



# Financial Report FY2010 Second Quarter

ended May 31, 2010

**OSI Geospatial Inc.**  
300-340 March Road  
Ottawa, ON K2K 2E4  
Tel: 613.287.0462  
Fax: 613.287.0466  
[www.osigeospatial.com](http://www.osigeospatial.com)



# MANAGEMENT'S DISCUSSION AND ANALYSIS

for the three and six months ended May 31, 2010

**OSI Geospatial Inc.**  
300-340 March Road  
Ottawa, ON K2K 2E4  
Tel: 613.287.0462  
Fax: 613.287.0466  
[www.osigeospatial.com](http://www.osigeospatial.com)

## **OSI Geospatial Inc.**

Management's Discussion and Analysis  
For the three and six months ended May 31, 2010 and 2009  
(expressed in Canadian dollars)

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

The following discussion and analysis provides a review of activities, results of operations, and financial condition of OSI Geospatial Inc. for the three and six months ended May 31, 2010 in comparison with those for the three and six months ended May 31, 2009. 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, 2010, and the audited annual consolidated financial statements for the year ended November 30, 2009 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, 2009.

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, 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 the 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 8, 2010.

© 2010 OSI Geospatial Inc. and its affiliated or related companies.

## OSI Geospatial Inc.

Management's Discussion and Analysis  
For the three and six months ended May 31, 2010 and 2009  
(expressed in Canadian dollars)

### OVERVIEW

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

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

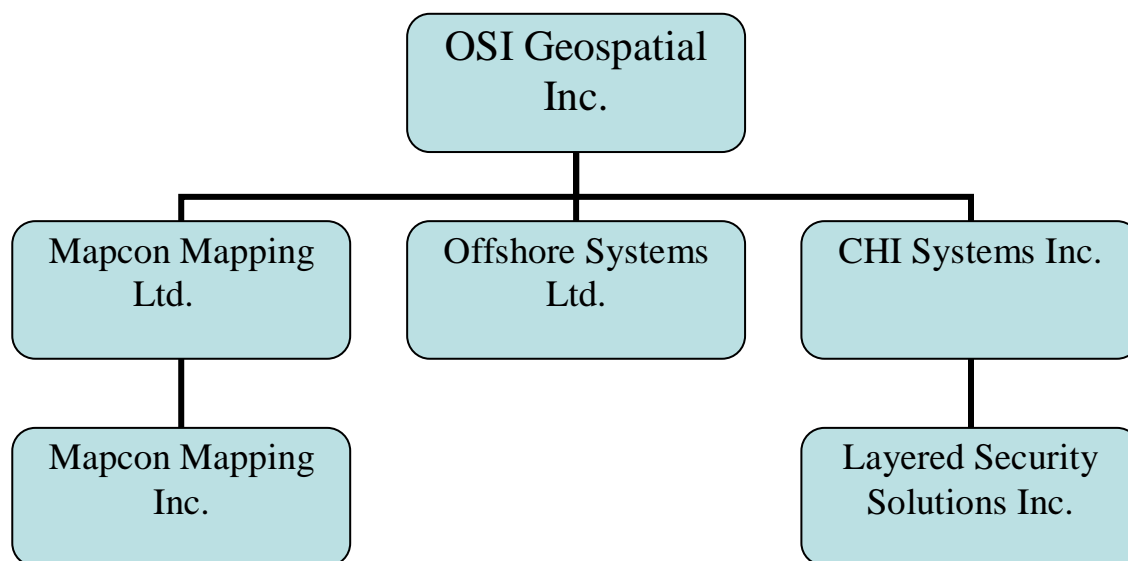
In April 2005, the Company completed the acquisition of all the outstanding shares of Mapcon Mapping Consultants Inc. ("Mapcon") of Salt Lake City, Utah. Mapcon is a land mapping company in the U.S. geospatial mapping market.

In December 2005, the Company completed the acquisition of CHI Systems Inc. ("CHI"), a United States defence contractor. CHI has four offices in the United States, is a supplier of technology and services to the U.S. Department of Defense and key defence prime contractors. With the sale of the Company's rights to its soldier systems intellectual property in February 2010, its San Diego office was transferred to the buyer, Harris Corporation.

CHI has developed C2, training simulation and cognitive agent applications to support its customers in multiple U.S. military agencies.

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

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



Our mission is to provide our customers in the military and security markets with quality geospatial products and services that will enhance operational performance and security through real-time situational awareness.

## OSI Geospatial Inc.

Management's Discussion and Analysis  
For the three and six months ended May 31, 2010 and 2009  
(expressed in Canadian dollars)

Our clients include the United States Navy, Army, Coast Guard, and Department of Homeland Security, the Canadian Navy and Coast Guard, the UK Royal Navy and other NATO allies around the world. The Company is leveraging our world leading technologies, such as ECPINS® and iGEN™ to grow our market share, expand our 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, L-3 Communications, General Dynamics and Raytheon. As we successfully integrate our technology into the solutions provided by the large defence systems integrators, we expect to 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 (T-ACT), 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 and mapping services that provide geospatial data production and consulting services.

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

## SELECTED DATA

The following tables contain financial information that is derived from the unaudited interim consolidated financial statements for the six months ended May 31, 2010 and 2009.

<b>Operations:</b>	<b>For the six months ended May 31,</b>	
In thousands of Canadian dollars except share related data	<b>2010</b>	<b>2009</b>
	<b>\$</b>	<b>\$</b>
Revenue	8,555	12,039
Gross profit	2,812	3,653
Gross profit percentage	33%	30%
Net income (loss)	1,332	(1,735)
Net income (loss) attributable to common shareholders:		
Basic and diluted	1,113	(2,045)
Earnings (loss) per share:		
Basic and diluted	0.02	(0.04)
Weighted average common shares outstanding:		
Basic	50,183,685	46,983,911
Diluted	50,294,988	46,983,911
<u>Dividends declared per share</u>		
Class A Preference Shares – Series A	–	–
Class B Preference Shares – Series 2	\$0.04	\$0.02
Common Shares	–	–

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

## OSI Geospatial Inc.

Management's Discussion and Analysis  
For the three and six months ended May 31, 2010 and 2009  
(expressed in Canadian dollars)

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 decrease in revenue for the six months ended May 31, 2010 as compared to the six months ended May 31, 2009 is largely due to the timing of new contracts that are awarded and the delivery schedules of existing contracts.

The lower gross profit in the six months ended May 31, 2010 as compared to the six months ended May 31, 2009 is due to the decrease in revenue in International Systems operations and U.S. 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, 2010 as compared to the six months ended May 31, 2009 is the result of less revenue derived from projects that included third party systems and labour. Projects that included third party systems and labour have less favourable margins than 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 as military command and control, homeland security, and maritime defence that do 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 values of some sales opportunities which the Company has been pursuing.

<b>Financial Position:</b>	<b>At May 31, 2010</b>	<b>At November 30, 2009</b>
In thousands of Canadian dollars		
	\$	\$
Working capital <sup>(1)</sup>	4,875	3,446
Current assets	9,745	8,750
Long term assets	6,995	7,009
Total assets	16,740	15,759
Current liabilities	4,870	5,304
Long term liabilities	477	492
Total liabilities	5,347	5,796
Shareholders' equity	11,393	9,963

(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 U.S. \$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. 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. The net proceeds provided additional working capital for the Company.

## OSI Geospatial Inc.

Management's Discussion and Analysis  
For the three and six months ended May 31, 2010 and 2009  
(expressed in Canadian dollars)

### RESULTS OF OPERATIONS – Three and six months ended May 31, 2010 as compared to three and six months ended May 31, 2009

#### Overall Performance

Three months ended	May 31, 2010	May 31, 2009	2010 to 2009
In thousands of Canadian dollars			
Net loss before income taxes	\$ (1,061)	\$ (1,018)	\$ (43)
Net loss	\$ (750)	\$ (1,038)	\$ 288
Net loss attributable to common shareholders	\$ (838)	\$ (1,192)	\$ 354
Loss per share – basic and diluted	(0.02)	(0.02)	-
Six months ended	May 31, 2010	May 31, 2009	2010 to 2009
In thousands of Canadian dollars			
Net income (loss) before income taxes	\$ 2,980	\$ (1,860)	\$ 4,840
Net income (loss)	\$ 1,332	\$ (1,735)	\$ 3,067
Net income (loss) attributable to common shareholders	\$ 1,113	\$ (2,045)	\$ 3,158
Earnings (loss) per share – basic and diluted	0.02	(0.04)	0.06

The lower net loss for the three months ended May 31, 2010 was mainly due to higher income tax recovery. The higher net income reported for the six months ended May 31, 2010 was largely driven by gain on sale of intellectual property, offset by lower gross profit and higher income tax expense.

#### Backlog

Firm backlog consists of firm fixed signed orders issued and executable subsequent to the balance sheet date. Firm backlog as at May 31, 2010 was at \$36 million compared to \$49 million at May 31, 2009. Of the \$36 million firm backlog, \$7 million is expected to be executed in fiscal 2010 and \$29 million is expected to be executed in fiscal year 2011 and beyond.

Firm backlog is a non-GAAP measure. This measure does not have a standardized meaning or comparable GAAP measure and is likely not comparable to similar measures presented by other companies and cannot be reconciled to any GAAP measurements. The Company discloses this non-GAAP measure as we believe it provides more insight into our performance specifically regarding revenue available for periods subsequent to May 31, 2010.

