

Atlantis Systems Corp.



Selected Highlights

- Development on the \$32-million contract for F/A-18 Integrated Maintenance Training Systems (IMTS) for the Canadian and Australian Air Forces progressed on schedule and delivery is expected in the fourth quarter of 2004.
- An approximate \$2 million contract extension was negotiated on the existing IMTS contract and follow-on contracts are being pursued with both the Australian and Canadian Air Forces during 2004.
- As a member of the Allied Wings team, Atlantis successfully pre-qualified as a bidder for the Government of Canada's Contracted Flight Training and Support (CFTS) initiative, a programme with the potential to generate up to \$100 million in revenues for Atlantis over a 20-year period.
- Subsequent to the year-end, Atlantis was awarded a \$6.5 million contract to provide Student Aircraft Interface Trainer Stations (SAITS) for the US Navy's F/A-18 Visual Environment Maintenance Trainers.
- The Board of Directors and Shareholders of Atlantis accepted a financing proposal, subsequent to the year-end, that would improve working capital by up to \$9 million.

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Message to Shareholders

This past year has been one of restructuring to focus the Company on its core expertise – Simulation Based Training Solutions. Through planned divestitures and cost cutting efforts, we began the first steps to building a solid foundation for our shareholders. Our efforts have paid off, as we are pleased to report a significant profit in our operations even after taking into account losses from discontinued operations.

Atlantis Systems Corp. reported net income from continuing operations of \$1,471,000 for the fiscal year ended December 31, 2003. During the year the Company completed the sale of its non-core business assets including the sale of its Intelligent Traffic Systems (ITS) division, the sale of the Vessel Traffic Systems (VTS) business, and the sale of the remaining interests in the Naval Systems business. The Company can now focus on its core business as a leader in the delivery of innovative, simulation-based training solutions. Atlantis Systems International (ASI), the Company's remaining operating subsidiary, reported sales of \$23,432,000 and net earnings of \$2,313,000.

Atlantis is poised for continued profitability. During the past few years the Management of ASI has successfully streamlined the organization resulting in cost savings of \$4,000,000 per year. ASI has also demonstrated its commitment to successfully delivering large, complex training systems to international customers highlighted by the installation and acceptance of the Naval Tactical



▲ Interior of the EH-101 helicopter Cockpit Procedures Trainer (CPT) developed for Westland Helicopters.

Team Trainer (NTTT) in Saudi Arabia. Concurrently Atlantis has substantially completed the Cockpits Procedure Trainer (CPT) for the Canadian Forces, which deploy the CH-149 Cormorant version of the AgustaWestland EH-101, and the CPT for the Integrated Display System variant of the EH-101.

Sales for the year of \$23,432,000 represent a 15% reduction from the \$27,449,000 of sales reported for the same period in 2002. Despite this sales reduction, and a special charge of \$594,000 related to severance costs, the Company was able to operate profitably. At the end of the year, the Company had an order backlog of \$11.3 million.

Highlights of the Year:

- Development of the F/A-18 Integrated Maintenance Training Systems (IMTS) for the Air Forces of Canada and Australia continued on schedule. Delivery of these systems, with a total value of \$32 million, is planned for the fall of 2004.
- An approximate \$2 million contract extension was negotiated during 2003 on the existing F/A-18 IMTS contract. The contract extension was finalized during the first quarter of 2004.
- A proposal was submitted for the planning phase for follow-on work for the Royal Australian Air Force (RAAF) F/A-18 IMTS. This upgrade work is expected to commence following the completion of the existing IMTS program. A similar upgrade is expected for the Canadian Forces (CF) F/A-18 IMTS.
- The prime contractor on the US Navy's E-6B Tacamo aircraft trainer programme decided to stop work on its contract. As a result Atlantis was subsequently notified that it was to cease work on the sub-contract. Atlantis will receive re-imburement for costs incurred. We expect resolution of this termination action to be concluded in 2004.



▲ F/A-18 Integrated Maintenance Training System built for the Canadian and Australian Forces, showing the replicated cockpit and two Interactive Panels.

- Work on the EH-101 CPT for the Canadian Forces Cormorant also continued throughout the year. The CPT was shipped during the fourth quarter of 2003, and final acceptance was received during the second quarter of 2004.
- The Canadian Department of National Defence (DND) awarded ASI contracts worth over \$1 million to upgrade an avionics trainer for the CC-130 Hercules and provide service and support for two other Atlantis training systems currently in service with the DND. This contract was completed during the fourth quarter of 2003.
- A \$1 million contract to supply testing equipment to Robins Air Force Base in the United States, and a \$350,000 contract to supply a Power Plant Simulator to Pratt & Whitney were completed during the fourth quarter of 2003.
- As a member of the Allied Wings team, ASI successfully pre-qualified as a bidder for the Government of Canada's Contracted Flight Training and Support (CFTS) initiative, a programme with the potential to generate up to \$100 million in revenues for Atlantis over a 20-year period. If Atlantis is awarded the contract, during the first two years of this programme it is anticipated that Atlantis would provide \$40 million of equipment to this programme.

