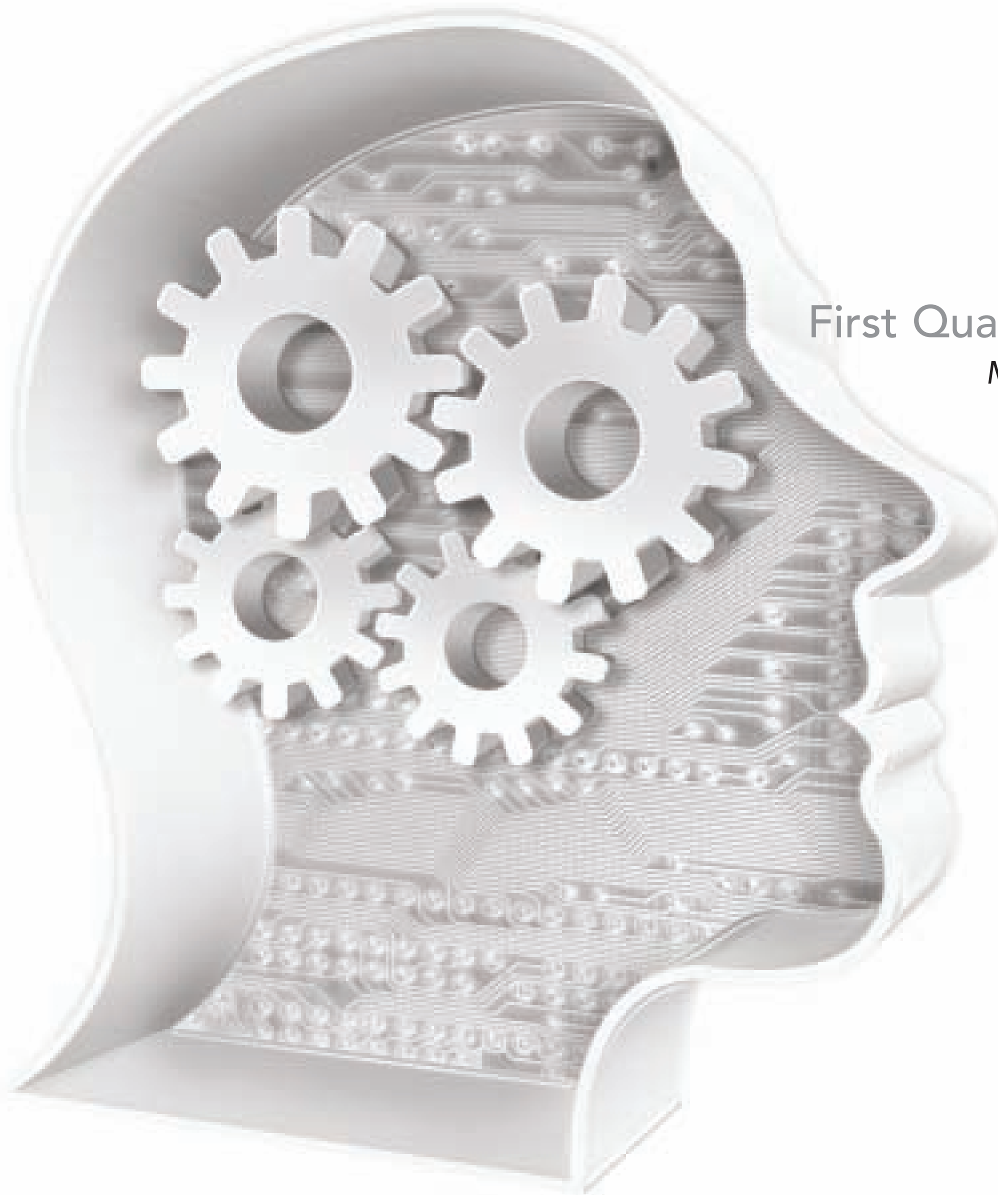


First Quarter Report

March 31, 2007

ATLANTIS

MESSAGE TO SHAREHOLDERS

Atlantis entered 2007 with a quarter made difficult by a combination of contract delays and slippage by sub-contractors. Revenue was a disappointing $5.8 million, below our forecast and below the previous quarter and the same quarter a year earlier.

Under the CFTS program, Atlantis recognizes revenue based on work performed in-house and milestones achieved by sub-contractors. Because some sub-contractor milestones scheduled for the first quarter were in fact achieved early in the second quarter, this affected our financial performance.

Of course, the revenue has not been lost, it has simply been delayed. But the situation does highlight the fact that Atlantis' financial results can, and have been, 'lumpy' over time. This variability is one of the key reasons why we have implemented a diversification strategy, and it is beginning to pay off.

For example, we entered the world's largest military market through Atlantis Systems America (ASA) and that investment will yield its first results this year. ASA was awarded its first direct contract subsequent to the end of the quarter and the revenues of US$2.7 million are expected to be recognized over the balance of 2007 and 2008.

Further, ASA employees are currently at about 90% utilization on ASI contracts such as CFTS. This has allowed the Company to cut back outsourcing – reducing its reliance on sub-contractors and the problems that can occur as noted above.

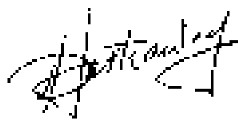
As well, ASA qualified as a U.S. defense contractor during the first quarter, allowing it to compete directly for high-value military contracts in a market where the national defence budget is over US $500 billion.

Atlantis has also diversified into the nuclear power generation sector, where small early contracts have been encouraging, reaching about 2% of total revenue in the quarter. More importantly, we are now an established presence, with larger contracts bid or in process and an extension signed after the end of the quarter.

In April we announced over $8 million in new contracts, maintaining the strength of the backlog. This is somewhat reduced from the unusually large backlog in the first year of the CFTS contract but there will be positive effects as the revenue proportions shift from the lower margin CFTS work.

We expect profitability to improve and revenues to grow as we continue to expand in markets where the end-user must maintain an ongoing learning process for its work force.

On May 4th, we announced the signing of an agreement with Tecsult Inc., a Quebec-based engineering firm, to acquire certain assets of Tecsult's wholly-owned subsidiary, Tecsult Eduplus, a Halifax-based courseware provider in the military aerospace and naval defence sectors. We are in the final stages of due diligence and expect to acquire the Eduplus learning management system, existing contracts and a five-year agreement with Tecsult Inc. to develop courseware. This transaction is subject to due diligence, Board and regulatory approval and is expected to close on or about June 20, 2007.



Andrew Day,
President and C.E.O.

Donald B. Hathaway,
Chairman of the Board

MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis ("MD&A") explains the financial condition and results of operations of Atlantis Systems Corp. ("our Company" or "we" or "our" or "us") as at and for the three months ended March 31, 2007 with comparisons to the three months ended March 31, 2006 and the year ended December 31, 2006 where applicable. This MD&A is intended to assist shareholders and other readers to understand our business and the key factors underlying our financial results. This MD&A should be read in conjunction with our unaudited consolidated financial statements and the notes thereto as at and for the three months ended March 31, 2007 and 2006. We prepare our consolidated financial statements in accordance with Canadian generally accepted accounting principles ("GAAP"). All amounts are stated in thousands of Canadian dollars except where otherwise noted. All tabular amounts are expressed in thousands of Canadian dollars except per share amounts. This MD&A is based on information available as at May 9, 2007 except where otherwise noted.

FORWARD-LOOKING STATEMENTS

Forward-looking statements look into the future and provide an opinion about the effect of certain events and trends on the business. Forward-looking statements may include words such as "plans", "intends", "anticipates", "should", "estimates", "expects", "believes", "indicates", "targeting", "suggests" and similar expressions.

This MD&A, and in particular the Business Outlook on page 14, contains forward-looking statements. These forward-looking statements are based on current expectations and various estimates, factors and assumptions and involve known and unknown risks, uncertainties and other factors. The material factors and assumptions that were applied in making the forward-looking statements in this MD&A include assumptions regarding: the proportion of in-house and subcontractor work on the Contracted Flying Training and Support ("CFTS") program and the ability of subcontractors to meet deadlines; the level of activity under the CFTS program; the completion profile of new and existing projects; the cost to complete existing contracted work; the performance of contracts in accordance with their terms; the proportion of CFTS to non-CFTS revenue; the number of stock options to be granted in the future; the completion date, development of applications, market and market share for our Helicopter Vocational Trainer ("HVT") product; the level of capital programs to be completed; expected developments in the nuclear industry; Atlantis Systems America, Inc.'s capability to deliver courseware, the level of spending on our direct U.S.-market initiative; and the fair value of our Company exceeding its carrying value in the financial statements, including goodwill.