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 backlog and revenue from quarter to quarter.

## OSI Geospatial Inc.

Management's Discussion and Analysis

For the three and six months ended May 31, 2010 and 2009

(expressed in Canadian dollars)

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 in backlog having a termination-for-convenience clause in firm backlog.

### Revenue

Three months ended	May 31, 2010	% of total revenue	May 31, 2009	% of total revenue	2010 to 2009
In thousands of Canadian dollars					
Maritime navigation and tactical solutions	\$ 1,093	21%	\$ 1,974	31%	\$ (881)
Advanced technology research and development	1,660	33%	2,911	46%	(1,251)
Mapping	2,359	46%	1,430	23%	929
	<u>\$ 5,112</u>	<u>100%</u>	<u>\$ 6,315</u>	<u>100%</u>	<u>\$ (1,203)</u>
Six months ended	May 31, 2010	% of total revenue	May 31, 2009	% of total revenue	2010 to 2009
In thousands of Canadian dollars					
Maritime navigation and tactical solutions	\$ 2,498	29%	\$ 5,496	46%	\$ (2,998)
Advanced technology research and development	3,584	42%	4,854	40%	(1,270)
Mapping	2,473	29%	1,689	14%	784
	<u>\$ 8,555</u>	<u>100%</u>	<u>\$ 12,039</u>	<u>100%</u>	<u>\$ (3,484)</u>

Our core revenue stream is derived from three sources: Maritime navigation and tactical solutions, Advanced technology research and development, and Mapping. In Maritime navigation and tactical solutions, our principal developed product, 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 21% and 31% of the revenue for the three months ended May 31, 2010 and 2009, respectively, and 29% and 46% of the revenue for the six months ended May 31, 2010 and May 31, 2009, respectively.

Advanced technology research and development through our U.S. Systems operations delivered 33% and 46% of the revenue for the three months ended May 31, 2010 and 2009, respectively. Advanced technology research and development delivered 42% and 40% of the revenue for the six months ended May 31, 2010 and 2009, respectively.

Mapping delivered 46% and 23% of the revenue for the three months ended May 31, 2010 and 2009, respectively. Mapping delivered 29% and 14% of the revenue for the six months ended May 31, 2010 and 2009, respectively.

Our results are primarily affected by the level, timing, and duration of customer orders and customer product delivery requirements. The main customers for our products and services in the six months 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. The main customers for our products and services in the six months ended May 31, 2009 were the Royal Australian Navy, the U.S Coast Guard, U.S. Army and the Royal Navy of the U.K. Revenue from these customers accounted for 40% of the consolidated revenue.

## OSI Geospatial Inc.

Management's Discussion and Analysis  
For the three and six months ended May 31, 2010 and 2009  
(expressed in Canadian dollars)

### Revenue by Segment

Three months ended	May 31, 2010	% of total revenue	May 31, 2009	% of total revenue	2010 to 2009
In thousands of Canadian dollars					
International Systems operations	\$ 851	17%	\$ 1,615	25%	\$ (764)
U.S. Systems operations	1,902	37%	3,270	52%	(1,368)
Mapping operations	2,359	46%	1,430	23%	929
	<u>\$ 5,112</u>	<u>100%</u>	<u>\$ 6,315</u>	<u>100%</u>	<u>\$ (1,203)</u>

Six months ended	May 31, 2010	% of total revenue	May 31, 2009	% of total revenue	2010 to 2009
In thousands of Canadian dollars					
International Systems operations	\$ 2,065	24%	\$ 3,612	30%	\$ (1,547)
U.S. Systems operations	4,018	47%	6,738	56%	(2,720)
Mapping operations	2,472	29%	1,689	14%	783
	<u>\$ 8,555</u>	<u>100%</u>	<u>\$ 12,039</u>	<u>100%</u>	<u>\$ (3,484)</u>

Revenue from the International Systems operations for the three and six months ended May 31, 2010 decreased 47% and 43%, 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, 2010 decreased over the same periods from the prior year by 42% and 40%, respectively. The decrease is mainly due to the timing of new contracts awarded and the delivery schedules of existing contracts.

Revenue from the Mapping operations for the three and six months ended May 31, 2010 increased over the same periods from the prior year by 65% and 46%, respectively, due to new contracts awarded and the delivery schedules of existing contracts.

### Gross Profit

Three months ended	May 31, 2010	May 31, 2009	2010 to 2009
In thousands of Canadian dollars			
Gross profit	\$ 1,706	\$ 1,934	\$ (228)
Gross profit percentage	34%	31%	3%
Six months ended			
In thousands of Canadian dollars			
Gross profit	\$ 2,812	\$ 3,653	\$ (841)
Gross profit percentage	33%	30%	3%

Gross profit decreased by 12% in the three months ended May 31, 2010 compared to the three months ended May 31, 2009 and the gross profit percentage is higher by 3% period-over-period.

## OSI Geospatial Inc.

Management's Discussion and Analysis  
For the three and six months ended May 31, 2010 and 2009  
(expressed in Canadian dollars)

Gross profit decreased by 23% in the six months ended May 31, 2010 compared to the six months ended May 31, 2009 and the gross profit percentage increased 3% period-over-period.

The decreased gross profit for the three and six months ended May 31, 2010 compared to prior year's periods is mainly due to lower revenue during the current period.

The increase in gross profit percentage for the three and six months ended May 31, 2010 compared to the prior year's periods is the 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, 2010	May 31, 2009	2010 to 2009
In thousands of Canadian dollars			
<b>Gross profit:</b>			
International Systems operations	\$ 419	\$ 791	\$ (372)
U.S. Systems operations	660	773	(113)
Mapping operations	627	370	257
Consolidated operations	<u>\$ 1,706</u>	<u>\$ 1,934</u>	<u>\$ (228)</u>
<b>Gross profit percentage:</b>			
International Systems operations	49%	49%	-
U.S. Systems operations	35%	24%	11%
Mapping operations	27%	26%	1%
Consolidated operations	<u>33%</u>	<u>31%</u>	<u>2%</u>
<hr/>			
Six months ended	May 31, 2010	May 31, 2009	2010 to 2009
In thousands of Canadian dollars			
<b>Gross profit:</b>			
International Systems operations	\$ 1,063	\$ 1,933	\$ (870)
U.S. Systems operations	1,208	1,356	(148)
Mapping operations	541	364	177
Consolidated operations	<u>\$ 2,812</u>	<u>\$ 3,653</u>	<u>\$ (841)</u>
<b>Gross profit percentage:</b>			
International Systems operations	51%	54%	(3%)
U.S. Systems operations	30%	20%	10%
Mapping operations	22%	22%	-
Consolidated operations	<u>33%</u>	<u>30%</u>	<u>3%</u>

Gross profit from the International Systems operations decreased 47% and 45% for the three and six months ended May 31, 2010, respectively, and gross profit percentages were the same for the three months ended May 31, 2010 and 3% lower for the six months ended May 31, 2010 when compared to the same periods in the prior years. The decreases in gross profit are the result of lower revenues in the International Systems operations. The lower gross profit percentage is the result of a decrease in high margin software sales and more revenues from lower margins on systems and services projects compared to the prior year's periods.

## OSI Geospatial Inc.

Management's Discussion and Analysis  
For the three and six months ended May 31, 2010 and 2009  
(expressed in Canadian dollars)

Gross profit from the U.S. Systems operations decreased 15% and 11% for the three and six months ended May 31, 2010, respectively. Gross profit percentage was 11% and 10% higher for the three and six months ended May 31, 2010, 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, 2010 when compared to the same periods last year was primarily the result of decrease in current period's revenue. The increase in the gross profit percentage for the three and six months ended May 31, 2010, is primarily the result of a lower proportion of revenue derived from projects that included third-party labour when compared to the same periods last year.

Gross profit from the Mapping operations for the three and six months ended May 31, 2010 increased 69% and 49%, respectively, and gross profit percentage were approximately the same when compared to the same periods in the prior year. The increases in gross profit were impacted by higher revenues for the three and six months ended May 31, 2010 when compared to the same periods in the prior year. Gross profit is impacted by the level of the fixed costs included in cost of sales. It is also driven by season as the revenue generating activities are mostly influenced by weather. The gross profit percentage of any given mapping project is largely influenced by two factors:

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

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

### Operating Expenses

	May 31, 2010	% of total revenue	May 31, 2009	% of total revenue	2010 to 2009
<b>Three months ended</b>					
In thousands of Canadian dollars					
General and administrative	\$ 1,893	37%	\$ 1,575	25%	\$ 318
Sales and marketing	686	13%	813	13%	(127)
Engineering	25	-	337	5%	(312)
<b>Six months ended</b>					
In thousands of Canadian dollars					
General and administrative	\$ 3,161	37%	\$ 2,785	23%	\$ 376
Sales and marketing	1,350	16%	1,627	14%	(277)
Engineering	201	2%	638	5%	(437)

**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 increased 20% and 14% for three and six months ended May 31, 2010, respectively, compared to the previous year's periods. The increase was largely due to termination costs and stock-based compensation costs for stock options granted in May 2010.