- Atlantis' quality management system, already one of the first in the industry to be registered to the ISO9001:2000 standard, achieved further recognition by gaining registration to the AS9100:2001 quality standard. This puts Atlantis in an advantageous position to compete for defence contracts from major companies that recognise and require this standard.
- Subsequent to the year end the Company announced that it has been awarded a \$6.5 million contract to provide Student Aircraft Interface Trainer Stations (SAITS) for the US Navy's F/A-18 Visual Environment Maintenance Trainers as part of an upgrade to the US Navy's existing training maintenance systems.

Subsequent to the year-end the Company announced that it has accepted a proposal for re-financing. This proposal would increase working capital by up to \$9 million.

Outlook for 2004

The Board of Directors of Atlantis Systems Corp. has accepted, and shareholders have approved, an offer of financing that consists of \$6 million in equity units and a commitment to provide a \$2 million debt facility. As a condition of the financing offer, up to \$2,750,000 of the Company's current liabilities (including accrued dividends on special shares, a line of credit and promissory notes) will be converted into Common Shares. It is also a condition of the financing offer that the Company's outstanding special shares – Series 2 in the amount of \$800,000 will be converted to Common Shares. The effect of the financing offer would result in an improvement in the working capital position of up to \$9 million.

Atlantis expects to successfully complete delivery and acceptance of the F/A-18 IMTS to both the Canadian and Australian Air Forces before the end of 2004 and is already working on proposals to upgrade the training systems as both Canada and Australia continue to upgrade their aircraft fleets. The Company also expects to deliver the second EH-101 Cockpit Procedures

Trainer to the Westland Helicopter schoolhouse in Yeovil, UK where it will be used to provide initial training to all of Westland's EH-101 customers.

Atlantis announced a contract award by Rockwell Collins for the upgrade of the Canadian Forces CC-130 Hercules training system located at Trenton, Ontario. This work will continue through 2005.

Atlantis continues to work towards securing major contracts within both Canada and the United States with specific emphasis on the Contracted Flight Training and Support (CFTS) and Maritime Helicopter programs in Canada and through its teaming relationship with Boeing on the US Navy TSC2 contract. The Company is also working to secure other opportunities both internationally and within Canada.

A staff reduction of over 30 percent was achieved during 2003 as a result of Management's continuing efforts to achieve greater efficiency in the Company's internal business processes. We will continue to focus on securing new contracts and increasing the efficiency of the Company's operations. Management remains committed to maximising the Company's productivity as an integral part of its drive to increase shareholder value.



▲ Technician working on the F/A-18 Integrated Maintenance Training System built for the Canadian and Australian Forces.

I would like to thank the employees of ASI for their perseverance and persistence during a tumultuous period in our industry sector. While the Board of Directors aggressively pursued funding strategies designed to assure Atlantis' long-term financial wherewithal, including strategic relationships with large companies, Atlantis' employees never lost sight of, despite abundant distractions, their dominant challenge: to maintain the Company's position as a quality provider of simulation solutions. I would be negligent if I failed to acknowledge the unique role played by Canadian Commercial Corporation (CCC), a Crown Corporation of the Canadian Government, without whose support and ongoing interest the Company's challenges might not have been surmounted.

Attendant upon the funding package described above, Andrew Day and his colleagues will reconstitute the Board of Directors. Leaving the Board will be Vanessa Morgan, Terrance King, Vincent Henry, Jamie Macintosh and me, Neil Raymond. These Directors have fulfilled their responsibilities as fiduciaries without compensation, often deliberating on short notice, on behalf of Atlantis' employees and shareholders. It has been my pleasure to serve with them and we collectively wish Andrew Day well as he begins to implement the next stage of growth and profitability for Atlantis Systems Corp.

On behalf of the Board of Directors,

Neil Raymond
Chairman of the Board

June 2004



Financial Reporting

Management's Discussion and Analysis

OVERVIEW

The following is a discussion of the material factors influencing the operating results and financial condition of Atlantis Systems Corp. (the "Company"), as at and for the year ended December 31, 2003 with comparisons to the year ended December 31, 2002 where applicable. All figures are in Canadian dollars unless otherwise specified. This document should be read in conjunction with the Consolidated Financial Statements of the Company and notes thereto as at and for the years ended December 31, 2003 and 2002.

RESULTS OF OPERATIONS

During 2003, the Company completed the sale of its Intelligent Traffic Systems (ITS) division, and the sale of the Vessel Traffic Systems (VTS) division of Denbridge Digital Limited (DDL). The financial statements for 2002 have been restated to reflect the disposition of these operations. The Consolidated Statements of Operations and Deficit for 2003, with the comparative numbers for 2002, reflect the operations of its sole remaining operating entity, Atlantis Systems International Inc. (ASI), along with corporate overheads, as continuing operations.

ASI's operations represent 100% of the consolidated revenues with 55% of ASI's fiscal year 2003 revenue coming from one programme: the F/A-18 Integrated Maintenance Training System (IMTS) for the Canadian and Australian forces. We expect completion of this programme in October 2004.