It is important to note that:

- Unless otherwise indicated, forward-looking statements in this MD&A describe our expectations as of May 9, 2007.
- Readers are cautioned not to place undue reliance on these forward-looking statements as our actual results, performance or achievements may differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements if known or unknown risks, uncertainties or other factors affect our business, or if our estimates or assumptions prove inaccurate. Therefore, we cannot provide any assurance that the predictions of forward-looking statements will materialize.
- We assume no obligation to update or revise any forward-looking statement, whether as a result of new information, future events or for any other reason, except as required by applicable securities laws and regulations.

Material factors that could cause our actual results to differ materially from the forward-looking statements in this MD&A include risks and uncertainties relating to but not limited to: the CFTS program; reliance on subcontractors; our U.S. subsidiary, ASA; reliance on key customers; the level of military expenditures and

developments in the nuclear industry; HVT development and sales; relationships with existing U.S. prime contractors; and the availability of skilled personnel. For additional information regarding risks and uncertainties that could affect our business, please see the Business Risk Factors section of our Annual MD&A and the Description of the Business – Risk Factors section in our Annual Information Form, both of which are available on the System for Electronic Data and Retrieval (SEDAR) at www.sedar.com.

Additional information regarding our Company is contained in filings with securities regulatory authorities, including our Annual Information Form and Management Information Circular. These documents are available on SEDAR or on our website at www.atlantissi.com.

HIGHLIGHTS

Subsequent to first quarter-end, we announced the award of over $8 million in new contracts, including the first contract directly awarded to ASA.

Revenue for the three months ended March 31, 2007 was $5.8 million, a significant reduction from the $11.2 million recognized in the fourth quarter of 2006, a 32% decrease from the $8.5 million reported for the same quarter in the previous year. The reduction resulted from reduced revenues from the CFTS program because subcontractor milestones scheduled for the first quarter were in fact achieved early in the second quarter.

We recorded a loss of $1.8 million in the first quarter of 2007, primarily driven by reduced revenues at Atlantis Systems International Inc. ("ASI") (resulting in a $1.2 million loss at ASI) and expenses attributable to our U.S. operations ($0.6 million). This compared to a loss for the fourth quarter of 2006 of $148 and net income of $94 for the first quarter of 2006.

We reported cash and cash equivalents of $9.1 million at March 31, 2007 which was $5.1 million lower that the balance reported at last year's first quarter-end and $4.5 million below the reported balance of $13.6 million reported at December 31, 2006.

Also in the first quarter, Atlantis Systems America, Inc. ("ASA") completed the process of qualifying as a U.S. defence contractor, a process that began when the subsidiary was launched in early 2006.

As of the date of this MD&A, we had 343,879 warrants to purchase common shares outstanding (following the expiration of 1,972,000 warrants to purchase common shares on April 1, 2007), a significant reduction from the 17,017,283 warrants to purchase common shares outstanding at March 31, 2006.

At March 31, 2007, we had a total head count of 209, of which 55 were based at ASA in Orlando, Florida.

In early May, 2007, we announced that we had entered into an agreement with Tecsult Inc. to acquire certain assets of its wholly owned subsidiary, Tecsult Eduplus for cash and additional consideration based on future performance.

RESTATEMENT

In the first quarter of 2007 we reviewed our revenue recognition with multiple deliverables, including our prior year assessment that certain contracts contained separate units of accounting. As the assessment is that such contracts, which have initial phases and then provide for support services, do not qualify as separate units of accounting and should be treated as single contracts rather than as two separate contracts we restated our revenue for the year ended December 31, 2005 and for the first three quarters of 2006. For comparative purposes, in connection with this MD&A, the result of correcting this error is that we have reduced revenue and cost of revenue for the first quarter of 2006 by $149 and $103 respectively. This correction did not change the basic and diluted net income per share for the first quarter of 2006. All amounts relating to the three months ended March 31, 2006 presented herein have been adjusted to reflect this restatement, as applicable.

RESULTS OF OPERATIONS

Following is a discussion of the material factors influencing the operating results and the financial condition of our Company, as at and for the three months ended March 31, 2007 with comparisons to the three months ended March 31, 2006 and December 31, 2006, where applicable.

The Consolidated Statements of Operations, Comprehensive Income and Deficit for the three months ended March 31, 2007, with comparative numbers for the three months ended March 31, 2006, reflect the operations of our operating entities, ASI and ASA, and corporate overheads. All revenues for the first quarter of 2007 and 2006 were generated by the Canadian operating entity, ASI.

Revenues

The components of revenue for the three months ended March 31, 2007 and 2006 are as follows:

	Three Months Ended March 31			
	2007		2006 Restated	
	$	% of total	$	% of total
CFTS	$2,858	49%	$6,134	72%
IMTS	558	10%	1,780	21%
RDAF	1,445	25%	-	-
Nuclear Sector	129	2%	98	1%
Other	839	14%	519	6%
Total	$5,829	100%	$8,531	100%

We realized consolidated revenues of $5,829 in the first quarter of 2007, versus revenues of $8,531 for the same period in 2006, a decrease of 32%. The major component of the reduction related to the CFTS program. For the first quarter of 2007, 49% of revenues were generated from the CFTS program versus 72% for the first quarter of 2006. For the CFTS program, we recognize revenue based upon the proportion of work performed in-house (including by ASA) and achievement of milestones by our subcontractors on the program. For the first quarter of 2007, subcontractor milestones scheduled for the first quarter were in fact achieved early in the second quarter, resulting in the recognition of significantly lower revenue on the CFTS program versus the same period in the previous year and in the fourth quarter of 2006. ASI continued to recognize revenue arising from the delivery of courseware created by ASA for the CFTS program.

We expect ASA to continue to develop and deliver courseware for the CFTS program through 2008. CFTS revenue is expected to fluctuate over 2007 and 2008 depending upon the proportion of work performed in-house (including by ASA) in any given period and achievement of milestones by our subcontractors on the program.

In the first quarter of 2007, revenues from integrated maintenance training systems (“IMTS”) projects amounted to 10% of total revenues ($558) versus 21% ($1,780) for the first quarter of 2006. The 2007 amount primarily reflects sales of IMTS under contracts with the armed forces of Canada. In the second quarter of 2006, the Canadian Forces (“CF”) awarded us a contract to provide weapons load trainers (which expanded our IMTS offering) for the CF-18 aircraft fleet, along with support services for the weapons load trainers through 2020. Revenues of $498 were recognized in the first quarter of 2007 from the weapons load trainer program and work is expected to continue through 2007 and into early 2008 on this contract. Revenues recognized in the first quarter of 2006 on IMTS contracts were $1,376 from the Royal Australian Air Force (“RAAF”), $283 from the CF, and $121 from the U.S. Navy.

The reduction in IMTS revenues from the first quarter of 2007 to the same period in 2006 of $1,222 (a 69% reduction) was due to the completion of contracts with the U.S. Navy and RAAF in 2006.

In the third quarter of 2006, we were awarded a contract to provide a cockpit procedures trainer to the Royal Danish Air Force ("RDAF") for the EH-101 helicopter through prime contractor AgustaWestland, which will be delivered over a twenty-four month period. Revenues of $1,445 were recognized on this program in the first quarter of 2007.

Revenues from customers in the nuclear sector were $129 for the first quarter of 2007, or 2% of revenue. This strategic market initiative was begun in late 2005 and subsequent to first quarter-end of 2007 we have signed an extension to an existing contract in this sector for the balance of 2007.

Other revenues in the first quarter of 2007 of $839 included revenue of $342 from the upgrade of our existing Atlantis Boeing 767 flight training devices for Air Canada, along with $497 derived from a number of small, short-duration contracts. Other revenues in the first quarter of 2006 of $519, were also derived from a number of small, short-duration contracts.

During the three months ended March 31, 2007, while we had contracts with multiple customers, one customer, the CF, represented 58% of revenue. In addition, as at March 31, 2007, the same customer represented 52% of combined accounts receivable and unbilled revenue. Our second largest customer represented 25% of revenue with 24% of the combined outstanding balance of accounts receivable and unbilled revenue at quarter end.

During the three months ended March 31, 2006, one customer, the CF, represented 75% of revenue, and 4% of combined accounts receivable and unbilled revenue at March 31, 2006. Our second largest customer in the first quarter 2006 represented 16% of revenue and 45% of combined accounts receivable and unbilled revenue at March 31, 2006.

The order backlog at March 31, 2007 was $50.7 million, consisting of $42.7 million from the CFTS program (which includes $18.4 million in support services for the twenty-year support period) and $8.0 million from all other contracts. This order backlog of $50.7 million includes new orders with a combined value in excess of $5 million awarded in the first quarter. The order backlog of $50.7 million decreased $13.8 million from the comparable backlog of $64.5 million at March 31, 2006. This decrease consists of a $17.5 million net reduction on the CFTS program, offset by a $3.7 million increase in the non-CFTS order backlog. We expect between 35% and 45% of the order backlog to be realized as revenue over the remaining three quarters of 2007.