## OSI Geospatial Inc.

Management's Discussion and Analysis

For the three and six months ended May 31, 2010 and 2009

(expressed in Canadian dollars)

**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 16% and 17% for three and six months ended May 31, 2010 compared to the three and six months ended May 31, 2009. The decrease is primarily due to staff reduction, lower commissions, 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, 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 decreased 93% and 68% for the three and six months ended May 31, 2010, compared to the three and six months ended May 31, 2009. The decrease is mainly related to reduction in staff level and more related costs being charged to cost of sales and pre-contract costs to support specific customer orders during the three and six months ended May 31, 2010 when compared to the same periods last year. We believe that in order to maintain our technological leadership, we must continue to develop existing products and introduce innovative new products that challenge and redefine the industry standards.

### Amortization

Three months ended	May 31, 2010	May 31, 2009	2010 to 2009
In thousands of Canadian dollars			
<b>Amortization</b>	\$ 84	\$ 110	\$ (26)
Six months ended	May 31, 2010	May 31, 2009	2010 to 2009
In thousands of Canadian dollars			
<b>Amortization</b>	\$ 171	\$ 223	\$ (52)

Total amortization decreased by 24% and 23% for the three and six months ended May 31, 2010 as compared to the same periods in the prior year. For the three and six months ended May 31, 2010, a portion of the amortization, \$31,000 and \$68,000, respectively, (2009 – \$49,000 and \$97,000, respectively) was included in cost of sales for equipment used in revenue-generating activities.

## OSI Geospatial Inc.

Management's Discussion and Analysis  
For the three and six months ended May 31, 2010 and 2009  
(expressed in Canadian dollars)

### Interest expense

Three months ended	May 31, 2010	May 31, 2009	2010 to 2009
In thousands of Canadian dollars			
<b>Interest expense</b>	\$ 7	\$ 20	\$ (13)
Six months ended	May 31, 2010	May 31, 2009	2010 to 2009
In thousands of Canadian dollars			
<b>Interest expense</b>	\$ 45	\$ 50	\$ (5)

Interest expense decreased by 65% and 10% in the three and six months ended May 31, 2010 as compared to the three and six months ended May 31, 2009, respectively. With the cash proceeds from the sale of intellectual property, the Company did not utilize its credit facilities for the entire three and six months ended May 31, 2010.

### Foreign exchange

Three months ended	May 31, 2010	May 31, 2009	2010 to 2009
In thousands of Canadian dollars			
<b>Foreign exchange loss (gain)</b>	\$ 29	\$ (16)	\$ (45)
Six months ended	May 31, 2010	May 31, 2009	2010 to 2009
In thousands of Canadian dollars			
<b>Foreign exchange loss (gain)</b>	\$ 19	\$ (16)	\$ (35)

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 not in the Company's favour for the three and six months ended May 31, 2010 and were in the Company's favour during the three and six months ended May 31, 2009.

### Technology Partnerships Canada royalty

Three months ended	May 31, 2010	May 31, 2009	2010 to 2009
In thousands of Canadian dollars			
<b>Royalty</b>	\$ 43	\$ 113	\$ (70)
Six months ended	May 31, 2010	May 31, 2009	2010 to 2009
In thousands of Canadian dollars			
<b>Royalty</b>	\$ 112	\$ 208	\$ (96)

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

## OSI Geospatial Inc.

Management's Discussion and Analysis  
For the three and six months ended May 31, 2010 and 2009  
(expressed in Canadian dollars)

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 1.4% on annual gross revenue of its subsidiary, Offshore Systems Ltd., for the period January 1, 2006 to December 31, 2008; and 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., for the period December 1, 1999 to November 30, 2008. If the total royalties paid and payable as at November 30, 2008 does not equal or exceed \$7.8 million, the Company will continue to pay royalties on gross revenue generated after November 30, 2008 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 met 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, 2010	May 31, 2009	2010 to 2009
In thousands of Canadian dollars			
Gain on sale of intellectual property	\$ -	\$ -	\$ -
Six months ended	May 31, 2010	May 31, 2009	2010 to 2009
In thousands of Canadian dollars			
Gain on sale of intellectual property	\$ 5,227	\$ -	\$ 5,227

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.

### Income taxes

Three months ended	May 31, 2010	May 31, 2009	2010 to 2009
In thousands of Canadian dollars			
Future income tax expense	\$ 101	\$ 12	\$ 89
Current income tax expense (recovery)	(412)	8	(420)
	<u>(311)</u>	<u>20</u>	<u>(331)</u>
Six months ended	May 31, 2010	May 31, 2009	2010 to 2009
In thousands of Canadian dollars			
Future income tax expense (recovery)	\$ 989	\$ (140)	\$ 1,129
Current income tax expense	659	15	644

## OSI Geospatial Inc.

Management's Discussion and Analysis

For the three and six months ended May 31, 2010 and 2009

(expressed in Canadian dollars)

<u>1,648</u>	<u>(125)</u>	<u>1,773</u>
--------------	--------------	--------------

Based on the information available at the time of the issue of the interim financial statements for the six months ended May 31, 2010, 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 six months ended May 31, 2010 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 period resulting from the sale of intellectual property. At May 31, 2010, we have current future tax asset of \$233,000 and non-current future tax liability of \$75,000 as we believe that it is more likely than not that these differences will be realized in future fiscal years. In accordance with Canadian GAAP, we have provided a valuation allowance against future tax assets where realization did not meet the requirements of "more likely than not" under the liability method of tax allocation. We continue to evaluate our taxable position quarterly and consider factors such as estimated taxable income, the history of losses for tax purposes, and the growth of the Company, among others.

We recognized current income tax expense for the six months ended May 31, 2010 mainly due to taxable income earned from the sale of intellectual property.

### LIQUIDITY AND CAPITAL RESOURCES - May 31, 2010 compared to November 30, 2009

In thousands of Canadian dollars	May 31, 2010	November 30, 2009	2010 to 2009
<b>Current assets</b>	\$ 9,745	\$ 8,750	\$ 995
<b>Current liabilities</b>	4,870	5,304	(434)
<b>Working capital <sup>(1)</sup></b>	4,875	3,446	1,429

<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 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, 2010, our current assets increased primarily due to an increase in cash as a result of the sale of intellectual property during the period. Our working capital has increased mainly due to the increase in cash, and decrease in current liabilities, offset by a decrease in current portion of future tax asset. Current liabilities decreased because of payment of bank indebtedness and factored advances payable, lower unearned revenue, offset by the accrual of income taxes payable. Current portion of future tax asset decreased due to utilization of future tax asset to offset the taxable income generated mainly from the sale of intellectual property.

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. At May 31, 2010, we had no borrowings against our U.S. accounts receivable factoring facility. We have an accounts receivable factoring facility with a Canadian financial institution with a maximum limit of \$2.0 million and a variable limit with a U.S. financial institution that is based on the outstanding accounts receivable of the U.S. operations. During the three and six months ended May 31, 2010, we did not utilize these facilities during the entire period. We utilize our forward exchange contract facility to reduce our exposure to exchange rate movements.

## OSI Geospatial Inc.

Management's Discussion and Analysis  
For the three and six months ended May 31, 2010 and 2009  
(expressed in Canadian dollars)

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

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

<u>Three months ended</u>	<u>May 31, 2010</u>	<u>May 31, 2009</u>	<u>2010 to 2009</u>
In thousands of Canadian dollars			

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

Operating activities	\$ (841)	\$ 1,963	\$ (2,804)
Investing activities	(202)	(113)	(89)
Financing activities	(92)	(1,364)	1,272
Effect of foreign exchange on cash	(7)	27	(34)

<u>Six months ended</u>	<u>May 31, 2010</u>	<u>May 31, 2009</u>	<u>2010 to 2009</u>
In thousands of Canadian dollars			

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

Operating activities	\$ (2,329)	\$ 2,099	\$ (4,428)
Investing activities	4,568	(163)	4,731
Financing activities	(879)	(1,447)	568
Effect of foreign exchange on cash	35	24	11

Cash flows used in operating activities for the three months ended May 31, 2010 were the result of net loss for the period, increase in accounts receivable, increase in income taxes payable, and increase in prepaid expenses and deposits, reduced by amortization, future tax expense, and decrease in accounts payable and accrued liabilities.

Cash flows used in operating activities for the six months ended May 31, 2010 were the result of net income for the period increased by amortization, stock-based compensation, future tax expense, increase in accounts payable and accrued liabilities, and increase in income taxes payable, offset by the gain on disposal of intellectual property.

Cash flows used in investing activities for the three months ended May 31, 2010 were primarily reflective of the acquisitions of equipment, furnishings and intangibles.

Cash flows provided by investing activities for the six months ended May 31, 2010 were mainly due to disposal of intellectual property.

## OSI Geospatial Inc.

Management's Discussion and Analysis  
For the three and six months ended May 31, 2010 and 2009  
(expressed in Canadian dollars)

Cash flows used in financing activities for the three and six months ended May 31, 2010 were the result of repayments of credit facilities.

As a result of the above mentioned changes, the credit facilities utilization decreased by \$72,000 for the three months ended May 31, 2010 and \$836,000 for the six months ended May 31, 2010.

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, 2010 we had entered into forward exchange contracts in the amount of £210,000 and €71,000.