Management continues to focus on reducing discretionary expenditures. Interest expense decreased as the Company completed the Saudi Arabian Naval Tactical Training Team (NTTT) system, and repaid the term loan associated with this programme. The Company's bank indebtedness was reduced by \$5,262,000 mainly as a result of the repayment of the demand loan associated with the NTTT programme.

Sales for the year ended December 31, 2003 were \$23,432,000 versus \$27,449,000 for the year ended December 31, 2002; a 15% decrease. This sales decline is the result of substantial completion of major naval

contracts in 2002, offset by a slight increase in revenues on the F/A-18 Integrated Maintenance Training Systems (IMTS) contract in 2003. Revenues from naval contracts were \$6,686,000 lower for the year ended December 31, 2003 versus 2002. This was partially offset by increased revenues of \$1,371,000 achieved on the F/A-18 IMTS for the twelve months ended December 31, 2003.

Gross margin for fiscal year 2003 was \$7,557,000 or 32%, consistent with the gross margin percentage of 30% achieved in 2002. The slightly higher gross margin accomplished in 2003 reflects the improved gross margin realised on the F/A-18 IMTS programme. Expenses were reduced by 22% from 2002 with the US marketing reorganisation being a major contributor to the reduction in operating expenses.

The Company reported net income for the year ended December 31, 2003 of \$987,000 (\$0.07 per share) versus a net loss of \$1,121,000 ((\$0.08) per share) in 2002. ASI, the only remaining operating subsidiary of the Company, reported net income of \$2,313,000 (\$0.16 per share) in 2003 versus \$969,000 (\$0.07 per share) in 2002. The discontinued operations (primarily the VTS and ITS divisions) are identified separately in the financial statements and contributed net losses of \$484,000 in 2003 and \$1,151,000 in 2002.

The Company incurred general and administrative ("G&A") expenses of \$3,682,000 for year ended December 31, 2003 versus \$3,906,000 for the same period in 2002. This reduction in costs was achieved despite one-time charges of \$594,000 associated with the reduction of staffing levels in ASI in 2003.

Selling and marketing expenses for the year ended December 31, 2003 were \$1,386,000 as compared to \$2,134,000 during the same period in 2002. Savings were realised as a result of reducing sales and marketing personnel in the international marketplace and cost saving initiatives implemented throughout the year.

Management expects the Company to maintain productivity while realising ongoing savings of up to \$3,000,000 per year, reflective of fewer operating employees and marketing personnel.

Research and development (R&D) expenses for the year ended December 31, 2003 were \$181,000. This represents a decrease of \$472,000 from the same period in 2002. Both periods saw a decline in R&D charges reflecting the large amount of R&D that is now integrated into ASI's large simulation contracts and being expensed through cost of sales. Atlantis achieved operating income from continuing operations, before depreciation, amortisation, interest expense, and financing costs of \$2,362,000 for the year ended December 31 2003 compared to \$1,591,000 during the same period in 2002.

The Company incurred interest expense and financing costs of \$1,086,000 for the year ended December 31, 2003 as compared to \$1,274,000 in the same period in 2002. The demand loan associated with the Saudi Arabia NTTT program was repaid during the fourth quarter of 2003 resulting in decreased interest payments.

The loss from discontinued operations for the year ended December 31, 2003 was \$484,000 which includes the gain on the sale of the ITS division in the amount of \$1,005,000, offset by the loss on closure of the VTS division of \$645,000 and operating losses incurred in the first quarter of 2003 by DDL of \$844,000. Comparative numbers for discontinued operations in 2002 represent the DDL operating losses for those periods.

No major new contracts were awarded to ASI in 2003. A proposal was submitted for the planning phase for follow-on work for the RAAF F/A-18 IMTS. This upgrade work is expected to commence following the completion of the current program. A similar upgrade is expected for the CF F/A-18 IMTS.

ASI's order backlog at December 31, 2003 was \$11.3 million, all of which is expected to be realised as revenue during the first eight to ten months of 2004. For 2003, the Company had a net income of \$987,000

(\$0.07 per share) compared to a loss of \$1,121,000 ((\$0.08) per share) in 2002.

LIQUIDITY AND CAPITAL RESOURCES

Share Capital

During the year, the Company settled certain debt by issuing 300,000 common shares and 75,000 common share purchase warrants. Each warrant expires on October 1, 2006 and is exercisable to purchase one common share at a price of \$0.50 per common share.

As of June 14, 2004, the Company had 14,287,008 common shares outstanding. There are currently 757,500 incentive stock options outstanding at exercise prices ranging from \$0.40 to \$4.00 with expiry dates of July 19, 2005 to July 31, 2006.

Working Capital

At December 31, 2003, the Company had a working capital deficiency of \$9,147,000, which represents an improvement of \$1,357,000 from 2002. The major components of this deficiency include deferred revenue of \$1,643,000 and accrued costs on percentage of completion of \$3,546,000. The accrued costs on percentage of completion will require funding over the next twelve months. The majority of this accrual relates to material purchases on the F/A-18 IMTS programme, which is scheduled for completion in October 2004.