Subsequent to March 31, 2007 we announced that ASA had received directly a U.S. $2.7 million contract with a customer in the U.S. defence sector which will be included in order backlog in the second quarter of 2007. This is the first direct order received by our subsidiary, ASA. This order is expected to be delivered over the next eighteen months.

Order backlog at March 31, 2006 was $64.5 million, consisting of $60.2 million from the CFTS program (which included $18 million in support services through the twenty-year support period) and $4.3 million from all other contracts.

Order backlog is defined as that portion of a legally binding commercial agreement that provides sufficient detail on our obligations and our customers' obligations to form the basis for a contract and an order that has not yet been recognized as revenue.

Gross Margin

Gross margin for the three months ended March 31, 2007 was $1,226 or 21%, compared with gross margin of $2,516 or 29% for the comparable period in 2006. The reduction in the dollar value of gross margin reflects the lower revenue in the first quarter of 2007 versus the same period in 2006. The gross margin percentage decreased despite the proportionate decrease in lower-margin CFTS revenue (from 72% of revenue in the first quarter of 2006 to 49% of total revenue in the first quarter of 2007), due to the higher proportion of manufacturing and facility costs to revenue in the quarter and due to the inclusion in cost of revenue of $300 of overhead in costs incurred by ASA and attributed to ASI's CFTS courseware development activities.

We believe that the 21% gross margin realized in the first quarter of 2007 is not indicative of the expected rate going forward. We expect gross margins to fluctuate between 25% and 35% going forward depending on the mix in a particular quarter between CFTS and non-CFTS revenue and the amount of revenue we anticipate will be recognized by ASA, which we expect will initially generate lower margins due to competitive pressures, lack of economies of scale and start-up inefficiencies.

Operating Expenses

We incurred general and administrative ("G&A") expenses of $1,997 for the three months ended March 31, 2007, versus $1,583 for the same period in 2006, a 26% increase. The 2007 amount includes $357 incurred by ASA, a reduction of $147 from the $504 incurred by ASA in the same period of 2006. This reduction is due primarily to the attribution of a portion of overhead costs to cost of sales related to the CFTS courseware development activities performed by ASA on behalf of ASI. The increase at ASI of $661 is due primarily to increased personnel-related costs in the balance of 2006 due to the hiring of additional management and finance personnel to support our anticipated future business activity and increased costs related to compliance with regulatory requirements.

Sales and Marketing ("S&M") expenses of $912 for the three months ended March 31, 2007 represent a 47% increase over the $622 incurred in the same period in 2006. The 2007 amount includes $182 incurred by ASA, a reduction of $105 from the $287 incurred by ASA in the same period of 2006. This reduction in S&M spending at ASA results from lower levels of spending on introductory marketing programs in the first quarter of 2007 versus the same period in 2006. The increase at ASI of $395 is due to increases in personnel levels within marketing and spending on marketing programs and conferences.

We expect combined spending on G&A and S&M at ASA to increase over 2006 levels provided ASA continues to be successful in winning direct contracts (in addition to those as a subcontractor to ASI).

We incurred stock option expenses of $42 for the three months ended March 31, 2007 versus $35 for the same period in 2006. The increase of $7 primarily reflects the accrual of expense related to the grant of options to employees in December of 2006. The remaining compensation-related costs will be expensed over a three-year period at the rate of approximately $125 for the remainder of 2007, $121 for 2008 and $15 for 2009. However, this expected expense for 2007 of $167 does not take into account any future grants or cancellations for the balance of the year.

Research and development ("R&D") expenses of approximately $37 for the three months ended March 31, 2007 were included in cost of revenue, up from the $19 incurred in the same period of 2006. These expenses represented an investment in the development of simulation-based training intellectual property. Additional R&D is integrated into large simulation contracts and is expensed through cost of revenue. Also, during the first quarter 2006, we funded and capitalized costs of $76 related to the development of our virtual-reality, full-motion helicopter simulator (referred to as HVT). There were no costs funded or capitalized in the first quarter of 2007. We expect this development project to be completed in 2007 and we expect to recover this investment through market opportunities that are expected to arise from the introduction and commercialization of this technology in 2007. No amortization has been recorded to date. In 2007, we will continue to invest in R&D initiatives that we believe will lead to further market opportunities, however, capitalization of R&D expenditures will depend on the initiatives' ability to meet the required tests for capitalization.

Other Items

We incurred depreciation and amortization expense of $153 in the three months ended March 31, 2007 versus $73 in the same period of 2006. The increase of $80 primarily reflects the investment in capital assets in 2006 of $1,266 and the investment of $163 in the first quarter of 2007. Of the $1,266 spent in 2006, $441 is attributable to ASA and of the $163 spent in the first quarter of 2007, $50 is attributable to ASA. We expect depreciation and amortization expense will increase in 2007 versus 2006 due to the level of investment in 2006 and further anticipated investment in 2007.

Interest and financing (income) costs resulted in income of $102 in the three months ended March 31, 2007 versus a net expense of $109 in the same period of 2006. The first quarter 2007 income of $102 primarily represents interest income of $109 offset by interest paid on the remaining debenture of $2 and bank service charges, support fees and other costs of $5. The 2006 first quarter amount represents interest paid on the $3.1 million convertible debentures of $78, accretion of the carrying value to par (at March 30, 2008) of $85, amortization of deferred financing costs of $24 and bank service charges, support fees and other costs of $13 offset by interest income of $91.

The $100 convertible debenture is still outstanding. As at March 31, 2007, we continued to be in breach of two of the financial covenants contained in the $100 convertible debenture, for which we received a waiver from the holder.

Interest at the prescribed rate of 10% per annum of the par value of the $100 convertible debenture will continue to be paid until maturity (March 30, 2008).

Due to our cash position at March 31, 2007, we do not expect to use accounts receivable for financing in 2007 and expect any other financing to be completed on commercial terms appropriate for a company of our size and status.

Other Expenses

There was no income tax (recovery) expense shown for either of the three months ended March 31, 2007 or 2006 because we had previously recorded a full valuation allowance for all future income tax assets (specifically cumulative operating loss carry-forwards and temporary differences) as we believed there was uncertainty in realizing the full benefit of these items. As a result, any income tax recovery in the first quarter of 2007 was not recognized and an income tax expense related to earnings in the first quarter of 2006 were offset by utilizing an equal portion of the unrecognized operating loss carry-forwards from previous years. As at March 31, 2007, we continue to carry a full valuation allowance against our income tax assets due to the continued uncertainty surrounding their full usage. There will be no income tax expense against earnings in Canada until either all unrecognized operating loss carry-forwards of approximately $15 million are used or expire. Likewise, there will be no income tax expense against earnings in the United States until all unrecognized operating loss carry forwards of approximately $3.4 million are used or expire.

U.S. Marketplace Expenses and Charges Incurred by ASA

For the three months ended March 31, 2007, costs incurred by ASA for our direct expansion into the U.S. marketplace were $578. These costs were primarily incurred on combined G&A and S&M expenses. No revenue or order backlog was recognized in the first quarter of 2007 by ASA. Subsequent to March 31, 2007, ASA was awarded its first direct contract for U.S. $2.7 million from a customer in the U.S. defence sector. Revenues from this contract will be recognized over the balance of 2007 and 2008.

For the three months ended March 31, 2006, costs incurred by ASA were $802. These costs were primarily incurred on combined G&A and S&M expenses. No revenue or order backlog was recognized in the first quarter of 2006 by ASA.

Loss

We lost $1,775 (($0.03) per share) for the three months ended March 31, 2007 compared to a net income of $94 ($0.00 per share) for the same period in 2006. The calculation of diluted net (loss) / income per share for the first quarter of 2007 and 2006 did not result in any dilution versus reported basic earnings per share.

Summary of Quarterly Results (unaudited)

Following are the quarterly results for the previous eight quarters:

	2007	2006				2005		
	Mar 31	Dec 31	Sep 30 Restated	Jun 30 Restated	Mar 31 Restated	Dec 31 Restated	Sep 30	June 30
Revenues	$5,829	$11,152	$11,509	$5,923	$8,531	$7,137	$8,471	$12,799
Gross margin	1,226	2,964	3,794	1,589	2,516	3,067	4,349	1,512
Operating Expenses*	2,951	3,056	2,649	3,028	2,240	2,216	1,886	937
Net income (loss)	(1,775)	(148)	1,373	(2,754)	94	569	1,554	426
Net income (loss) per share (basic)	($0.03)	($0.00)	$0.03	($0.05)	$0.00	$0.01	$0.03	$0.01

* Represents the sum of G&A, S&M and stock option expenses

As previously mentioned, we reviewed our revenue recognition for contracts with multiple deliverables and have determined that the recognition of revenue for the fourth quarter of 2005 and the first three quarters of 2006 was incorrect. The table above reflects the corrected amounts for each of those four consecutive quarters.