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

## CONTRACTUAL OBLIGATIONS

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

Payments due by period	Total	Less than 1 year	1 to 3 years	4 to 5 years	After 5 years
In thousands of Canadian dollars					
Facility leases	\$ 2,820	\$ 674	\$ 1,152	\$ 510	\$ 484
Capital equipment leases	90	45	45		
Operating equipment leases	35	25	10		
<b>Total contractual obligations</b>	<b>\$ 2,945</b>	<b>\$ 744</b>	<b>\$ 1,207</b>	<b>\$ 510</b>	<b>\$ 484</b>

## OFF BALANCE SHEET ARRANGEMENTS

### Guarantees

The Company has entered into a guarantee agreement for one of the Company's subsidiaries, CHI. The Company has guaranteed CHI's accounts receivable factoring facility with a U.S. financial institution. At May 31, 2010, the carrying amount of CHI's factored advances payable was U.S. \$nil (November 30, 2009 – U.S. \$227,000).

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

## TRANSACTIONS WITH RELATED PARTIES

The Company had no related party transactions during the periods reported.

## **OSI Geospatial Inc.**

Management's Discussion and Analysis  
For the three and six months ended May 31, 2010 and 2009  
(expressed in Canadian dollars)

### **CRITICAL ACCOUNTING ESTIMATES**

The preparation of financial statements in conformity with Canadian GAAP requires the Company's management to make estimates and assumptions which affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses for the years reported. Significant areas requiring the use of estimates include valuation of goodwill and intangible assets, future income tax assets, and revenue recognition. Management reviews its estimates based on management's best knowledge of current events and actions that the Company may undertake in the future. Actual results could differ from these estimates.

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

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

In November 2009, the Company performed impairment tests for goodwill and intangible assets with indefinite useful lives, and determined that goodwill was impaired. This resulted in a non-cash impairment charge of \$4.5 million that was recorded in the consolidated financial statements for the year ended November 30, 2009. In November 2008, the Company determined that these assets were not impaired. The impairment test involves considerable use of judgment, and requires management to make estimates and assumptions. The fair values of the reporting units are derived from certain valuation models, which consider various factors such as cost of capital, discount rates, the Company's stock price, future earnings, and earnings multiples. Changes in estimates and assumptions can affect the reported value of goodwill and intangible assets with indefinite useful lives.

#### *Future income tax assets*

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

#### *Revenue recognition*

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

### **PROPOSED TRANSACTIONS**

We are not currently engaged in any proposed transactions.

## OSI Geospatial Inc.

Management's Discussion and Analysis

For the three and six months ended May 31, 2010 and 2009

(expressed in Canadian dollars)

### SELECTED QUARTERLY DATA (UNAUDITED)

In thousands of Canadian dollars

For the three months ended	May 31, 2010	February 28, 2010	November 30, 2009	August 31, 2009
Revenue	\$ 5,112	\$ 3,444	\$ 4,743	\$ 6,212
Gross profit	1,706	1,155	1,435	2,362
Gross profit percentage	33%	34%	30%	38%
Net income (loss)	(750)	2,082	(5,713)	(263)
Net income (loss) attributable to common shareholders				
Basic	(838)	1,951	(5,860)	(410)
Diluted	(838)	2,082	(5,860)	(410)
Earnings (loss) per share:				
Basic	(0.02)	0.04	(0.12)	(0.01)
Diluted	(0.02)	0.04	(0.12)	(0.01)

For the three months ended	May 31, 2009	February 28, 2009	November 30, 2008	August 31, 2008
Revenue	\$ 6,315	\$ 5,724	\$ 8,146	\$ 6,327
Gross profit	1,934	1,719	3,332	2,243
Gross profit percentage	31%	30%	41%	36%
Net income (loss)	(1,038)	(697)	1,029	(682)
Net income (loss) attributable to common shareholders				
Basic	(1,192)	(853)	873	(838)
Diluted	(1,192)	(853)	873	(838)
Earnings (loss) per share:				
Basic	(0.02)	(0.02)	0.02	(0.02)
Diluted	(0.02)	(0.02)	0.02	(0.02)

### CRITICAL ACCOUNTING POLICIES

These items are substantially unchanged as discussed in the Company's MD&A for the year ended November 30, 2009 as contained in our 2009 Annual Report filed on SEDAR at [www.sedar.com](http://www.sedar.com).

### RECENT ACCOUNTING PRONOUNCEMENTS

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

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

The CICA has issued CICA Handbook Section 1601, *Consolidated Financial Statements*, and CICA Handbook Section 1602, *Non-controlling Interests*, which replace CICA Handbook Section 1600,

## **OSI Geospatial Inc.**

Management's Discussion and Analysis  
For the three and six months ended May 31, 2010 and 2009  
(expressed in Canadian dollars)

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

The CICA has issued EIC 175, *Multiple Deliverable Revenue Arrangements*, which addresses how to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting. This abstract also addresses how arrangement consideration should be measured and allocated to the separate units of accounting in the arrangement. EIC 175 applies to revenue arrangements with multiple deliverables entered into or materially modified in the first annual fiscal period beginning on or after January 1, 2011. Accordingly, the Company will adopt the new sections for its fiscal year beginning December 1, 2011. The Company does not expect that the adoption of this standard will have a material impact on its consolidated financial statements.

### **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

## OSI Geospatial Inc.

Management's Discussion and Analysis  
For the three and six months ended May 31, 2010 and 2009  
(expressed in Canadian dollars)

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, 2010, we had entered into the following foreign exchange forward contracts, which were not treated as hedges in accordance with CICA Section 3865:

<i>Sell</i>	<i>Exchange rate in relation to CAD</i>	<i>Value date</i>
EURO 71,000	1.3252	July 2010 to October 2010
GBP 210,000	1.5142 to 1.5313	October 2010 to November 2010

### DISCLOSURE OF OUTSTANDING SHARE DATA

As at July 8, 2010, we had 51,602,083 issued and outstanding common shares and 4,703,333 outstanding stock options. As at July 8, 2010, we also had 30,262 issued and outstanding Class A preference shares and 100,829 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 5,961,380 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*. Management, as at the end of the period covered by this interim filing, designed disclosure controls and procedures to provide reasonable, but not absolute, assurance that (i) material information relating to the issuer is made known to management by others, particularly during the period in which the interim filings were being prepared; and (ii) information required to be disclosed by the issuer in its annual filings, interim filings or other reports filed or submitted by it under securities legislation is recorded, processed, summarized and reported within the time periods specified in securities legislation.

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. Management did not identify material weaknesses relating to the design of internal controls over financial reporting existing at the end of the period covered by this interim filing.

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

## **OSI Geospatial Inc.**

Management's Discussion and Analysis

For the three and six months ended May 31, 2010 and 2009

(expressed in Canadian dollars)

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.

The Chief Executive Officer and the Chief Financial Officer have evaluated the effectiveness of the Company's internal control over financial reporting and have determined that the Company's internal control over financial reporting was effective as of November 30, 2009.

### **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, 2009 as contained in our 2009 Annual Report filed on SEDAR at [www.sedar.com](http://www.sedar.com).

# **OSI Geospatial Inc.**

**Interim Consolidated Financial Statements (Unaudited)  
Three and Six Months ended May 31, 2010 and 2009  
(expressed in Canadian dollars)**

(Prepared in accordance with Canadian Generally Accepted Accounting Principles)

---

# OSI Geospatial Inc.

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

## Consolidated Balance Sheets (unaudited)

In thousands of Canadian dollars	May 31, 2010	November 30, 2009
<b>Assets</b>		
<b>Current assets</b>		
Cash	\$ 1,710	\$ 315
Restricted cash	262	-
Accounts receivable and unbilled revenue	5,801	5,880
Inventory (note 5)	1,012	1,139
Prepaid expenses and deposits	727	375
Current portion of future income tax asset	233	1,041
	<hr/>	<hr/>
	9,745	8,750
<b>Restricted cash</b>	371	-
<b>Deferred development costs</b>	577	653
<b>Future income tax asset</b>	-	113
<b>Equipment and furnishings</b>	1,307	1,473
<b>Intangible and other assets</b>	461	446
<b>Goodwill (note 6)</b>	4,279	4,324
	<hr/>	<hr/>
	\$ 16,740	\$ 15,759
<b>Liabilities</b>		
<b>Current liabilities</b>		
Bank indebtedness	\$ -	\$ 599
Factored advances payable	-	240
Accounts payable and accrued liabilities	4,195	3,806
Income taxes payable	369	-
Dividends payable	2	-
Unearned revenue	224	550
Current portion of deferred rent	41	41
Current portion of capital lease obligations	39	68
	<hr/>	<hr/>
	4,870	5,304
<b>Deferred rent</b>	239	260
<b>Capital lease obligations</b>	41	54
<b>Unearned revenue</b>	122	178
<b>Future income tax liability</b>	75	-
	<hr/>	<hr/>
	5,347	5,796
<b>Shareholders' Equity</b>		
Issued and outstanding		
Class A, Series A preference shares	30	30
Class B, Series 2 preference shares (note 7a)	3,237	5,383
Common shares (note 7a)	30,769	29,876
	<hr/>	<hr/>
	34,036	35,289
<b>Warrants (note 7b)</b>	-	4,546
<b>Contributed surplus</b>	9,245	3,322
<b>Accumulated deficit</b>	(30,511)	(31,838)
<b>Accumulated other comprehensive loss</b>	(1,377)	(1,356)
	<hr/>	<hr/>
	11,393	9,963
	<hr/>	<hr/>
	\$ 16,740	\$ 15,759