There are a number of individual components of the working capital deficiency:

- \$1,849,000 comprises promissory notes primarily owing to Innovium Capital Corp. ("Innovium") which is a shareholder of the Company and with whom the Company shares three common directors. Innovium has indicated that it will convert this debt to equity.
- \$489,000 of related party debt is included in accounts payable. The related parties are prepared to convert this debt to equity.
- \$1,643,000 relates to the deferred revenues on the F/A-18 IMTS, and the cockpit procedures trainer of the AgustaWestland EH-101 helicopter. Deferred revenue represents the difference between invoices submitted to the customer and revenue reflected in the financial statements. This obligation was reduced

by \$1,928,000 during the year. We anticipate that this trend will continue as we finish the F/A-18 IMTS programme.

- The accrued costs on percentage of completion represent \$3,546,000 of the working capital deficiency. The majority of this accrual relates to the F/A-18 IMTS programme and cash is required in the short term in order to extinguish this liability and complete the programme.
- The balance of the working capital is a deficit of \$1,620,000. The major components of this deficit are accounts receivable and unbilled revenue of \$1,435,000, and inventory of \$1,830,000 offset by accounts payable and accrued liabilities of \$3,471,000 (net of related party payables) and the bank loan of \$1,101,000. The inventory consists of two completed flight training simulators, spare parts and amounts expended on current shorter term contracts (work-in-progress).

Bank indebtedness was \$1,101,000 at December 31, 2003. This indebtedness was a temporary informal facility provided by the bank that was paid in full subsequent to year-end.

No significant capital expenditures are currently budgeted or anticipated. Any long-term development efforts will be funded through current operations.

OUTLOOK

The Board of Directors of Atlantis Systems Corp. has accepted, and shareholders have approved, an offer of financing that consists of up to \$6 million in equity units and a commitment to provide a \$2 million debt facility. As a condition of the financing offer, up to \$2,750,000 of the Company's current liabilities (including accrued dividends on special shares, line of credit and promissory notes) will be converted into equity units of Atlantis. It is also a condition of the financing offer that the Company's outstanding Series 2 Special Shares in the amount of \$800,000 will be converted to Atlantis equity units. Shareholders have approved these conditional conversions. The financing will result in an improvement in the working capital position of approximately \$8,750,000.

During 2004, Atlantis plans to complete the IMTS programme, the Cockpit Procedures Trainer (CPT) for the Canadian Forces CH-149 Cormorant and the cockpit procedures trainer for the Integrated Display System variant of the AgustaWestland EH-101 helicopter.

The Company continues to focus on its military product line: military systems maintenance trainers, cockpit procedures trainers, and other significant defence-related programmes currently under negotiation.

ASI finished fiscal 2003 with a backlog of business of \$11.3 million (compared to \$28.0 million as at December 31, 2002). Subsequent to December 31, 2003 the Company announced a \$1.2 million contract to provide a major systems upgrade to the CC-130 aircraft trainers in service with the Canadian Forces, and a \$6.5 million contract to provide Student Aircraft Interface Trainer Stations (SAITS) for the US Navy's F/A-18 Visual Environment Maintenance Trainers.

The Company will continue to focus on the military sector, as reflected in the F/A-18 IMTS project, the CH-149 Cormorant CPT, and other key programmes. Prospects for further sales in the military sector are very good. The selection of Atlantis in 2002 as the supplier to the Canadian and Australian forces of an IMTS for the F/A-18, with a total contract value of over \$30 million, puts the Company in an advantageous position to win follow-on contracts of similar significance. Selection of the Company in 2002 to supply the CPT for the CH-149 Cormorant Search and Rescue helicopter has enabled Atlantis to establish a strategic relationship with the helicopter manufacturer (AgustaWestland), ensuring Atlantis' participation as a CPT supplier in other international sales the manufacturer is pursuing. The potential of this relationship was demonstrated in January 2003, when Atlantis won a contract to provide a CPT for use in training helicopter pilots at the Westland Helicopters Training Facility in Yeovil, England.

Atlantis currently derives approximately 90% of its revenues from military contracts. Atlantis' advantage is its ability to modify its product line and adjust to

current realities with high fidelity systems that meet market needs, are reasonably priced, and are delivered in a timely fashion.

The Company's pursuit of the Government of Canada's Contracted Flying Training and Support (CFTS) project reflects a recognition of the trend towards turn-key, privately-funded, full-service initiatives in the military training industry, and will help position Atlantis to capture a share of the growing military training market as a full-service training solutions provider.

Atlantis is one of five industry-leading companies that comprise the Allied Wings team, which is one of only two pre-qualified bidders competing for the CFTS project. As part of the Allied Wings team, Atlantis would be responsible for the design, development, installation, operation, and support of the CFTS Ground Based Training System (GBTS) for a 20-year period. The GBTS courseware will include a broad range of academic presentation material, tutorial style Computer Based Training (CBT), interactive simulation CBT, Flight Training Device (FTD) briefings and flight training briefings. A suite of flight training equipment, ranging from desktop trainers to fixed-base flight simulators, will support the courseware. The administration of this training suite will be managed by a state-of-the-art Training Information Management System (TIMS).

The sale of the ITS division in the first quarter of 2003 and the write-off and sale of the VTS division will positively affect the consolidated results of the Company.

