontinued operations per share	-	-

In thousands of Canadian dollars	Three months ended May 31,	
	2011	2010
Sales	\$ -	\$ 2,359
Gross profit (loss)	-	628
Net loss from discontinued operations	-	374
Basic and diluted net loss from discontinued operations per share	-	(0.01)

On January 31, 2011, the Company closed the sale of its Mapping business unit for a selling price of \$1,400,000, which included a working capital adjustment of \$250,000. As such, this business unit has been considered as an operation held-for-sale and presented as discontinued operations in these financial statements. Assets and liabilities have been reclassified as assets held-for-sale and liabilities related to assets held-for-sale; and revenues and expenses related have been reclassified from continuing operations to discontinued operations for all reporting years.

### LIQUIDITY AND CAPITAL RESOURCES - May 31, 2011 compared to November 30, 2010

In thousands of Canadian dollars	May 31, 2011	November 30, 2010	2011 to 2010
<b>Current assets</b>	\$ 6,996	\$ 9,050	\$ (2,054)
<b>Current liabilities</b>	3,649	4,954	(1,305)
<b>Working capital<sup>(1)</sup></b>	3,347	4,096	(749)

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

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

At May 31, 2011, our current assets decreased primarily due to the sale of current assets held for sale,

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offset by an increase in cash. Our working capital has decreased mainly due to the decrease in assets held for sale, offset by the decrease in liabilities held for sale. Cash increased as a result of the sale of the Mapping operations.

We have credit facilities consisting of accounts receivable factoring arrangements and forward exchange contract facilities. The credit facilities permit us to borrow funds directly for general corporate purposes. We have an accounts receivable factoring facility with a Canadian financial institution with a maximum limit of \$2 million and a variable limit with a U.S. financial institution that is based on the outstanding accounts receivable of the U.S. operations. At May 31, 2011, we had \$nil borrowings against our Canadian accounts receivable factoring facility and \$nil borrowings against our U.S. accounts receivable factoring facility. We utilize our forward exchange contract facility to reduce our exposure to exchange rate fluctuations.

The Company declared semi-annual dividends to the Class B, Series 2 preference shareholders as follows:

<b>Date declared</b>	<b>Period covered</b>	<b>Dividends per share</b>
July 2009	December 2008 – May 2009	\$ 0.0175
January 2010	June 2009 – November 2009	0.0175
May 2010	December 2009 – May 2010	0.0175
February 2011	June 2010 – November 2010	0.0175

The partial dividends were paid in accordance with the Company's Articles of Incorporation and to preserve our financial resources in light of the current market conditions.

### Cash Flows

<b>Three months ended</b>	<b>May 31, 2011</b>	<b>May 31, 2010</b>	<b>2011 to 2010</b>
In thousands of Canadian dollars			

#### Cash flows provided by (used in):

<b>Operating activities</b>	\$ 1,596	\$ (847)	\$ 2,443
<b>Investing activities</b>	(277)	(189)	(88)
<b>Financing activities</b>	72	(92)	164
<b>Effect of foreign exchange on cash</b>	106	(7)	113

<b>Six months ended</b>	<b>May 31, 2011</b>	<b>May 31, 2010</b>	<b>2011 to 2010</b>
In thousands of Canadian dollars			

#### Cash flows provided by (used in):

<b>Operating activities</b>	\$ 1,071	\$ (2,336)	\$ 3,407
<b>Investing activities</b>	1,365	4,575	(3,210)
<b>Financing activities</b>	(265)	(879)	614
<b>Effect of foreign exchange on cash</b>	38	35	3

Cash flows used in operating activities for the three and six months ended May 31, 2011 were the result of net earnings for the period, increase in accounts receivable, increase in unearned revenue and decrease in accounts payable and accrued liabilities.

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Cash flows used in investing activities for the three months ended May 31, 2011 were primarily reflective of the acquisitions of equipment, furnishings and intangibles.

Cash flows provided by investing activities for the six months ended May 31, 2011 were primarily due to the sale of the Mapping operations.

Cash flows used in financing activities for the three and six months ended May 31, 2011 were primarily the result of changes in the credit facilities.

In order to reduce the impact of exchange rate fluctuations, we use the forward exchange contract facility to mitigate any foreign exchange gain or loss that might occur. We use the forward exchange contract facility only for known or reasonably certain future foreign currency transactions. At May 31, 2011, we had entered into forward exchange contracts in the amount of £nil.

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

## **Guarantees**

The Company has entered into a guarantee agreement for one of the Company's subsidiaries, CHI Systems Inc. ("CHI"). The Company has guaranteed CHI's accounts receivable factoring facility with a U.S. financial institution. At May 31, 2011, the carrying amount of CHI's factored advances payable was USD \$nil.

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

## **Contingency**

In January 2010, a claim for breach of contract and wrongful dismissal was filed against the Company by a former employee of the Company. The Company believes the claim is without merit and the Company has filed a counterclaim for breach of fiduciary obligations as an officer of the Company and contractual obligations under the former employee's Employment Agreement. The final outcome with respect to this claim and counterclaim cannot be predicted with certainty and no amount has been accrued in the financial statements.

## **Subsequent events**

On June 6, 2011, the Board of Directors reinstated the services of the former President and Chief Executive Officer. Under the terms of the management agreement, any unpaid severance at the time of reinstatement is forfeited. As a result, the Company will reverse \$225,000 of unpaid severance in its third quarter of 2011 financial statements.

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**SELECTED QUARTERLY DATA (UNAUDITED)**

The table below represents financial data of the Company for each of the previous eight fiscal quarters.