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

# OSI Geospatial Inc.

## Consolidated Statements of Operations and Deficit (unaudited)

In thousands of Canadian dollars, except share related data	Three months ended May 31,		Six months ended May 31,	
	2010	2009	2010	2009
<b>Revenue</b>				
Maritime navigation and tactical solutions	\$ 1,093	\$ 1,974	\$ 2,498	\$ 5,496
Advanced technology research and development	1,660	2,911	3,584	4,854
Mapping	2,359	1,430	2,473	1,689
	5,112	6,315	8,555	12,039
<b>Cost of sales</b>	3,406	4,381	5,743	8,386
<b>Gross profit</b>	1,706	1,934	2,812	3,653
<b>Expenses (income)</b>				
General and administrative	1,893	1,575	3,161	2,785
Sales and marketing	686	813	1,350	1,627
Engineering	25	337	201	638
Amortization	84	110	171	223
Interest expense	7	20	45	50
Interest income	-	-	-	(2)
Foreign exchange loss (gain)	29	(16)	19	(16)
Technology Partnerships Canada royalty	43	113	112	208
	2,767	2,952	5,059	5,513
<b>Net loss before other items</b>	(1,061)	(1,018)	(2,247)	(1,860)
Gain on sale of intellectual property (note 11)	-	-	5,227	-
<b>Net income (loss) before income taxes</b>	(1,061)	(1,018)	2,980	(1,860)
Future income tax expense (recovery)	101	12	989	(140)
Current income tax expense (recovery)	(412)	8	659	15
<b>Income tax expense (recovery)</b>	(311)	20	1,648	(125)
<b>Net income (loss)</b>	(750)	(1,038)	1,332	(1,735)
Accumulated deficit, beginning of period	(29,759)	\$ (24,821)	(31,838)	(22,121)
Dividends on Class B, Series 2 preference shares	(2)	-	(5)	(3)
<b>Accumulated deficit, end of period</b>	\$ (30,511)	\$ (25,859)	\$ (30,511)	\$ (25,859)
<b>Net income (loss) attributable to common shareholders</b> (note 7d)				
Basic and diluted	\$ (838)	\$ (1,192)	1,113	\$ (2,045)
<b>Earnings (loss) per share</b> (note 7d)				
Basic and diluted	\$ (0.02)	\$ (0.02)	\$ 0.02	\$ (0.04)
<b>Weighted average number of common shares outstanding</b> (note 7d)				
Basic	51,602,083	47,010,787	50,183,685	46,983,911
Diluted	51,602,083	47,010,787	50,294,988	46,983,911

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

## OSI Geospatial Inc.

### Consolidated Statements of Comprehensive Income (Loss) (unaudited)

In thousands of Canadian dollars	Three months ended May 31,		Six months ended May 31,	
	2010	2009	2010	2009
<b>Net income (loss)</b>	\$ (750)	\$ (1,038)	\$ 1,332	\$ (1,735)
<b>Other comprehensive loss, net of taxes</b>				
Unrealized loss on translation of self-sustaining foreign operations	(30)	(1,903)	(21)	(1,542)
<b>Comprehensive income (loss)</b>	<u>\$ (780)</u>	<u>\$ (2,941)</u>	<u>\$ 1,311</u>	<u>\$ (3,277)</u>

## OSI Geospatial Inc.

### Consolidated Statements of Accumulated Other Comprehensive Loss (unaudited)

In thousands of Canadian dollars	Three months ended May 31,		Six months ended May 31,	
	2010	2009	2010	2009
Accumulated other comprehensive income (loss), beginning of the period	\$ (1,347)	\$ 992	\$ (1,356)	\$ 631
Unrealized loss on translating financial statements of self-sustaining foreign operations	(30)	(1,903)	(21)	(1,542)
Accumulated other comprehensive loss, end of the period	<u>\$ (1,377)</u>	<u>\$ (911)</u>	<u>\$ (1,377)</u>	<u>\$ (911)</u>

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

# OSI Geospatial Inc.

## Consolidated Statements of Cash Flows (unaudited)

In thousands of Canadian dollars	Three Months ended May 31,		Six months ended May 31,	
	2010	2009	2010	2009
<b>Cash flows from (used in) operating activities</b>				
Net income (loss) for the period	\$ (750)	\$ (1,038)	\$ 1,332	\$ (1,735)
Items not affecting cash				
Amortization	115	159	239	320
Gain on disposal of intellectual property	-	-	(5,227)	-
Stock-based compensation	97	48	125	48
Future income tax expense (recovery)	101	12	989	(140)
	(437)	(819)	(2,542)	(1,507)
Changes in non-cash working capital items				
Accounts receivable	(973)	2,366	63	4,380
Inventory	41	(43)	127	313
Prepaid expenses and deposits	(249)	34	(352)	(186)
Accounts payable and accrued liabilities	1,559	710	396	(621)
Income taxes payable	(689)	(97)	381	(92)
Deferred rent	(10)	(10)	(20)	(20)
Unearned revenue	(83)	(178)	(382)	(168)
	(404)	2,782	213	3,606
	(841)	1,963	(2,329)	2,099
<b>Cash flows from (used in) investing activities</b>				
Increase in restricted cash	-	-	(638)	-
Deferred development costs	(30)	(35)	(55)	(53)
Additions to equipment and furnishings	(45)	(64)	(55)	(94)
Additions to intangible and other assets	(127)	(14)	(128)	(16)
Proceeds from disposal of intellectual property and related tangible assets, net of costs to dispose	-	-	5,444	-
	(202)	(113)	4,568	(163)
<b>Cash flows used in financing activities</b>				
Repayment of bank indebtedness	-	(1,343)	(599)	(1,409)
Factored advances payable	(72)	-	(237)	-
Repayment of capital lease obligations	(20)	(21)	(40)	(35)
Class B preference share dividends declared and paid	-	-	(3)	(3)
	(92)	(1,364)	(879)	(1,447)
<b>Effect of foreign exchange on cash balances</b>				
	(7)	27	35	24
<b>Increase (decrease) in cash</b>	(1,142)	513	1,395	513
<b>Cash – beginning of period</b>	2,852	-	315	-
<b>Cash – end of period</b>	\$ 1,710	\$ 513	\$ 1,710	\$ 513
Supplemental cash flow information:				
Interest paid	\$ (7)	\$ (17)	\$ (50)	\$ (47)
Income taxes paid	(279)	(3)	(280)	(3)

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

# OSI Geospatial Inc.

## Notes to the Interim Consolidated Financial Statements (unaudited)

Three and Six Months Ended May 31, 2010 and 2009

---

### 1 Basis of presentation

These unaudited interim consolidated financial statements have been prepared by management and include the accounts of OSI Geospatial Inc. and its subsidiaries, collectively referred to as OSI Geospatial or the Company. These unaudited interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP") and all amounts have been expressed in thousands of Canadian dollars unless otherwise noted.

These unaudited interim consolidated financial statements have been prepared using the same accounting policies used in the preparation of the audited annual consolidated financial statements for the year ended November 30, 2009.

These unaudited interim consolidated financial statements do not include all the information and footnote disclosures required by Canadian GAAP for annual audited consolidated financial statements. These unaudited interim consolidated financial statements should be read in conjunction with the Company's audited annual consolidated financial statements for the year ended November 30, 2009.

The preparation of these unaudited interim consolidated financial statements requires management to make estimates and assumptions that affect the amounts reported. Actual results could vary from these estimates and the operating results for the interim periods presented are not necessarily indicative of the results expected for the full year.

These unaudited interim consolidated financial statements are prepared on a going-concern basis, which assumes that the Company will continue in operation for the foreseeable future and be able to realize its assets and discharge its liabilities and commitments in the normal course of business. Certain conditions and uncertainties cast doubt about the validity of this assumption. The Company has a history of recurring losses and has an accumulated deficit of \$30.5 million. In October 2009, the Company replaced its U.S. line of credit with an accounts receivable factoring arrangement to support its U.S. working capital requirements. In January 2010, the Company replaced its Canadian line of credit with an accounts receivable factoring arrangement to support its Canadian working capital requirements. As per note 11, on February 1, 2010, the Company sold its soldier systems intellectual property for U.S. \$6.5 million. The net proceeds after corporate income taxes are approximately U.S. \$5.5 million with approximately U.S. \$5.0 million received in February 2010 and the balance to be received in fiscal 2011. The net proceeds provided additional working capital for the Company. The Company expects that its level of working capital should be sufficient to fund future operations for a period greater than twelve months.

The ability of the Company to continue as a going concern and meet its commitments and ongoing operating expenses is dependent on achieving profitable operations, and/or obtaining necessary levels of financing. There is no assurance that the Company will be successful in achieving these goals.

These unaudited interim consolidated financial statements do not include any adjustments to the carrying value of assets and liabilities, and changes to balance sheet classifications that might be necessary should the Company not continue as a going concern and these adjustments and reclassifications could be material.

# OSI Geospatial Inc.

Notes to the Interim Consolidated Financial Statements (unaudited)  
Three and Six Months Ended May 31, 2010 and 2009

---

## 2 Accounting changes

### Recent pronouncements

The following recent pronouncements issued by the Canadian Institute of Chartered Accountants (CICA) will be monitored by the Company:

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

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

The CICA has issued EIC 175, *Multiple Deliverable Revenue Arrangements*, which addresses how to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting. This abstract also addresses how arrangement consideration should be measured and allocated to the separate units of accounting in the arrangement. EIC 175 applies to revenue arrangements with multiple deliverables entered into or materially modified in the first annual fiscal period beginning on or after January 1, 2011. Accordingly, the Company plans to adopt the new Section for its fiscal year beginning December 1, 2011. The Company does not expect that the adoption of this standard will have a material impact on its consolidated financial statements.