BUSINESS RISK FACTORS

The future of the Company is dependent on Management being able to carve out a market niche as a supplier-of-choice of cost-effective high fidelity training systems in the military market. Implementation of this strategy is dependent on Management being able to secure sufficient working capital financing and the timely awarding of targeted military contracts.

The markets for Atlantis' current and planned products and services are characterised by rapid technological advances, competing technological platforms, emerging

and evolving industry standards, changes in customer requirements and frequent new product introductions and enhancements. Atlantis' future success will depend upon its ability to enhance its current products and services, develop and introduce new products and services that keep pace with technological developments, respond to evolving customer requirements, meet technical requirements of Atlantis' strategic partners, and achieve market acceptance for its products.

In any one fiscal year, Atlantis has typically derived a substantial portion of its revenues from a small number of contracts with major customers. The composition of this group of major customers has changed from year to year and Atlantis' revenues and profitability are dependent upon its ability to win key contracts from such major customers. In addition, the nature of Atlantis' business may involve lengthy sales cycles and delays over which it has no control. Any ongoing failure of Atlantis to ultimately achieve such sales could have a material adverse effect on the Company's business, financial condition, and results of operations.

Atlantis' historical operating results reflect substantial benefits from programmes sponsored by the Canadian government to support businesses like Atlantis'. If changes in law, or government policies, regarding these programmes, were to result in their termination or adverse modification, or if Atlantis were to become unable to participate in or take advantage of these programmes, the cost of Atlantis' operations could materially increase and there could be an adverse effect on Atlantis' results.

As it does not have US based operations, Atlantis is dependent upon business partners to act as prime contractors for US military procurements.

Management's Responsibility for Financial Reporting

The preparation of the consolidated financial statements of Atlantis Systems Corp. is the responsibility of Management. This responsibility includes the selection of appropriate accounting policies and the exercise of careful judgement in establishing reasonable and accurate estimates in accordance with accounting principles generally accepted in Canada applied on a consistent basis and as appropriate in the circumstances. Financial information shown elsewhere in this Annual Report is consistent with that contained in the consolidated financial statements.


Management of Atlantis Systems Corp. and its operating divisions has developed and maintains accounting systems and internal controls designed to provide reasonable assurance that assets are safeguarded from loss or unauthorised use and that the financial records are reliable.

The Board of Directors approves these consolidated financial statements and carries out its responsibility in this regard principally through the Audit Committee of the Board. The Audit Committee reviews the results of audit examinations performed by the independent external auditors with respect to Atlantis Systems Corp.'s accounting principles, practices and systems of internal control.

The consolidated financial statements have been audited by Deloitte & Touche, LLP, Chartered Accountants. Their report stating the scope of their audit and their opinion on the consolidated financial statements is presented below.



Julio DiGirolamo
Chief Financial Officer and Corporate Secretary



Tom Wallace
Treasurer and Director of Finance

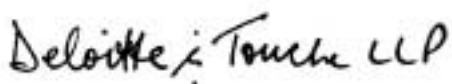
Auditor's Report

TO THE SHAREHOLDERS OF ATLANTIS SYSTEMS CORP. :

We have audited the consolidated balance sheets of Atlantis Systems Corp. as at December 31, 2003 and 2002 and the consolidated statements of operations and deficit and of cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2003 and 2002 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

A handwritten signature in black ink that reads "Deloitte & Touche LLP". The signature is written in a cursive, slightly slanted style.

Chartered Accountants
Toronto, Canada
June 14, 2004

Consolidated Balance Sheets

as at December 31, 2003 and 2002

	2003	2002
ASSETS		<i>(note 4)</i>
Current assets		
Cash and cash equivalents	\$ 4,000	\$ 4,000
Accounts receivable <i>(note 5)</i>	846,000	8,166,000
Unbilled revenue	589,000	88,000
Income taxes receivable <i>(note 6)</i>	78,000	172,000
Inventory	1,830,000	1,454,000
Deferred development costs	–	534,000
Current portion of mortgage receivable	–	250,000
Assets of discontinued operations	–	2,123,000
	3,347,000	12,791,000
Capital assets, net <i>(note 7)</i>	563,000	700,000
Mortgage receivable <i>(note 8)</i>	347,000	326,000
Investment <i>(note 4)</i>	310,000	–
Assets of discontinued operations	–	407,000
Goodwill	11,735,000	11,735,000
	12,955,000	13,168,000
	\$ 16,302,000	\$ 25,959,000
LIABILITIES		
Current liabilities		
Bank indebtedness <i>(note 9)</i>	\$ 1,101,000	\$ 6,363,000
Accounts payable and accrued liabilities	3,960,000	4,783,000
Accrued costs on percentage completion	3,546,000	4,356,000
Accrued dividends on special shares	174,000	92,000
Line of credit <i>(note 10)</i>	173,000	193,000
Promissory notes <i>(note 11)</i>	1,849,000	1,579,000
Deferred revenue	1,643,000	3,571,000
Liabilities of discontinued operations	48,000	2,358,000
	12,494,000	23,295,000
Special shares – Series 2 <i>(note 12)</i>	800,000	800,000
SHAREHOLDERS' EQUITY		
Share capital <i>(note 13)</i>	75,108,000	74,958,000
Contributed surplus	3,112,000	3,105,000
Deficit	(75,212,000)	(76,199,000)
	3,008,000	1,864,000
	\$ 16,302,000	\$ 25,959,000