Revenues over the eight-quarter period fluctuated reflecting our experience with large, multi-year contracts. The quarterly revenue profile for 2005 included the initial stages of the CFTS program awarded early in the second quarter from which we received approximately $83 million in orders, $65 million of which we expected to recognize as revenue over the first thirty months. CFTS revenue for the second, third and fourth quarters of 2005 were $9,199, $2,630 and $4,956 respectively for a total of $16,785. Our quarterly revenue profile for 2006 reflects fluctuations in CFTS revenue which depended upon the proportion of work performed in-house and the achievement of milestones by our subcontractors in any given quarter. CFTS revenues for each of the quarters of 2006 were $6,134, $3,210, $8,202 and $8,707 respectively for a total of $26,253. CFTS revenue for the first quarter of 2007 was only $2,858, reflecting the fact that subcontractor milestones scheduled for the first quarter were in fact achieved early in the second quarter.

Gross margin over the eight quarter period reflects not only revenue changes in each quarter but also certain specific items. For 2005, these items included the high proportion of CFTS-related revenues in the second quarter; additional revenue from a contract termination of $924 included in revenue in the third quarter, and the additional $1,300 included in revenue in the fourth quarter relating to the catch-up for the second and third quarters of the CFTS program related to the replacement of the initial enabling contract with the final contract in the fourth quarter of 2005. For 2006, the lower gross margin percentage in the second quarter included a $172 foreign exchange loss, and was further reduced since manufacturing and facility costs represented a larger proportion of second quarter revenue versus the other quarters in 2006. The lower gross margin percentage in the fourth quarter included a reduction of approximately $400 due to the recognition of additional costs related to our existing contracts. The lower gross margin percentage in the first quarter of 2007 included approximately $400 of additional costs relating to research and development, foreign exchange and ASA overhead costs attributed to CFTS courseware development activities.

Operating expenses (defined as combined G&A, S&M and stock option expenses) have increased significantly over the eight-quarter period, reflecting our direct expansion into the U.S. marketplace through ASA starting in the fourth quarter of 2005. On a quarterly basis, these amounts were: $189, $780, $899, $729, $742 and $539 respectively. As well, ASI has increased its spending through the first quarter of 2007 for personnel-related costs including the hiring of additional management and finance personnel to support both anticipated future business activity and increased costs related to compliance with regulatory requirements.

The net income (loss) for the eight quarters primarily reflects fluctuations in revenue. However, results for the second and third quarters of 2006 include the effects of the requirement to report the $3.1 million convertible debentures as a current liability ($1,064 expense) and the subsequent repayment of the $3.0 million convertible secured debenture ($224 income) respectively.

Net income (loss) per share (basic) also reflected the fluctuations in earnings over the eight quarters as well as the effect of the increase in the number of common shares outstanding from March 31, 2005 to March 31, 2007 of approximately 9.5 million common shares issued over the period, to approximately 54.7 million.

The diluted net income (loss) per share for the eight quarters is not shown since the calculation, using the treasury method, did not result in any dilution versus reported basic earnings per share except for the third quarters of 2005 and 2006, where diluted earnings per share were both $0.02 versus basic earnings per share of $0.03.

CASH FLOW, LIQUIDITY AND CAPITAL RESOURCES

Cash Flow

We had cash and cash equivalents of $9,118 at March 31, 2007 compared to $14,244 at March 31, 2006 and $13,636 at December 31, 2006. The March 31, 2007 and December 31, 2006 amounts exclude the $2,051 of restricted cash which is related to the contract with AgustaWestland discussed later in this section. The sources for the changes in cash and cash equivalents for the three months ended March 31, 2007 and 2006 are as follows:

	Three Months Ended March 31	
	2007	2006
Cash flows provided by (used in)		
Operating activities	$(5,337)	$5,791
Investing activities	(162)	(379)
Financing activities	981	77
Change in cash and cash equivalents	(4,518)	5,489
Cash and cash equivalents at beginning of period	13,636	8,755
Cash and cash equivalents at end of period	$9,118	$14,244

Operating Activities

Cash outflow from operating activities of $5,337 in the three months ended March 31, 2007 represented a $11,128 decrease over cash flow in the comparable quarter of 2006. For the three months ended March 31, 2007, the cash outflows from operating activities of $5,337 were primarily due a loss of $1,775 which was partially offset by non-cash charges included in the results for items such as depreciation and amortization and stock option expenses for a total of $194. This outflow was increased by the net change in non-cash working capital which used $3,755 of additional cash in the quarter. The $3,755 cash outflow on account of net changes in non-cash working capital was primarily due to: an increase in unbilled revenue attributable to the contract with AgustaWestland to provide cockpit procedures trainers to the RDAF; a reduction in accounts payable due to the first quarter payments for CFTS-related subcontractor milestone achievements in the fourth quarter of 2006 partially offset by a reduction in accounts receivable related to collections from the CFTS program and from contracts to provide IMTS to the CF.

For the three months ended March 31, 2006, cash flow from operating activities of $5,791 was primarily due to income of $94, supplemented by non-cash charges included in the results of $217, as well as the net change in non-cash working capital which generated an additional $5,680 in the quarter. These amounts were partially offset by the capitalization of deferred development costs of $76 and additions to other long-term assets of $120.

Cash outflow from operating activities for the three months ended March 31, 2007 of $5,337 represented a $11,128 decrease in cash flows from operating activities from the comparable period in 2006. This decrease was primarily due to significantly lower cash flows from non-cash working capital items of $9,435 and a lower contribution from operating results of $1,892 (including non-cash charges therein) partially offset by reduced cash funding of deferred development costs of $76 and other long-term assets of $123 in the three months ended March 31, 2007 versus the same period in 2006.

Investing Activities

Cash used in investing activities was $162 for the three months ended March 31, 2007 versus $379 for the comparable period in 2006. Of the 2007 amount, $163 represented investment in capital assets as follows: $50 represented investment in computer hardware, software, leasehold improvements and furniture and fixtures in ASA and the balance of $113 primarily represented purchases of computer hardware, communications equipment and leasehold improvements in our Brampton, Ontario operating facility. The 2006 amount for the comparable period consisted primarily of $262 for ASA with the balance of $117 incurred as a result of infrastructure improvements at our Brampton, Ontario facility. We expect such expenditures to be lower in 2007 than in 2006.

There was no change in restricted cash (cash designated and held as collateral against performance-related bonds issued on our behalf by a third party) of $2,051. This restricted cash represents the collateral provided for a letter of credit issued by a Canadian financial institution as a condition of the contract to provide a cockpit-procedures trainer to the RDAF via prime contractor AgustaWestland. We expect restricted cash to decline by approximately one half during the balance of 2007 as we achieve contract milestones that trigger the reduction in the value of the letter of credit.

Financing Activities

Cash flow from financing activities for the three months ended March 31, 2007 amounted to $981, compared to a cash flow of $77 for the same period in 2006. The $981 inflow represented proceeds from the exercise of common share purchase warrants of $873 and proceeds from the exercise of stock options of $108. The 2006 amount represented proceeds from the exercise of stock options of $77.

Liquidity

We last raised funds through equity or debt transactions in the second quarter of 2005. No funds were raised through the issuance of debt or equity in 2006 or the first quarter of 2007 other than proceeds from the exercise of stock options and common share purchase warrants.

We maintain a committed secured bank operating line of credit of up to $5.0 million with a major Canadian chartered bank. The operating line is not currently drawn. This credit facility permits us to borrow funds directly for operating and subsidiary funding purposes. The facility has financial covenants covering maximum borrowing base, a minimum current ratio and a minimum tangible net worth. Any advances are repayable on demand. As at March 31, 2007, we were in compliance with all financial covenants included in this facility.

In July of 2006, as a condition of the contract to provide a cockpit procedures trainer to the RDAF via prime contractor AgustaWestland, we entered into a letter of credit with a Canadian financial institution in the amount of $2,051. This letter of credit has been fully collateralized by restricting the use of an equal amount of our cash on hand with the counterparty to the letter of credit. The initial progress billings from the customer which were received in the third quarter of 2006 were approximately equal to the value of the initial letter of credit. The

value of this letter of credit and the amount of restricted cash (which is reported separately on our consolidated balance sheet at March 31, 2007) will decline as contract milestones are achieved through June 2008. We expect this letter of credit to decline by approximately one half during the remainder of 2007 as we achieve contract milestones that trigger the reduction in the value of the letter of credit.