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

## 3 Nature of operations

OSI Geospatial delivers integrated navigation 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, OSI Geospatial provides advanced technology research and development engineering services in support of the military and security requirements and mapping services that provide geospatial data production and consulting services. OSI Geospatial conducts its operations through three business units – International Systems, U.S. Systems and Mapping.

# OSI Geospatial Inc.

## Notes to the Interim Consolidated Financial Statements (unaudited)

Three and Six Months Ended May 31, 2010 and 2009

---

### 4 Credit facilities

In January 2010, the Company moved its Canadian credit facilities to another Canadian financial institution. The financing agreement consists of accounts receivable factoring arrangements.

At May 31, 2010, the Company had total borrowing capacity under its Canadian accounts receivable factoring arrangement of \$2.0 million. Under the terms of the factoring agreement, the Company may be requested to repay any amounts owing plus applicable interest. The fees charged under this agreement are: a) discount equal to discount percentage as set forth in the applicable schedule; b) 18.25% interest on any receivables that are required to be repurchased, payable from the designated due date until payment is made; and c) per diem equal to discount factor as set forth in the applicable schedule for any receivable not collected, payable from the designated due date until full payment of receivable is received. The financial institution is not entitled to both the interest and the per diem on any given day in respect of the same receivable. The credit facility is secured by a general assignment of accounts covering substantially all of the Company's present and future Canadian accounts receivable, claims and interests. This arrangement is being recorded as a financing from the factoring company and factoring costs are being charged to operations as incurred. At May 31, 2010, the amount advanced under this facility was \$nil (November 30, 2009 – \$nil).

In October 2009, the Company's subsidiary, CHI Systems Inc. (CHI), entered into accounts receivable factoring arrangements with a U.S. financial institution. Under the terms of the factoring agreement, CHI shall repurchase the accounts that remain unpaid because of certain events as specified in the agreement. Fees charged under this agreement are a servicing fee of 0.275% for the first 15 days, 0.293% after 15 days and a daily discount fee of 0.0132%. The daily discount fee is the prime rate as published in *The Wall Street Journal* on the purchase date plus 1.5% per annum. This arrangement is being recorded as a financing from the factoring company and factoring costs are being charged to operations as incurred. The facility is secured by a security agreement covering substantially all of CHI's present and future property and interests. At May 31, 2010, the amount advanced under this facility was \$nil (November 30, 2009 – \$240,000).

The Company has a foreign exchange facility with a Canadian chartered bank whereby it can enter into forward foreign exchange contracts. The maximum facility is based on a bank formula for deemed risk and is calculated using recent volatility in the currency of the contract as well as the length of the contract. At May 31, 2010, the foreign exchange facility would enable the Company to enter into U.S. dollar denominated forward foreign exchange contracts for approximately \$7 million (November 30, 2009 - \$9 million). This facility is insured through insurance solutions provided by Export Development Canada. As at May 31, 2010, the Company has drawn on its forward foreign exchange contract facility in the amount of \$413,000 (November 30, 2009 - \$918,000). A foreign exchange gain on these contracts of \$4,000 and a foreign exchange loss of \$8,000 was recognized at May 31, 2010 and November 30, 2009, respectively.

# OSI Geospatial Inc.

Notes to the Interim Consolidated Financial Statements (unaudited)

Three and Six Months Ended May 31, 2010 and 2009

## 5 Inventory

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

In thousands of Canadian dollars

	<b>May 31, 2010</b>	<b>November 30, 2009</b>
Materials and components	\$ 759	\$ 806
Work-in-process	70	150
Finished goods	183	183
	<b>\$ 1,012</b>	<b>\$ 1,139</b>

The cost of finished goods and components inventories recognized as expense and included in cost of sales for the three and six months ended May 31, 2010 were \$98,000 and \$198,000, respectively (three and six months ended May 31, 2009 - \$300,000 and \$ 1,148,000, respectively).

## 6 Goodwill

In thousands of Canadian dollars

	<b>For the six months ended May 31, 2010</b>	<b>For the year ended November 30, 2009</b>
Balance, beginning of the period	\$ 4,324	\$ 10,269
Impairment charge	-	(4,453)
Unrealized loss in translation of self-sustaining foreign operations	(45)	(1,492)
Balance, end of the period	<b>\$ 4,279</b>	<b>\$ 4,324</b>

# OSI Geospatial Inc.

Notes to the Interim Consolidated Financial Statements (unaudited)

Three and Six Months Ended May 31, 2010 and 2009

---

## 7 Capital stock

### a) Class B, Series 2 preference shares and Common shares

During the six months ended May 31, 2010, 66,861 (2009 – 2,500) Class B, series 2 preference shares were converted into 3,932,999 common shares. Accordingly, the Class B, series 2 preference shares were reduced by \$2,146,000 and the carrying value of the shares converted. The common shares were increased by \$893,000 and the contributed surplus was increased by \$1,253,000.

### b) Warrants

On April 10, 2010, 12,395,067 common share purchase warrants, which were valued at \$4,546,000 using the Black-Scholes model, expired. Accordingly, the Company has reduced warrants by \$4,546,000 with a corresponding increase to contributed surplus.

### c) Stock option plans

A summary of the outstanding and exercisable options of the Company's stock option plans at May 31, 2010 is as follows:

In Canadian dollars

	Number of options	Weighted average exercise price
Outstanding at November 30, 2009	4,153,166	\$ 0.65
Granted	1,990,000	0.23
Forfeited	(577,500)	0.56
Expired	(352,000)	0.88
Surrendered	(510,333)	0.91
Outstanding at May 31, 2010	4,703,333	\$ 0.44
Exercisable at May 31, 2010	3,176,648	\$ 0.54

### Stock-based compensation

For the three and six months ended May 31, 2010, the Company incurred non-cash stock-based compensation expense of \$97,000 and \$125,000, respectively, (three and six months ended May 31, 2009 - \$48,000) related to 1,990,000 stock options granted during the six months ended May 31, 2010 and 1,275,000 stock options granted during the year ended November 30, 2009. Of the stock options granted during the six months ended May 31, 2010, 663,000 vested immediately, 663,000 will vest over one year and 664,000 will vest over two years from the grant date. Of the stock options granted during the year ended November 30, 2009, 809,000 vested immediately, 233,000 will vest over one year and 233,000 will vest over two years from the grant date. The expense was included in general and administrative costs and the offsetting amount was recorded in contributed surplus. The weighted average fair value of the stock options at grant date is \$0.15 per stock option (2009 - \$0.07).

# OSI Geospatial Inc.

## Notes to the Interim Consolidated Financial Statements (unaudited)

### Three and Six Months Ended May 31, 2010 and 2009

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

	<u>2010</u>	<u>2009</u>
Risk-free interest rate	2.62%	2.45%
Expected volatility	71%	66%
Estimated average option lives	5 years	5 years
Dividend yield	0.0%	0.0%

#### Stock Option Plan

The Company has adopted a rolling stock option plan under the rules of the TSX Exchange to replace the existing three stock option plans. The plan was approved by the Company's shareholders at the annual general meeting that was held on May 28, 2009. Under the plan, the Company is authorized to grant options to directors, officers, employees and consultants, enabling them to acquire up to 10% of the issued and outstanding common shares of the Company. The exercise price of each option is set by the Board of Directors at the time such option is allocated under the plan, and cannot be less than the volume weighted average trading price for the five trading days immediately prior to the date of grant. The options can be exercisable for a maximum term of 10 years with a vesting schedule to be determined by the Board of Directors.

#### **d) Loss per share**

In thousands of Canadian dollars, except share related data	<b>For the three months ended May 31,</b>	
<b>Loss per share – basic and diluted</b>	<u>2010</u>	<u>2009</u>
Net loss for the period	\$ (750)	\$ (1,038)
Less:		
Class B, Series 2 preference share dividends (*A)	(88)	(154)
Net loss available to common shareholders	\$ (838)	\$ (1,192)
Weighted average number of common shares outstanding – basic and diluted	51,602,083	47,010,787
Loss per share – basic and diluted	\$ (0.02)	\$ (0.02)

(\*A) Dividends for three and six months ended May 31, 2010 of \$88,000 and \$219,000, respectively (three and six months ended May 31, 2009 - \$154,000 and \$310,000, respectively) are included which represent the dividends earned by the shareholders of the Class B Series 2 cumulative preference shares. As at May 31, 2010, there were \$1,437,000 (November 30, 2009 - \$1,219,000) of dividends in arrears for the Class B, Series 2 cumulative preference shares.

The outstanding preferred shares, warrants and stock options were anti-dilutive for the purposes of calculating diluted loss per share for the three months ended May 31, 2010 and 2009.