Commitments and contingencies *(notes 1 and 17)*

On behalf of the Board:



Vanessa Morgan
Director



Jamie Macintosh
Director

The accompanying notes are an integral part of these consolidated statements

Consolidated Statements of Operations and Deficit

For the years ended December 31, 2003 and 2002

	2003	2002
		<i>(note 4)</i>
Revenue from commercial operations	\$ 23,432,000	\$ 27,449,000
Cost of sales	15,875,000	19,218,000
Gross margin	7,557,000	8,231,000
Other income	54,000	53,000
	7,611,000	8,284,000
Expenses		
General and administrative	3,682,000	3,906,000
Selling and marketing	1,386,000	2,134,000
Research and development	181,000	653,000
Operating income before depreciation, amortisation, interest expense, and financing costs	2,362,000	1,591,000
Depreciation and amortisation	205,000	287,000
Interest expense and financing costs	1,086,000	1,274,000
Operating income before the undernoted items	1,071,000	30,000
Sale of technology <i>(note 21)</i>	400,000	–
Net income from continuing operations	1,471,000	30,000
Results of discontinued operations <i>(note 4)</i>	(484,000)	(1,151,000)
Net income (loss)	987,000	(1,121,000)
Deficit, beginning of year	(76,199,000)	(75,078,000)
Deficit, end of year	\$ (75,212,000)	\$ (76,199,000)
Net income from continuing operations per common share <i>(note 15)</i>	\$ 0.10	\$ 0.00
Net income (loss) per common share <i>(note 15)</i>	\$ 0.07	\$ (0.08)

The accompanying notes are an integral part of these consolidated statements

Consolidated Statements of Cash Flows

For the years ended December 31, 2003 and 2002

	2003	2002
		<i>(note 4)</i>
Cash flows provided by (used in):		
Operating activities:		
Net income from continuing operations	\$ 1,471,000	\$ 30,000
Items not affecting cash:		
Depreciation and amortisation	205,000	287,000
Accrued interest on special shares	82,000	89,000
Write off of deferred development costs	534,000	–
Interest on mortgage receivable	(21,000)	(19,000)
Stock options issued for consulting service	7,000	–
	2,278,000	387,000
Net change in non-cash working capital of continued operations <i>(note 19)</i>	3,496,000	(2,734,000)
	5,774,000	(2,347,000)
Results from discontinued operations	(484,000)	(1,151,000)
Items not affecting cash:		
Investments	(310,000)	–
Depreciation	7,000	24,000
Gain on disposal of assets	400,000	7,000
Shares and warrants issued for consulting services	150,000	–
	(237,000)	(1,120,000)
Net change in non-cash working capital of discontinued operations <i>(note 19)</i>	(187,000)	398,000
	(424,000)	(722,000)
Investing activities:		
Investment in capital assets	(68,000)	(118,000)
Investment in development costs	–	(534,000)
	(68,000)	(652,000)
Financing activities:		
Bank indebtedness	(5,262,000)	2,433,000
Line of credit	(20,000)	18,000
Promissory notes	–	842,000
Common shares	–	420,000
	(5,282,000)	3,713,000
Net decrease in cash and cash equivalents	–	(8,000)
Cash and cash equivalents, beginning of year	4,000	12,000
Cash and cash equivalents, end of year	\$ 4,000	\$ 4,000
Supplemental information:		
Interest paid	\$ 377,000	\$ 430,000
Income taxes paid	–	1,000
Conversion of debt into common shares and warrants	150,000	–
Conversion of special shares into common shares	–	915,000

The accompanying notes are an integral part of these consolidated statements

Notes to the Consolidated Financial Statements

December 31, 2003 and 2002

Expressed in Canadian dollars unless otherwise indicated

1. BASIS OF PRESENTATION AND CONTINUATION OF THE BUSINESS

The consolidated financial statements of Atlantis Systems Corp. (the "Company") are prepared in accordance with Canadian generally accepted accounting principles on a going concern basis, which assumes that the Company will be able to discharge its liabilities and realise the carrying value of its assets in the normal course of business. The Company operates with a significant working capital deficiency. The Company's ability to continue as a going concern and discharge its liabilities and realise the carrying value of its assets in the normal course of business depends upon, among other things, being able to raise sufficient additional working capital and being able to maintain profitable operations.

Without additional funding, the ability of the Company to continue as a going concern is substantially in doubt. The financial statements do not include adjustments to the carrying value and classification of the Company's assets and liabilities should the going concern assumption not be appropriate. In May 2004, the Board of Directors of the Company accepted an offer of financing (see note 22).