Our remaining $100 convertible debenture is convertible at the holder's option any time prior to April 1, 2008 into 181,818 common shares at a conversion price of $0.55 per share. We had the right to redeem this debenture until March 30, 2007 at par without premium or penalty. Had we redeemed this debenture by March 30, 2007, the holder would have been able, for two years after redemption, to exercise common share purchase warrants to purchase 181,818 shares at $0.60 per share. We did not exercise this right of redemption and therefore the 181,818 common share purchase warrants conditionally issued in respect of this debenture are not eligible to be exercised and are considered to have expired. In addition, we have the right to convert the principal amount of this debenture into common shares at $0.55 per share if the trading price of our common shares closes at or above $1.50 for at least ninety consecutive trading days. The terms of this debenture include covenants covering minimum amounts for working capital, a minimum working capital ratio and minimum cumulative earnings before interest, taxes, depreciation and amortization targets. As at March 31, 2007, we were in breach of two of the financial covenants contained in this convertible debenture, for which we received a waiver from the holder.

Capital Resources

In the first quarter of 2007, we did not grant any options to purchase common shares. During the first quarter of 2006, we granted options to purchase 350,000 common shares. These options carry a term of five years, vest over two or three years and have exercise prices of either $0.62 or $0.68.

At our annual and special meeting of shareholders held in May of 2006, shareholders approved a revised stock option plan which allows for the issuance of options up to an amount equal to 15% of the issued and outstanding common shares, and which provides that any exercised options will increase the pool of options available for grant. As at March 31, 2007, based on the actual number of common shares outstanding, the Plan would allow for the issuance of a total of 8,204,915 options to purchase common shares of our Company. There are currently 5,599,540 options to purchase common shares outstanding, leaving 2,605,375 options available for issuance under the Plan. In addition, there are a further 250,000 options to purchase common shares outstanding which were issued outside the Plan in 2006 with the approval of the Toronto Stock Exchange under Rule 613(c). The amount of options available for issuance will change as we grant options during the balance of 2007 and as the actual number of common shares outstanding changes as well.

As at March 31, 2007, we continued to be in breach of two of the financial covenants in our remaining $100 convertible debenture, for which the holder granted us a waiver. It is our intention to repay this debenture on March 30, 2008 unless the debenture is converted prior to that date. The cure for these financial covenant breaches (which are measured following the completion of our results each quarter) requires us to have cumulative positive earnings of $2,000 over four quarters before interest, taxes, depreciation and amortization. We cannot predict at this time when (if at all) in 2007 we will no longer be in breach of these financial covenants. The holder of the debenture has not demanded repayment of the outstanding principal and accrued interest at this time, however we can not predict whether the holder will do so in the future. As a result, the debenture is presented as a current liability.

During the three months ended March 31, 2007, 1,456,121 warrants to purchase common shares were exercised at a price of $0.60. As at March 31, 2007, there were 2,315,879 warrants outstanding, 1,972,000 ($1.00 exercise price) which, subsequently, were not exercised and expired on April 1, 2007; 93,879 ($0.60 exercise price) which expire on June 30, 2007; and 250,000 ($0.60 exercise price) which expire on March 30, 2008. Thus, as of the date of this MD&A, there remain 343,879 warrants to purchase common shares outstanding.

For the three months ended March 31, 2007, contributed surplus increased from $8,574 to $8,589 as a result of the inclusion as an equity item the net of the following two items: first, an increase of $42 recognized as stock option compensation costs in the consolidated statement of operations and second, a reduction of $27 as a result of the exercise of options to purchase common shares whose value was transferred to the share capital account.

Outstanding Share Data

The following table summarizes the changes in the common shares, common share purchase warrants and options to purchase common shares for the three months ended March 31, 2007.

	Common Shares	Warrants	Options
Outstanding at December 31, 2006	52,977,476	3,772,000	6,123,959
Issued / Exercised	1,721,955	(1,456,121)	(265,834)
Granted	-	-	-
Cancelled / Expired	-	-	(8,585)
Outstanding at March 31, 2007	**54,699,431**	**2,315,879**	**5,849,540**

As at March 31, 2007, we had 2,315,879 common share purchase warrants outstanding at exercise prices ranging from $0.60 to $1.00 with expiry dates of April 1, 2007, June 30, 2007 and March 30, 2008. As at March 31, 2007, there were 5,849,540 stock options outstanding at exercise prices ranging from $0.40 to $0.68 with expiry dates from October 2, 2008 through December 28, 2011.

On April 1, 2007, 1,972,000 of the remaining 2,315,879 common share purchase warrants expired. During the balance of the second quarter, a further 93,879 common share purchase warrants will either expire or be exercised at a price of $0.60, provided the prevailing market price for our common shares materially exceeds the exercise prices shown, leaving 250,000 outstanding. On April 1, 2007, 181,818 common share purchase warrants conditionally issued in respect of the $100 convertible debenture expired.

COMMITMENTS AND CONTINGENCIES

As a result of offset commitments from a military contract with a foreign government, we agreed to make a one-time investment of $121 in a development fund in that country to satisfy this commitment. This investment was made in April of 2007. We may withdraw the market value of our investment in this fund in five years.

As a condition for a license agreement to a Canadian government agency for technology that has been used to help develop our HVT product, we contributed $70 in 2006 to a technology development fund controlled and managed by the Canadian government agency and will pay a variable license fee based on unit sales. In the first quarter of 2007, $54 from this fund was authorized for transfer to ourselves as a result of qualifying work performed.

Certain funding from the Canadian Network for the Advancement of Research, Industry and Education Inc. recognized in prior years related to development activities is contingently repayable if the resulting products are commercially successful. Contributions recognized in prior years which may be repayable total $3,749, of which $1,877 may be repayable based on a percentage of sales over an unlimited period and $1,872 may be repayable based on a percentage of sales over a limited period. To date, no amount was due or repaid. Any subsequent repayments will be recorded as an expense in the period we become liable to make the payments.

Off-Balance Sheet Arrangements

In the normal course of business, we may be required to issue letters of credit or performance guarantees. As at March 31, 2007, we had one letter of credit outstanding with a Canadian financial institution in the amount of $2,051 supporting our contract to provide a cockpit procedures trainer to the RDAF via prime contractor AgustaWestland (2006 - nil).

FINANCIAL INSTRUMENTS

We may use foreign exchange forward contracts to manage exposures created when sales and purchases are made in foreign currencies. As at March 31, 2007, there were no foreign exchange forward contracts outstanding (2006 - nil).

We do not use derivative instruments to reduce our exposure to interest rate risk or to change our exposure from floating to fixed interest rates. The interest rate is fixed (at 10%) on the $100 convertible debenture, and the rate floats on the credit facility (which is currently undrawn).

Effective January 1, 2007, we adopted four new accounting standards of the Canadian Institute of Chartered Accountants (CICA) Handbook Section 3855, “Financial Instruments – Recognition and Measurement”; Section 3861, “Financial Instruments – Disclosure and Presentation”; Section 3865, “Hedges”, and, Section 1530, “Comprehensive Income,” prospectively without restatement.

These Sections provide requirements for the recognition, measurement and disclosure of financial instruments and on the use of hedge accounting. In addition, Section 1530 establishes standards for reporting and presenting comprehensive income, which is defined as the change in equity from transactions and other events and circumstances from non-owner sources. Under these new accounting standards, policies followed for periods prior to the effective date generally are not reversed and therefore, the comparative figures have not been restated.

The adoption of these Sections had no effect on our Company’s opening deficit amount. Under Section 3855, financial instruments must be classified into one of the following five categories: held-for-trading, held-to-maturity, loans and receivables, available-for sale financial assets or other financial liabilities. All financial instruments, including derivatives, are measured in the balance sheet at fair value except for loans and receivables, held-to-maturity investments and other financial liabilities which are measured at amortized cost. Subsequent measurement and changes in fair value will depend on their initial classification, as follows: held-for trading financial assets are measured at fair value and changes in fair value are recognized in net income; available-for-sale financial instruments are measured at fair value with changes in fair value recorded in other comprehensive income until the investment is derecognized or impaired at which time the amounts would be recorded in net income. Upon adoption of these new accounting standards, our Company designated its cash, cash equivalents and restricted cash as held-for trading, which are measured at fair value. Trade and other receivables and the mortgage receivable are classified as loans and receivables, which are measured at amortized cost. Accounts payable and accrued liabilities and the convertible debenture are classified as other financial liabilities which are measured at amortized cost.