# OSI Geospatial Inc.

## Notes to the Interim Consolidated Financial Statements (unaudited)

Three and Six Months Ended May 31, 2010 and 2009

In thousands of Canadian dollars, except share related data	For the six months ended May 31,	
	2010	2009
<b>Earnings (loss) per share – basic</b>		
Net income (loss) for the period	\$ 1,332	\$ (1,735)
Less:		
Class B, Series 2 preference share dividends (*A)	(219)	(310)
Net income (loss) available to common shareholders	\$ 1,113	\$ (2,045)
Weighted average number of common shares outstanding – basic	50,183,685	46,983,911
Earnings (loss) per share – basic	\$ 0.02	\$ (0.04)

In thousands of Canadian dollars, except share related data	For the six months ended May 31,	
	2010	2009
<b>Earnings (loss) per share – diluted</b>		
Net income (loss) for the period	\$ 1,332	\$ (1,735)
Less:		
Class B, Series 2 preference share dividends (*A)	(219)	(310)
Net income (loss) available to common shareholders	\$ 1,113	\$ (2,045)
Weighted average number of common shares outstanding	50,183,685	46,983,911
Dilutive effect of Class A, Series A preference shares (*D)	30,262	-
Dilutive effect of Class B, Series 2 preference shares (*C) (*D)	-	-
Dilutive effect of warrants (*D)	-	-
Dilutive effect of stock options (*B) (*D)	81,041	-
Adjusted weighted average number of common shares outstanding – diluted	50,294,988	46,983,911
Earnings (loss) per share – diluted	\$ 0.02	\$ (0.04)

(\*A) Dividends for three and six months ended May 31, 2010 of \$88,000 and \$219,000, respectively (three and six months ended May 31, 2009 - \$154,000 and \$310,000, respectively) are included which represent the dividends earned by the shareholders of the Class B Series 2 cumulative preference shares. As at May 31, 2010, there were \$1,437,000 (November 30, 2009 - \$1,219,000) of dividends in arrears for the Class B, Series 2 cumulative preference shares.

(\*B) Some of the outstanding stock options that were outstanding at May 31, 2010 were not included in the calculation of diluted earnings per share because the exercise price of those stock options were greater than the average market price of the common shares.

(\*C) The outstanding Class B, Series 2 preference shares were anti-dilutive for the purposes of calculating diluted loss per share for the six months ended May 31, 2010.

(\*D) The outstanding preferred shares, warrants and stock options were anti-dilutive for the purposes of calculating diluted loss per share for the six months ended May 31, 2009.

# OSI Geospatial Inc.

## Notes to the Interim Consolidated Financial Statements (unaudited)

Three and Six Months Ended May 31, 2010 and 2009

If all preferred shares were converted, and all warrants and options were exercised, there would be a total of 62,266,796 common shares outstanding at May 31, 2010 (November 30, 2009 – 76,093,696). As a result of the exercise of all warrants and options, the Company would receive cash of \$2.0 million (November 30, 2009 - \$13.2 million).

### 8 Financial instruments

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

#### Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations. Credit risk arises principally from the Company's cash, accounts receivable and its foreign exchange contracts. The Company provides credit to its customers in the normal course of its operations. The Company's credit risk review includes performing credit evaluations of the financial condition of significant customers. The Company's customers are for the most part national and international government clients and large public customers. A significant portion of the Company's accounts receivable is from long-time customers and at May 31, 2010, 76% (November 30, 2009 – 62%) of its accounts receivable was with national and international government clients and 13% (November 30, 2009 – 20%) of its accounts receivable was from large international public companies. Due to the low risk nature of the government clients and a history of excellent collections, provisions for doubtful accounts are made on a customer by customer basis, based on ongoing customer discussions.

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

The carrying amount of financial assets represents the maximum credit exposure. The maximum exposure to credit risk at the reporting date was:

In thousands of Canadian dollars

	<b>May 31, 2010</b>	<b>November 30, 2009</b>
Cash	\$ 1,710	\$ 315
Restricted cash	633	-
Trade accounts receivable	2,758	2,607
Unbilled revenue	2,902	3,164
Other	151	119
Allowance for doubtful accounts	(10)	(10)
	<b>\$ 8,144</b>	<b>\$ 6,195</b>

# OSI Geospatial Inc.

## Notes to the Interim Consolidated Financial Statements (unaudited)

Three and Six Months Ended May 31, 2010 and 2009

The aging of the trade accounts receivable at the reporting date was:

In thousands of Canadian dollars

	<b>May 31, 2010</b>	<b>November 30, 2009</b>
Current	\$ 2,615	\$ 2,401
Past due (61 - 90 days)	28	150
Past due greater than 90 days	115	56
	<b>\$ 2,758</b>	<b>\$ 2,607</b>

Based on historic default rates, the Company believes that there are minimal requirements for an allowance for doubtful accounts.

### **Market risk**

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

#### *Foreign exchange risk*

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

The Company did not designate its foreign exchange forward contracts as a hedge of underlying assets, liabilities, firm commitments or anticipated transactions in accordance with CICA Handbook Section 3865, *Hedges*, and accordingly did not use hedge accounting. As a result of this, the foreign exchange forward contracts are recorded on the consolidated balance sheet at fair value in other receivables when the contracts are in a gain position and in other accrued liabilities when the contracts are in a loss position. The fair value of the foreign exchange forward contracts was a recorded asset in other receivables of \$4,000 at May 31, 2010 and a recorded liability in accounts payable and accrued liabilities of \$8,000 at November 30, 2009. Changes in fair value of these contracts are recognized as gains or losses in the consolidated statement of operations.

# OSI Geospatial Inc.

## Notes to the Interim Consolidated Financial Statements (unaudited)

Three and Six Months Ended May 31, 2010 and 2009

The forward foreign exchange contracts primarily require the Company to sell certain foreign currencies for Canadian dollars at contractual rates. The Company had the following forward foreign exchange contracts:

In thousands of dollars						May 31, 2010	
Type	Notional	Currency	Maturity	Equivalent to Canadian Dollars		Fair Value	
Sell	8	EURO	July 2010	11	\$	-	
Sell	63	EURO	October 2010	84		3	
Sell	30	GBP	October 2010	46		1	
Sell	180	GBP	November 2010	273		-	
					\$	<u>4</u>	

In thousands of dollars						November 30, 2009	
Type	Notional	Currency	Maturity	Equivalent to Canadian Dollars		Fair Value	
Sell	200	GBP	April 2010	350	\$	-	
Sell	120	USD	April 2010	127		-	
Sell	163	EURO	February 2010	253		(6)	
Sell	120	EURO	April 2010	188		(2)	
					\$	<u>(8)</u>	

A 10% strengthening (weakening) of the Canadian dollar against each of the Great Britain pound, the United States dollar, and the Euro would have decreased (increased) earnings from operations at May 31, 2010 by a total of \$40,000 (November 30, 2009- \$5,000). A 10% strengthening (weakening) of the Canadian dollar against the U.S. dollar would have decreased (increased) the reporting currency earnings U.S. operations for the six months ended May 31, 2010 by a total of \$255,000 (the year ended November 30, 2009 - \$51,000). A 10% strengthening (weakening) of the Canadian dollar against the U.S. dollar would also impact the reporting currency balance sheet values at May 31, 2009 with an offsetting adjustment of approximately \$651,000 (November 30, 2009 - \$1,183,000) to other comprehensive income.

### *Interest rate risk*

The Company is exposed to interest rate risk on its variable interest operating line of credit. A 1% increase (decrease) in the interest rate would have resulted in \$nil and \$nil increase (decrease) in the loss of the Company for the three and six months ended May 31, 2010 (three and six months ended May 31, 2009 - \$4,000 and \$8,000, respectively).

### **Liquidity risk**

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company's approach to managing liquidity risk is to ensure that it will always have sufficient liquidity to meet liabilities when due. The Company has an accounts receivable factoring credit facility of \$2.0 million in Canada and a variable limit in the U.S. that is based on the outstanding accounts receivable of the U.S. operations. At May 31, 2010, the Company utilized \$nil (November 30, 2009 - \$nil) and U.S. \$nil (November 30, 2009 - U.S. \$227,000). As at November 30, 2009, the Company has operating line of credit facility of \$1

# OSI Geospatial Inc.

## Notes to the Interim Consolidated Financial Statements (unaudited)

Three and Six Months Ended May 31, 2010 and 2009

million in Canada and utilized \$860,000. All of the Company's financial liabilities, other than capital lease obligations, have contractual maturities of less than 45 days.

The table below analyzes the following liabilities which will settle as indicated based on the remaining periods at May 31, 2010 to the contractual maturity date. The amounts disclosed in this table are the contractual undiscounted cash flows. Balances within twelve months equal the carrying balance as the impact of discounting is not significant.

<b>Payments due by period</b>	<b>Total</b>	<b>Less than 1 year</b>	<b>1 to 3 years</b>	<b>4 to 5 years</b>	<b>After 5 years</b>
In thousands of Canadian dollars					
Facility leases	\$ 2,820	\$ 674	\$ 1,152	\$ 510	\$ 484
Capital equipment leases	90	45	45	-	-
Operating equipment leases	35	25	10	-	-
<b>Total contractual obligations</b>	<b>\$ 2,945</b>	<b>\$ 744</b>	<b>\$ 1,207</b>	<b>\$ 510</b>	<b>\$ 484</b>

### Fair values

#### a) Establishing fair value

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

The fair values of the Company's forward foreign exchange contracts are based on the current market values of similar contracts with the same remaining duration as if the contracts had been entered into on May 31, 2010 and November 30, 2009.