In thousands of Canadian dollars

For the three months ended	May 31, 2011	February 28, 2011	November 30, 2010	August 31, 2010
Revenue	\$ 4,008	\$ 2,690	\$ 4,587	\$ 2,831
Gross profit	2,483	899	2,083	666
Gross profit percentage	62%	33%	45%	24%
Net income (loss) from continuing operations	1,145	(1,217)	(480)	(883)
Net (loss) from discontinued operations	-	(67)	(24)	(126)
Net income (loss)	1,145	(1,284)	(504)	(1,009)
Net income (loss) available to common shareholders				
Basic	1,092	(1,351)	(571)	(1,082)
Diluted	1,092	(1,351)	(571)	(1,082)
Earnings (loss) per share – basic and diluted				
Continuing operations	0.02	(0.02)	(0.01)	(0.02)
Discontinued operations	-	-	-	-
Net earnings (loss)	0.02	(0.02)	(0.01)	(0.02)
For the three months ended	May 31, 2010	February 28, 2010	November 30, 2009	August 31, 2009
Revenue	\$ 2,752	\$ 3,330	\$ 3,992	\$ 4,893
Gross profit	1,078	1,193	1,083	1,823
Gross profit percentage	39%	36%	27%	37%
Net income (loss) from continuing operations	(1,124)	2,377	(5,293)	(545)
Net income (loss) from discontinued operations	374	(295)	(420)	282
Net income (loss)	(750)	2,082	(5,713)	(263)
Net income (loss) available to common shareholders				
Basic	(838)	1,951	(5,860)	(410)
Diluted	(838)	2,082	(5,860)	(410)
Earnings (loss) per share – basic and diluted				
Continuing operations	(0.02)	0.05	(0.11)	(0.01)
Discontinued operations	-	-	(0.01)	-
Net earnings (loss)	(0.02)	0.05	(0.12)	(0.01)

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### **CRITICAL ACCOUNTING POLICIES**

These items are substantially unchanged as discussed in the Company's MD&A for the year ended November 30, 2010, as contained in our 2010 Annual Report filed on SEDAR at [www.sedar.com](http://www.sedar.com).

#### **International Financial Reporting Standards**

The Canadian Accounting Standards Board has confirmed that the use of International Financial Reporting Standards ("IFRS") will be required commencing 2011 for publicly-accountable, profit-oriented enterprises. IFRS will be replacing current Canadian GAAP followed by the Company. The Company will be required to prepare its interim and annual consolidated financial statements in accordance with IFRS for the periods beginning on or after December 1, 2011, and will be required to provide information that conforms to IFRS for the comparative periods presented.

The Company commenced the process to transition from current Canadian GAAP to IFRS in 2009. We have engaged third-party consultants to assist us in this process. Progress reports are provided to the audit committee on the status of the IFRS implementation project on a quarterly basis.

A preliminary diagnostic review and preliminary assessment of accounting impact was completed by the third-party consultants. The diagnostic review and preliminary assessment included the determination, at a high level, of the financial reporting differences under IFRS and the key areas that may be impacted. The major areas of focus identified by the assessment include first year implementation decisions, impairment, share-based payments, government assistance, and financial statement presentation and disclosure. The final impact of the conversion on the Company's financial statements cannot be reasonably determined at this time.

The Company will continue to monitor results from the existing conversion plan, as well as ongoing changes to IFRS, and adjust its transition and implementation plans accordingly.

### **FINANCIAL INSTRUMENTS AND OTHER INSTRUMENTS**

#### **Foreign Exchange Forward Contracts**

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

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

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

At May 31, 2011, the Company we had no foreign exchange forward contracts.

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### **DISCLOSURE OF OUTSTANDING SHARE DATA**

As at May 31, 2011, we had 53,386,729 issued and outstanding common shares and 2,795,000 outstanding stock options. As at May 31, 2011, we also had 30,262 issued and outstanding Class A preference shares and 70,490 issued and outstanding Class B preference shares series 2 convertible into common shares at conversion ratios of 1:1 and 1:58.82353, respectively, which represents 4,176,733 common shares.

### **DISCLOSURE CONTROLS AND PROCEDURES**

Management, including the Chief Executive Officer and the Chief Financial Officer, is responsible for establishing and maintaining disclosure controls and procedures as defined in National Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings*. As such, the Company maintains a set of disclosure controls and procedures designed to ensure that information required to be disclosed in filings is recorded, processed, summarized and reporting within the time specified in the Canadian Securities Administrators rules and forms.

Disclosure controls and procedures provide only a reasonable level of assurance that they are effective. Accordingly, they may not detect that all disclosure requirements have not been met. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

### **INTERNAL CONTROLS OVER FINANCIAL REPORTING**

Management, including the Chief Executive Officer and the Chief Financial Officer, is responsible for establishing and maintaining internal control over financial reporting as defined in National Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings*. Management, as at the end of the period covered by this interim filing, designed internal control over financial reporting to provide reasonable, but not absolute, assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP. The control framework management used to design the issuer's internal control over financial reporting is that established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the design of internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

### **CHANGES IN INTERNAL CONTROLS OVER FINANCIAL REPORTING**

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

### **RISKS AND UNCERTAINTIES**

The primary risks and uncertainties that affect and may affect us and our business, financial condition and results of operations are substantially unchanged as discussed in the Company's MD&A for the year ended November 30, 2010, as contained in our 2010 Annual Report filed on SEDAR at [www.sedar.com](http://www.sedar.com).