2. NATURE OF OPERATIONS

The Company is continued under the laws of Canada and is listed on the Toronto Stock Exchange. Atlantis Systems International ("ASI") is the only remaining operating subsidiary of the Company at year-end. ASI is an internationally recognised developer and supplier of simulation-based training systems for flight crew training, aircraft maintenance training, and other high-tech applications. In fiscal 2002, the Company had the following additional subsidiaries that were disposed of in fiscal 2003 as detailed in note 4: Denbridge Digital, Ltd. (United States) and Denbridge Digital Limited (United Kingdom). The Denbridge Digital entities collectively were high technology companies that designed, manufactured, and installed vessel traffic surveillance and management systems for marine, air traffic control, and highway applications. The parent company of these disposed entities, Denbridge Digital Limited, remains an inactive holding company owned 85% by the Company. It, in turn owns 100% of DNB Datawave Sciences (Barbados), which is also inactive.

3. SIGNIFICANT ACCOUNTING POLICIES

a. Going concern

The financial statements were prepared using accounting principles applicable to a going concern, which assumes that the Company will continue in operation for a reasonable period of time and will be able to realise its assets and discharge its liabilities in the normal course of operations.

b. Revenue recognition

Revenue from long-term contracts for developing and building simulators and training systems is recognised 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. 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 recognised to date. The results reported under the percentage of completion method are based on Management's estimates of total labour costs to complete the various contracts. Should total actual labour costs be materially higher or lower than these estimates, adjustment to future results would be necessary.

c. Research and development costs

The Company expenses all research costs. Development costs are expensed unless they meet generally accepted criteria for capitalisation. In 2003, no deferred development costs were capitalised (2002 – \$940,000), none were amortised (2002 – \$406,000) and \$534,000 (2002 – nil) were written-off in the year. Deferred development costs are amortised over the period the related revenue is recognised. The Company assesses the recoverability of the capitalised costs by determining whether the unamortised balance can be recovered through undiscounted projected future net cash flows of the related products. The benefits of investment tax credits are recognised as a reduction of research and development expenditures in the period the qualifying expenditure is incurred if there is reasonable assurance the tax credits will be realised.

d. Foreign currency translation

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the rates in effect at the balance sheet date. Other assets and liabilities are translated at the rates prevailing at the transaction dates. Revenues and expenses are translated at average rates prevailing during the year. Gains and losses arising from fluctuations in exchange rates are reflected in net earnings for the year.

From time to time, the Company enters into forward foreign exchange contracts to manage exposures resulting from foreign exchange fluctuations in the ordinary course of business. Gains and losses on these contracts are deferred and accounted for as part of the transactions being hedged. The Company negotiates forward contracts only with financially sound counter parties.

e. Cash and cash equivalents

Cash and cash equivalents include deposits and other highly liquid financial instruments all having a remaining maturity of 90 days or less at the date of purchase.

f. Inventory

Inventories of finished goods, work-in-process, and parts and supplies are recorded at the lower of cost, determined on a first-in, first-out basis, and net realisable value. Included in finished good inventory are two flight simulators recorded at a \$1,183,000 carrying value. The Company is actively pursuing several customers to sell these items and the carrying value reflects Management's best estimate of net realisable value.

g. Capital assets

Capital assets are recorded at cost, net of any investment tax credits, and depreciated or amortised generally on a straight-line basis over the estimated useful lives of the related assets, at annual rates between 2% and 33%.

h. Goodwill and other intangible assets

In 2001, the Company acquired all of the shares of ASI, and accounted for this transaction using the purchase method of accounting. The transaction resulted in goodwill of \$12,330,000 and during 2001 the Company recorded goodwill amortisation of \$595,000. Effective January 1, 2002, the Company adopted prospectively the recommendation of the Canadian Institute of Chartered Accountants revised Handbook Section 3062, Goodwill and Other Intangible Assets. Under the new standard, the Company no longer amortises its goodwill. Instead, the Company reviews, on an annual basis or more frequently if required, its goodwill in relation to the fair value of each reporting unit to which goodwill applies and the value of other assets in that reporting unit. A provision is made for any goodwill that is considered impaired. In addition, the standard includes provisions for the reclassification of certain existing recognised intangibles such as goodwill, the reassessment of the useful lives of existing recognised intangibles, the reclassification of certain intangibles out of previously reported goodwill and the identification of reporting units for purposes of assessing potential future impairments of goodwill. Section 3062 also required the Company to complete a transitional goodwill impairment test within six months from the date of adoption. This transitional review was completed as at January 1, 2002 for the goodwill that had been recorded by the Company.

The review indicated no impairment of goodwill as at January 1, 2002. The Company performed an annual impairment test as at December 31, 2002, indicating no impairment of the recorded goodwill. The Company performed an annual impairment test at December 31, 2003, indicating no impairment of the recorded goodwill.

i. Stock-based compensation plans

The Company has a stock-based compensation plan, which is described in note 13. Effective January 1, 2003, the Company adopted on a prospective basis the fair-value method of accounting for stock-based compensation awards granted to employees for options granted on or after that date. Under the new policy, the Company determines the fair value of the stock options on their grant date and records the fair value as a compensation expense over the period that the stock options vest, with a corresponding increase to contributed surplus. When these options are exercised, the amounts of proceeds, together with the amount recorded in contributed surplus are recorded in share capital. The adoption of this accounting policy had no impact in 2003 as no options were granted to employees. In 2003, compensation expense increased by \$7,000 and net income decreased by \$7,000, as a result of options granted to consultants. The fair value of these options was determined using the Black Scholes option-pricing model.