The carrying amounts of each of the financial instruments are:

In thousands of Canadian dollars		<b>May 31, 2010</b>	<b>November 30, 2009</b>
Held-for-trading			
Cash	\$	1,710	\$ 315
Restricted cash		633	-
Forward contracts		4	(8)
Loans and receivables			
Trade accounts receivable		2,758	2,607
Other liabilities			
Bank indebtedness		-	(599)
Factored advances payable		-	(240)
Accounts payable and accrued liabilities		(4,195)	(3,806)
Capital lease obligation		(80)	(122)

# OSI Geospatial Inc.

## Notes to the Interim Consolidated Financial Statements (unaudited)

Three and Six Months Ended May 31, 2010 and 2009

### b) Fair-value hierarchy

Financial instruments recorded at fair value on the consolidated balance sheet are classified using the fair-value hierarchy that reflects the significance of the inputs used in making the measurements. The fair-value hierarchy has the following levels:

Level 1 – valuation based on quoted prices (unadjusted) in active markets for identical assets and liabilities;

Level 2 – valuation techniques based on inputs other than quoted prices included in Level 1 that are observable for the asset and liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices); and

Level 3 – valuation techniques using inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The fair-value hierarchy requires the use of observable market inputs whenever such inputs exist. A financial instrument is classified to the lowest level of the hierarchy for which a significant input has been considered in measuring fair value.

The following table presents the fair value of the financial instruments that are carried at fair value classified using the fair-value hierarchy described above:

In thousands of Canadian dollars	May 31, 2010			
	Level 1	Level 2	Level 3	Total
Financial assets				
Forward foreign exchange contracts	\$ -	\$ 4	\$ -	\$ 4
Total financial assets	\$ -	\$ 4	\$ -	\$ 4
In thousands of Canadian dollars	November 30, 2009			
	Level 1	Level 2	Level 3	Total
Financial liabilities				
Forward foreign exchange contracts	\$ -	\$ (8)	\$ -	\$ (8)
Total financial liabilities	\$ -	\$ (8)	\$ -	\$ (8)

## 9 Capital structure management

The Company's objective is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The Company reviews on a semi-annual basis whether any dividends should be paid.

The Company monitors capital on a basis consistent with others in the industry based on total debt to shareholders' equity. Management defines capital as the Company's total shareholders' equity excluding accumulated other comprehensive income and total debt is defined as bank indebtedness and capital lease obligations.

There were no changes in the Company's approach to capital management during the period. Neither the Company nor any of its subsidiaries is subject to externally imposed capital requirements other than disclosed in note 4.

# OSI Geospatial Inc.

Notes to the Interim Consolidated Financial Statements (unaudited)

Three and Six Months Ended May 31, 2010 and 2009

In thousands of Canadian dollars

	May 31, 2010	November 30, 2009
Bank indebtedness	\$ -	\$ 599
Factored advances payable	-	240
Capital lease obligation	80	122
Total debt	<u>\$ 80</u>	<u>\$ 961</u>
Total equity	11,393	9,963
Less accumulated other comprehensive loss	1,377	1,356
Net equity	<u>\$ 12,770</u>	<u>\$ 11,319</u>

## 10 Segmented information

The Company operates in four segments: International Systems Operations, U.S. Systems Operations, Mapping Operations and Corporate and public company costs. Operating segments are identified as components of the Company for which separate discrete financial information is available for evaluation by the chief operating decision maker regarding how to allocate resources and assess performance. The Company's chief operating decision maker is the Chief Executive Officer.

The Company's reportable segments are as outlined below which are defined by their primary type of service offerings. Information about the Company's reportable segments is as follows:

In thousands of Canadian dollars

**Three Months Ended May 31, 2010**

	International Systems Operations	U.S. Systems Operations	Mapping Operations	Corporate and Public Company Costs	Total
Revenue	\$ 851	\$ 1,902	\$ 2,359	\$ -	\$ 5,112
Gross profit	419	660	627	-	1,706
Technology Partnerships Canada	43	-	-	-	43
Interest expense	1	3	-	3	7
Income tax recovery	-	(301)	-	(10)	(311)
Amortization	45	40	24	6	115
Net earnings (loss)	(260)	(80)	373	(783)	(750)
Equipment and furnishings expenditures	16	29	-	-	45
Intangible expenditures	115	10	2	-	127

# OSI Geospatial Inc.

Notes to the Interim Consolidated Financial Statements (unaudited)

Three and Six Months Ended May 31, 2010 and 2009

In thousands of Canadian dollars

## Six Months Ended May 31, 2010

	International Systems Operations	U.S. Systems Operations	Mapping Operations	Corporate and Public Company Costs	Total
Revenue	\$ 2,065	\$ 4,018	\$ 2,472	\$ -	\$ 8,555
Gross profit	1,063	1,208	541	-	2,812
Technology Partnerships Canada	112	-	-	-	112
Interest expense	8	9	-	28	45
Income tax expense (recovery)	-	1,658	-	(10)	1,648
Amortization	91	88	48	12	239
Net earnings (loss)	(479)	2,980	78	(1,247)	1,332
Equipment and furnishings expenditures	16	39	-	-	55
Intangible expenditures	115	11	2	-	128

In thousands of Canadian dollars

## Three Months Ended May 31, 2009

	International Systems Operations	U.S. Systems Operations	Mapping Operations	Corporate and Public Company Costs	Total
Revenue	\$ 1,615	\$ 3,270	\$ 1,430	\$ -	\$ 6,315
Gross profit	791	773	370	-	1,934
Technology Partnerships Canada	113	-	-	-	113
Interest expense	4	15	-	1	20
Income tax expense	-	12	-	8	20
Amortization	54	64	33	8	159
Net earnings (loss)	(527)	215	77	(803)	(1,038)
Equipment and furnishings expenditures	6	56	-	2	64
Intangible expenditures	-	14	-	-	14

In thousands of Canadian dollars

## Six Months Ended May 31, 2009

	International Systems Operations	U.S. Systems Operations	Mapping Operations	Corporate and Public Company Costs	Total
Revenue	\$ 3,612	\$ 6,738	\$ 1,689	\$ -	\$ 12,039
Gross profit	1,933	1,356	364	-	3,653
Technology Partnerships Canada - net	208	-	-	-	208
Interest expense	4	30	-	16	50
Income tax expense (recovery)	-	(140)	-	15	(125)
Amortization	108	128	69	15	320
Net earnings (loss)	(425)	328	(207)	(1,431)	(1,735)
Equipment and furnishings expenditures	7	78	2	7	94
Intangible expenditures	-	16	-	-	16

# OSI Geospatial Inc.

Notes to the Interim Consolidated Financial Statements (unaudited)

Three and Six Months Ended May 31, 2010 and 2009

In thousands of Canadian dollars

	International Systems Operations	U.S. Systems Operations	Mapping Operations	Corporate and Public Company Costs	Total
<b>Total assets employed</b>					
As at May 31, 2010	\$ 4,619	\$ 8,014	\$ 3,345	\$ 762	\$ 16,740
As at November 30, 2009	\$ 4,636	\$ 8,448	\$ 2,439	\$ 236	\$ 15,759

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

In thousands of Canadian dollars

	Three months ended May 31,		Six months ended May 31,	
	2010	2009	2010	2009
United States	\$ 2,546	\$ 4,006	\$ 4,737	\$ 7,532
Canada	1,882	1,115	1,978	1,473
United Kingdom	291	513	703	1,026
Australia	151	445	404	1,658
Netherlands	37	-	159	-
New Zealand	58	63	122	125
Other	147	173	452	225
<b>Total</b>	<b>\$ 5,112</b>	<b>\$ 6,315</b>	<b>\$ 8,555</b>	<b>\$ 12,039</b>

Geographically, equipment and furnishings and intangible and other assets are reported based on location. At May 31, 2010 and November 30, 2009, all of the Company's equipment and furnishings and intangible and other assets were located in Canada and the U.S. as follows:

In thousands of Canadian dollars

	May 31, 2010		
	Canada	U.S.	Total
Equipment and furnishings	\$ 1,126	\$ 181	\$ 1,307
Intangible and other assets	259	202	461
Goodwill	-	4,279	4,279
<b>Total</b>	<b>\$ 1,385</b>	<b>\$ 4,662</b>	<b>\$ 6,047</b>

In thousands of Canadian dollars

	November 30, 2009		
	Canada	U.S.	Total
Equipment and furnishings	\$ 1,215	\$ 258	\$ 1,473
Intangible and other assets	168	278	446
Goodwill	-	4,324	4,324
<b>Total</b>	<b>\$ 1,383</b>	<b>\$ 4,860</b>	<b>\$ 6,243</b>

# **OSI Geospatial Inc.**

Notes to the Interim Consolidated Financial Statements (unaudited)

Three and Six Months Ended May 31, 2010 and 2009

---

## **11 Sale of soldier systems intellectual property**

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.

Pursuant to the terms of the contract with Harris, U.S. \$500,000 was held in escrow on behalf of the Company for the purposes of, among other things, funding the payment of any indemnification obligations of the Company. 50% of the escrow fund will be released on the first year anniversary of the closing date and the other 50% will be released upon the expiration of the escrow period in September 2011. The escrow fund is included in restricted cash in the interim consolidated balance sheet.

## **12 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 believed the claim was without merit and the Company filed a counterclaim for breach of fiduciary obligations as an officer of the Company and contractual obligations under the former employee's Employment Agreement. In April 2010, a settlement was reached and this lawsuit was dismissed. The Company accrued for this settlement as at May 31, 2010.

## **13 Subsequent event**

In July 2010, 24,300 Class B, series 2 preference shares were converted into 1,429,411 common shares.