Section 3865 “Hedges” sets out standards specifying when and how an entity can use hedge accounting. The adoption of this new standard is optional. This Section offers entities the possibility of applying different reporting options than those set out in Section 3855 “Financial Instruments – Recognition and Measurement” to qualifying transactions that they elect to designate as hedges for accounting purposes. There was no effect on our Company as a result of the adoption Section 3865.

RELATED PARTY TRANSACTIONS

In the first quarter of 2007, the following amount was incurred for an entity in which a director of our Company is an owner, partner or principal: $248,803 (2006 - $86) for legal services. The amount included in accounts payable as due to related parties as at March 31, 2007 was $179 (2006 $59).

SUBSEQUENT EVENTS

On May 4th, we announced that we had entered into an agreement with Tecsult Inc., a Quebec-based engineering firm, to acquire certain assets of Tecsult’s wholly-owned subsidiary, Tecsult Eduplus, a courseware provider in the military aerospace and naval defence sectors. Under the terms of the agreement, we will purchase certain Eduplus assets, including its learning management system and existing contracts. The agreement includes a cash

portion and additional consideration based on the performance of the business unit over the coming five years. In addition, we expect to enter into a five-year partnership agreement with Tecsult Inc., for the development of courseware. This transaction is subject to the completion of due diligence, Board and regulatory approval. We expect this transaction to close on or about June 20, 2007.

BUSINESS OUTLOOK

The following contains forward-looking statements about our business outlook for the remainder of 2007. Reference should be made to "Forward-Looking Statements" on page 2. For a description of material factors that could cause our actual results to differ materially from the forward-looking statements in the following, please see the Business Risk Factors section of our Annual MD&A and the Description of the Business – Risk Factors section in our Annual Information Form.

We believe that we are well positioned to improve profitability in future periods. We have established an operating facility in the United States and we have qualified as a U.S. defence contractor. We have received our first direct order from a customer in the U.S. defence sector, which provides us with a foothold in the sector. We will continue to examine potential acquisitions or mergers that would facilitate our entry into new simulation training sectors and / or geographic markets.

We expect that:

- Approximately 35% to 45% of our order backlog as at March 31, 2007 of $50.7 million (which includes the $18.4 million in CFTS support services for the twenty-year support period) will be realized as revenue in the remainder of 2007;
- Revenues from the initial contract under the CFTS program for the balance of 2007 will decrease versus 2006, however we are pursuing additional opportunities under the CFTS program that may result in marginal additional revenue in 2007;
- The timing and amount of CFTS program revenue to be recognized in 2007 will depend upon:
  - the proportion of work performed in-house;
  - the achievement of milestones by our subcontractors; and
  - changes in the estimated costs to complete the CFTS program;
- CFTS revenue will continue to fluctuate over 2007 and 2008 depending upon the proportion of work performed in-house in any given period and achievement of milestones by our subcontractors on the program;
- We expect ASA to continue to develop and deliver courseware for the CFTS program through 2008;
- The timing and amount of other contract revenue to be recognized in 2007 will depend upon:
  - the proportion of work performed in-house; and
  - changes in the estimated costs to complete the contracts;
- Gross margin percentages in 2007 will continue to fluctuate between 25% and 35% depending on the mix between anticipated CFTS and non-CFTS revenue and the anticipated amount of revenue recognized by ASA, which we expect will initially generate lower margins;
- Combined spending on G&A and S&M at ASI is expected to increase proportionately provided there are revenue gains in 2007; additional spending on G&A and S&M is expected to occur in 2007 provided ASA is successful in winning further new orders (other than as a subcontractor to ASI);

- Interest expense and financing costs will reduce significantly as a result of the recognition of the remaining accretion expense and deferred financing cost amortization related to the Debentures in the second quarter of 2006;
- Depreciation and amortization expense will increase in 2007 versus 2006 due to the level of investment in 2006 and further anticipated investment in 2007;
- We will continue to act as marketing lead for the Allied Wings consortium and will participate in a portion of any revenues arising from this role;
- Cash and cash equivalents are expected to decline as we do not expect the same level of customer deposits and expect to complete one or more acquisitions in 2007 with consideration likely to include a cash component;
- Restricted cash is expected to decline by approximately one half during 2007 as we achieve contract milestones on the RDAF program that trigger the reduction in the value of the letter of credit;
- Capital expenditures will be lower than 2006 levels; and
- We will make at least one acquisition in 2007, consideration for which may consist of any combination of cash and common shares.

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

During the three months ended March 31, 2007, there have been no changes in our Company's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our Company's internal control over financial reporting.

BUSINESS RISK FACTORS

Our operations and financial results are subject to various risks and uncertainties. For a complete discussion of our Company's business risk factors, please refer to the Business Risk Factors section of our Annual MD&A and the Description of Business – Risk Factors section of our Annual Information Form, both of which are available on SEDAR at www.sedar.com.

Additional information about us can also be found in our Annual Information Form and in our Management Information Circular, both of which are available on SEDAR at www.sedar.com.

May 9, 2007

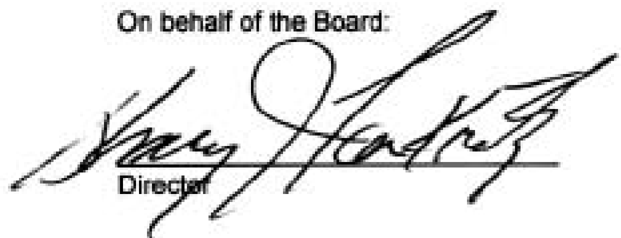
ATLANTIS SYSTEMS CORP.
Consolidated Balance Sheets

(Expressed in thousands of Canadian dollars)

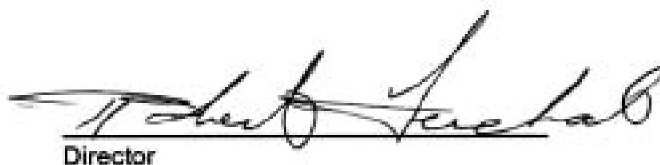
		March 31, 2007 (unaudited)		December 31, 2006
ASSETS				
Current assets				
Cash and cash equivalents	$	9,118	$	13,636
Trade and other receivables (Note 5)		4,474		6,459
Unbilled revenue		2,155		524
Inventory		484		427
		16,231		21,046
Restricted cash (Note 9)		2,051		2,051
Capital assets, net		1,715		1,747
Other long-term assets		108		111
Mortgage receivable		388		384
Deferred development costs (Note 6)		1,669		1,669
Goodwill		11,735		11,735
		17,666		17,697
	$	33,897	$	38,743

		March 31, 2007 (unaudited)		December 31, 2006
LIABILITIES				
Current liabilities				
Accounts payable and accrued liabilities	$	2,988	$	7,024
Accrued costs on percentage completion		497		444
Deferred revenue		9,341		9,452
Convertible debenture (Note 7)		100		100
		12,926		17,020
SHAREHOLDERS' EQUITY				
Share capital (Note 10)		89,088		88,080
Contributed surplus		8,589		8,574
Deficit		(76,706)		(74,931)
		20,971		21,723
	$	33,897	$	38,743

On behalf of the Board:



Director



Director

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

ATLANTIS SYSTEMS CORP.
Consolidated Statements of Operations, Comprehensive Income and Deficit
For the three months ended March 31
(Expressed in thousands of Canadian dollars except per share amounts)

		2007 (unaudited)		2006 (unaudited) (Restated - Note 2)
Revenue (Note 5)	**$**	**5,829**	$	8,531
Cost of revenue		**4,603**		6,015
Gross margin		**1,226**		2,516
Expenses				
General and administrative		**1,997**		1,583
Selling and marketing		**912**		622
Stock options		**42**		35
		2,951		2,240
Operating (loss) income before the undernoted items		**(1,725)**		276
Depreciation and amortization		**153**		73
Interest and financing (income) costs, net (Note 8)		**(102)**		109
Gain on disposal of capital assets		**(1)**		-
Net (loss) income and comprehensive income		**(1,775)**		94
Deficit, beginning of year		**(74,931)**		(73,496)
Deficit, end of year	**$**	**(76,706)**	$	(73,402)
Net (loss) income per share (Note 12)				
Basic	**$**	**(0.03)**	$	-
Diluted	**$**	**(0.03)**	$	-
Weighted average number of shares				
Basic		**53,600,477**		52,676,735
Diluted		**53,600,477**		54,093,780

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

ATLANTIS SYSTEMS CORP.
Consolidated Statement of Cash Flows
For the three months ended March 31
(Expressed in thousands of Canadian dollars)

		2007 (unaudited)		2006 (unaudited) (Restated - Note 2)
Cash flows provided by (used in) :				
Operating activities				
Net (loss) income	$	(1,775)	$	94
Items not affecting cash:				
Depreciation and amortization		153		73
Stock options expensed		42		35
Accretion on debentures		-		85
Amortization of deferred financing costs		-		24
		(1,581)		311
Interest on mortgage receivable		(4)		(4)
Deferred development costs		-		(76)
Other long-term assets		3		(120)
Net change in non-cash working capital (Note 15)		(3,755)		5,680
		(5,337)		5,791
Investing activities				
Purchase of capital assets		(163)		(379)
Proceeds from disposal of capital assets		1		-
		(162)		(379)
Financing activities				
Exercise of common share purchase warrants		873		-
Exercise of options to purchase common shares		108		77
		981		77
Net (decrease) increase in cash and cash equivalents		(4,518)		5,489
Cash and cash equivalents, beginning of year		13,636		8,755
Cash and cash equivalents, end of year	$	9,118	$	14,244

SUPPLEMENTAL INFORMATION

		2007		2006
Cash and cash equivalents are comprised of:				
Cash		9,087		14,214
Cash equivalents		31		30
		9,118		14,244
Interest paid	$	2	$	166
Income taxes paid	$	-	$	-

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

ATLANTIS SYSTEMS CORP.
Notes to the Interim (Unaudited) Consolidated Financial Statements
March 31, 2007 and 2006
(Expressed in thousands of Canadian dollars except per share amounts, unless otherwise indicated)

1. NATURE OF OPERATIONS

Atlantis Systems Corp. (the "Company") continued under the laws of Canada and is listed on the Toronto Stock Exchange (TSX-AIQ). Atlantis Systems International Inc. ("ASI") and Atlantis Systems America Inc. ("ASA") are operating subsidiaries of the Company. ASI is a training integrator specializing in military, commercial aviation and energy markets worldwide. ASI combines desktop and full-flight simulation, knowledge management, learning management systems and multimedia courseware to provide integrated training systems to customers in the military, commercial aviation and energy markets. ASA has been established to provide similar services in the United States. In addition, the Company has an 85% interest in Denbridge Digital Limited, which is an inactive holding company.

2. RESTATEMENT OF PRIOR YEAR FINANCIAL STATEMENTS

The Company reviewed its revenue recognition for contracts with multiple deliverables and determined that the recognition of revenue for the three months ended March 31, 2006 was incorrect. The restatement required to correct this error was a reduction in revenue and cost of revenue of $149 and $103, respectively. The correction of this error had no impact on net income per share for the quarter ended March 31, 2006.

3. INTERIM FINANCIAL STATEMENT PREPARATION

The disclosures in these interim unaudited consolidated financial statements do not meet all disclosure requirements of Canadian generally accepted accounting principles for annual financial statements. These interim unaudited consolidated financial statements should be read in conjunction with the annual financial statements of the Company and the notes thereto. Except as explained in Note 4, the interim unaudited consolidated financial statements are prepared using the same accounting principles and application thereof as the annual financial statements for the year ended December 31, 2006. Note disclosures have been presented for material updates to the information previously reported.

4. SIGNIFICANT ACCOUNTING POLICIES

Financial instruments

On January 1, 2007, the Company adopted the Canadian Institute of Chartered Accountants (CICA) Handbook Section 3855, Financial Instruments – Recognition and Measurement; Section 1530, Comprehensive Income, Section 3251, Equity, Section 3861, Financial Instruments – Disclosure and Presentation and Section 3865, Hedges. The principal changes in the accounting for financial instruments due to the adoption of these accounting standards are described below. These standards have been adopted prospectively and comparative amounts for the prior periods have not been restated.

(a) Financial assets and financial liabilities

Under the new standards, financial assets and financial liabilities are initially recognized at fair value and are subsequently accounted for based on their classification as described below. The classification depends on the purpose for which the financial instruments were acquired and their characteristics. Except in very limited circumstances, the classification is not changed subsequent to initial recognition.

Held for trading

Financial assets that are purchased and incurred with the intention of generating profits in the near term are classified as held for trading. These instruments are accounted for at fair value with the change in the fair value recognized in net income during the period. Cash and cash equivalents and restricted cash were classified as held for trading on January 1, 2007.

Available-for-sale

Financial assets classified as available-for-sale are carried at fair value with the changes in fair value recorded in other comprehensive income. When a decline in fair value is determined to be

other-than-temporary, the cumulative loss included in accumulated other comprehensive income is removed and recognized in net income. Gains and losses realized on disposal of available-for-sale

securities are recognized in other income. No investments were classified as available-for-sale on , January 1, 2007.

Held-to-maturity

Securities that have a fixed maturity date and which the Company has positive intention and the ability to hold to maturity are classified as held-to-maturity and accounted for at amortized cost using the effective interest rate method. No investments were classified as held-to-maturity.

Loans and Receivables

Trade and other receivables and mortgage receivable are classified as loans and receivables, which are measured at amortized cost.

Other financial liabilities

Accounts payable and accrued liabilities, and the convertible debenture are classified as other financial liabilities, which are measured at amortized cost using the effective interest rate method.

(b) Embedded derivatives

Derivatives may be embedded in other financial and non-financial instruments (the “host instrument”). Under the new standards, embedded derivatives are treated as separate derivatives when their economic characteristics and risks are not clearly and closely related to those of the host instrument, the terms of the embedded derivative are the same as those of a stand-alone derivative, and the combined contract is not held for trading or designated at fair value. These embedded derivatives are measured at fair value with subsequent changes recognized in the Statement of Operations, Comprehensive Income and Deficit as an element of general and administrative expenses.

The change in accounting policy related to embedded derivatives had no impact to the opening deficit at the date of adoption, nor any impact during the period.

(c) Determination of fair value

The fair value of a financial instrument on initial recognition is the transaction price, which is the fair value of the consideration given or received. Subsequent to initial recognition, fair value is determined by using valuation techniques which refer to observable market data.

(d) Comprehensive income

Comprehensive income is composed of the Company’s net income and other comprehensive income. Other comprehensive income includes unrealized gains and losses on available-for-sale securities, net of income taxes. The components of comprehensive income are disclosed in the Consolidated Statement of Operations, Comprehensive Income and Deficit. The Company does not currently have any other comprehensive income.

(e) Hedge accounting

Section 3865, hedges, sets out standards specifying when and how an entity can use hedge accounting. The adoption of this new standard is optional. This section offers entities the possibility of applying different reporting options than those set out in Section 3855, Financial Instruments – Recognition and Measurement, to qualifying transactions that they elect to designate as hedges for accounting purposes. There was no impact on the Company as a result of adopting Section 3865.

Revenue recognition

Revenue from long-term contracts for developing, building and supporting simulators and training systems is recognized using the percentage of completion method where revenue is recorded as labour costs are incurred, based on actual labour costs incurred to date on a contract, relative to the estimated total labour costs to complete the contract. When subcontractor or material costs form a significant portion of total costs, revenue is recognized as costs are incurred based on labour, material and actual sub-contract costs incurred to date on a contract, relative to the estimated total labour, material and sub-contract costs to complete the contract. In the event that the Company has large contracts where it can segment costs into separate sub-components, revenue is to be recognized as each sub-component progresses to completion. All other revenues and related costs are recorded at the time the services are performed or the product is delivered. Full provision is made for any anticipated losses in the period in which the relevant facts become known.

Unbilled revenue represents revenue earned in excess of amounts billed on uncompleted contracts. Deferred revenue represents the extent that billings to clients are in excess of revenue recognized to date. The results reported under the percentage of completion method are based on the Company's estimates of total labour and sub-contract costs to complete the various contracts. Should total actual labour or sub-contract costs be materially higher or lower than these estimates, adjustment to future results would be necessary.

Disputes arise in the normal course of the Company's business on projects where the Company contests with customers or owners for additional funds because of events such as delays or changes in contract specifications. Such disputes, whether claims or unapproved changes in process of negotiation, are recorded at the lesser of their estimated value or actual costs incurred and only when realization is certain. Claims against the Company are recognized when the loss is considered probable and reasonably determinable.

The Company follows the accounting recommendations of Emerging Issues Committee ("EIC") EIC-141 "Revenue Recognition", EIC-142, "Revenue Arrangements with Multiple Deliverables" and EIC-143, "Accounting for Separately Priced Extended Warranty and Product Maintenance Contracts". EIC-141 summarizes the principles set as interpretive guidance on the application of CICA Handbook section 3400, "Revenue". Specifically this EIC presents the criteria to be met for revenue recognition to be considered achieved. EIC-142 addresses certain aspects of the accounting by a vendor for arrangements under which it will perform multiple revenue generating activities for a given customer. Finally, EIC-143 considers the issue of how revenue and costs from separately priced extended warranty or product maintenance contracts should be recognized. The Company currently has contracts that include multiple deliverables as defined in EIC-142. For each of these contracts, the delivered item does not qualify as a separate unit of accounting. As a result, the consideration allocable to the delivered item is combined with the consideration allocable to the undelivered item and revenue recognition is determined on the combined deliverables as a single unit of accounting.

5. CONCENTRATION OF CREDIT RISK

The Company has contracts with many customers; however, as at March 31, 2007 two customers each represented 52% and 24% of the accounts receivable and unbilled revenue (December 31, 2006 – 77% and 3%) and during the quarter, each represented 58% and 25% of revenues (2006 –75% and 0%).

6. DEFERRED DEVELOPMENT COSTS

In 2006, the Company continued to fund a specific development project focused on the Helicopter Vocational Trainer (HVT) concept. No development costs have been capitalized in the first quarter of 2007 (2006 - $127). The development project is expected to be completed in the second quarter of 2007 and there are sufficient identified markets and forecasted sales of the HVT product to recover the costs capitalized and generate profits. No amortization has been recorded to date.

7. CONVERTIBLE DEBENTURE

At March 31, 2007, the Company continues to be in breach of two of the convertible covenants on its convertible debenture outstanding. As a result, the debenture is included as a current liability.

8. INTEREST AND FINANCING (INCOME) COSTS, NET

	2007	2006
Interest expense	**$ 2**	$ 165
Finance and bank charges	**5**	35
Interest income	**(109)**	(91)
	$ (102)	$ 109

9. OPERATING LINE OF CREDIT AND RESTRICTED CASH

At March 31, 2007 and December 31, 2006, the Company had no bank indebtedness.

The Company has available a general operating line of credit in the amount of $5,000. The line of credit bears interest at the bank's prime lending rate plus 0.75%. The line of credit is collateralized by a general security agreement over all present and future personal property.

In July 2006, as a condition of a new contract to provide a cockpit procedures trainer, the Company entered into a letter of credit with a Canadian financial institution in the amount of $2,051. The letter of credit has been fully collateralized by the Company restricting the use of an equal amount of its cash on hand with the counterparty to the letter of credit. The value of this letter of credit and the amount of restricted cash will decline as the contract milestones are achieved through June 2008.

10. SHARE CAPITAL

In the three months ended March 31, 2007, the Company expensed $42 (2006 - $35) relating to the fair value of options granted in fiscal 2006 and 2005 and is reflected in the Consolidated Statements of Operations, Comprehensive Income and Deficit.

In the three months ended March 31, 2007, 265,834 common share stock options were exercised resulting in additional share capital in the amount of $108, while there were 8,585 common share stock options that either expired or were cancelled. As at March 31, 2007, the Company had 5,849,540 common share options outstanding.

In the three months ended March 31, 2007, 1,456,121 common share warrants were exercised resulting in additional share capital in the amount of $873. As at March 31, 2007 the Company had 2,315,879 common share warrants outstanding.

11. RESEARCH AND DEVELOPMENT

Research and development expenditures included in cost of revenue for the three months ended March 31, 2007 were $37 (2006 - $19).

12. NET (LOSS) INCOME PER SHARE

Basic earnings per share figures are calculated using the weighted average number of common shares outstanding during the period. Diluted earnings per share reflects the dilution that would occur if outstanding stock options, share purchase warrants and convertible debentures were exercised or converted into common shares using the treasury stock method.

The treasury method of calculating the diluted earnings per share requires that only those of the Company's stock options and share purchase warrants and convertible debentures whose exercise prices are lower than the average share prices for the relevant periods be used in the calculation of dilution.

The weighted average number of shares outstanding used in the calculation of basic earnings per share for the three months ended March 31, 2007 was 53,600,477 (2006 – 52,676,735).

The weighted average number of shares outstanding used in the calculation of the diluted earnings per share using the treasury stock method for the quarters ended March 31, 2007 and 2006 were as follows:

	2007	2006
Weighted average common shares outstanding	**53,600,477**	52,676,735
Weighted average potential common shares		
Share purchase warrants	**-**	11,457
Stock options	**-**	1,405,588
	53,600,477	54,093,780

For the quarter ending March 31, 2007, the inclusion of the Company's stock options and share purchase warrants in the computation of diluted loss per share had an anti-dilutive effect on the loss per share and, therefore, was excluded from the computation. Conversion of the convertible debenture for the quarter ended March 31, 2007, using the "if-converted" method, had an anti-dilutive effect on loss per share and, therefore, was excluded from the computation.

13. GEOGRAPHIC INFORMATION

	Revenue		**Capital Assets and Goodwill**	
	2007	2006 (restated - Note 2)	**2007**	2006
Canada	**$ 4,212**	$ 6,932	**$ 13,086**	$ 13,129
International	**1,617**	1,599	**364**	353
	$ 5,829	$ 8,531	**$ 13,450**	$ 13,482

The allocation of revenues to the geographic segments is based upon the location of the customer.

14. FINANCIAL INSTRUMENTS

The reported values of financial instruments which consist of cash and cash equivalents, restricted cash, trade and other receivables, accounts payable and accrued liabilities, and convertible debenture approximate their fair values due to their current nature.

Carrying value of the mortgage receivable approximates its fair value.

The Company performs periodic credit evaluations of the financial condition of its customers. Allowances are maintained for potential credit losses consistent with the credit risk of specific customers.

Interest rate risk to the Company's operations arises from fluctuations in interest rates and the degree of volatility of these rates. The Company does not use derivative instruments to reduce its exposure to interest rate risk.

15. NET CHANGE IN NON-CASH WORKING CAPITAL

Net change in non-cash working capital of continuing operations:

		2007		2006 (Restated - Note 2)
Trade and other receivables	**$**	**1,985**	$	4,668
Unbilled revenue		**(1,631)**		978
Inventory		**(57)**		(39)
Accounts payable and accrued liabilities		**(3,994)**		208
Accrued costs on percentage completion		**53**		(253)
Deferred revenue		**(111)**		118
	$	**(3,755)**	$	5,680

16. RELATED PARTY TRANSACTIONS

All related party transactions are in the normal course of operations, measured at their exchange amounts established and agreed to by the related parties. Amounts due to related parties are subject to normal trade terms. In 2007, the Company paid the following amounts to firms in which a director of the Company is an owner, partner or principal: $205 (2006 - $86) for legal services. The cost of these services was charged to general and administrative expenses. The amount due to related parties included in accounts payable and accrued liabilities as at March 31, 2007 was $200 (2006 - $59).

17. SUBSEQUENT EVENT

On May 1, 2007, the Company entered into an asset purchase agreement with Tecsult Inc.. The Agreement includes a cash portion and additional consideration based on the performance of the business unit over the next five years. The asset purchase agreement is not yet final and is subject to the completion of due diligence.

18. PRIOR PERIOD FINANCIAL STATEMENTS

Certain prior period comparatives have been reclassified in order to conform to the current basis of presentation.

CORPORATE INFORMATION

CURRENT BOARD OF DIRECTORS:

Andrew Day
President and Chief Executive Officer

Terence Donnelly [2]
Executive Vice President
Mandrake Management Consultants Inc.

Robert A. Ferchat, CA, CPA [1,3]
Corporate Director

Donald B. Hathaway, FCMC, ICD.D [2]
Chairman of the Board

David J. McFadden, Q.C. [2,3]
Chair, National Energy and Infrastructure Group
Gowling Lafleur Henderson LLP

Henry Pankratz, FCA [1,3]
President
CavanCore Capital

David Williams [1]
President
Roxborough Holdings Limited

OFFICERS OF ATLANTIS SYSTEMS CORP.:

Andrew Day
President, Chief Executive Officer and acting Chief Financial Officer

Douglas Donderi
Corporate Secretary and Vice President, Corporate Development

1. Audit Committee
2. Management Resources Committee
3. Corporate Governance & Nominating Committee

OFFICERS AND SENIOR MANAGEMENT OF ATLANTIS SYSTEMS INTERNATIONAL, INC.:

Andrew Day
President, Chief Executive Officer and acting Chief Financial Officer

Blake Melnick
Chief Operating Officer

Douglas Donderi
Corporate Secretary and Vice President, Corporate Development

Craig Baba
Vice President, Finance

Laurence Esterhuizen
Vice President, Strategic Business Development

Carolyn Godbout
Vice President, Information Technology and Knowledge Systems

Terry Killow
Vice President, Program Management/Systems Engineering

Jay Konduros
Vice President, Operations

Chris Lewis
Vice President, Advanced Programs

Ian McIntyre
Vice President, Marketing and Sales

OFFICERS OF ATLANTIS SYSTEMS AMERICA, INC.:

Arthur A. Marubbio
President

Michael Cook
Secretary

TRANSFER AGENT:

Computershare Trust Company of Canada

STOCK EXCHANGE LISTING:

Toronto Stock Exchange – AIQ

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