j. Income taxes

The Company and its subsidiaries use the asset and liability method for accounting for income taxes. Under this method, temporary differences between the tax basis of an asset or liability and its carrying amount on the balance sheet are used to calculate future income tax liabilities or assets. Future income tax liabilities or assets are calculated using substantively enacted tax rates anticipated to apply in the periods that the temporary differences are expected to reverse. The effect of the change in income tax rates on future income tax liabilities or assets is recognised in income in the period that the change occurs. Future income tax assets are evaluated annually and if realisation is not considered more likely than not, the value of the future tax asset is adjusted by a charge to income.

k. Use of estimates

The presentation of financial statements in accordance with generally accepted accounting principles requires Management to make estimates and assumptions. These estimates affect the reported amounts of assets and liabilities and disclosures of contingencies at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Management makes estimates related to revenue recognition and estimated costs to complete for percentage of completion basis on long-term contracts, and estimates related to allowance for doubtful accounts and inventory reserves. It is reasonably possible that changes in future conditions in the near term could require a material change in recognised amounts.

4. DISCONTINUED OPERATIONS

On March 19, 2003, the Company completed the sale of its Intelligent Traffic Systems ("ITS") division, Denbridge Digital, Ltd., based in Hayward, California to SRC Technologies, Inc. ("SRC" – formerly Connectivity, Inc.), a Florida-based wireless communications company, for US\$440,000 of convertible preferred shares. The sale resulted in SRC assuming US\$560,000 of net liabilities of the ITS division. The preferred shares are secured against the assets of the ITS division. The preferred shares are to be converted into 440,000 publicly traded common shares of SRC on the fifth anniversary of the closing. These shares are recorded on the financial statements at \$310,000. Subsequent to the sale, SRC was sold to CNE Group, Inc. ("CNE"), an AMEX traded Company. The preferred shares of SRC were substituted for preferred shares of CNE. The new agreement calls for the preferred shares of CNE to be redeemed for 440,000 publicly traded common shares of CNE on the fifth anniversary of the closing. The sale of the ITS division resulted in a net increase of working capital of \$843,000, due to the assumption of the ITS division liabilities by SRC, and a gain of \$1,005,000. The ITS division recorded an operating loss during 2003 of \$96,000 (2002 – \$129,000) on sales of \$15,000 (2002 – \$953,000).

During the second quarter of 2003, the Company announced the sale of the Vessel Traffics Systems ("VTS") division, Denbridge Digital Ltd. (United Kingdom) to its United Kingdom-based management group. This resulted in

a write-off of \$645,000, comprised of the write-off of net assets, an accrual for closure costs, and operating losses of the VTS division. No further impact on the Statement of Operations is anticipated. The remaining components of the loss from discontinued operations for the year represent the operating losses incurred by the VTS business. For 2003, the VTS business reported a net loss on operations of \$748,000 (2002 – \$1,022,000) on sales of \$452,000 (2002 – \$2,551,000).

Comparative numbers for 2002 have been restated to reflect the effect of the two above discontinued operations.

5. CONCENTRATION OF CREDIT RISK

The Company has contracts with many customers; however, as at December 31, 2003 one customer represented 23% of the accounts receivable (2002 – 78%) and 55% of sales (2002 – 37%).

6. INCOME TAXES RECEIVABLE

Income taxes receivable relates to investment tax credits (“ITCs”) that were acquired by the Company when it acquired ASI. ASI is no longer a Canadian controlled private corporation and is not eligible for future refundable investment tax credits.

Further ITCs acquired in the purchase of ASI available for carryforward against future years’ federal income taxes payable total approximately \$94,000 and expire between 2006 and 2010. None of these ITCs has been recognised in the accounts.

In addition, a claim for a tax refund in the amount of \$324,000 was allowed by the Canada Revenue Agency during 2003 based upon qualifying SR&ED expenditures by a Canadian Controlled Private Corporation (CCPC) during the period commencing September 1, 2000 and ending May 31, 2001. Of this amount, \$246,000 has been received as at year-end. At December 31, 2003, the \$78,000 balance is recorded as income taxes receivable.

7. CAPITAL ASSETS

Capital assets consist of the following:

	December 31, 2003			December 31, 2002		
	Cost	Accumulated amortisation	Net book value	Cost	Accumulated amortisation	Net book value
Equipment, furniture and fixtures	\$1,148,000	\$ 640,000	\$ 508,000	\$1,080,000	\$ 457,000	\$ 623,000
Leasehold improvements	108,000	53,000	55,000	108,000	31,000	77,000
	\$1,256,000	\$ 693,000	\$ 563,000	\$1,188,000	\$ 488,000	\$ 700,000

8. MORTGAGE RECEIVABLE

The mortgage receivable earns interest monthly at 4.5% per annum and requires principal payments of \$250,000 on December 31, 2008 and \$200,000 on December 1, 2013. These amounts are discounted at a rate of 9%. If the Company defaults on the payment of the premises rent, the mortgage receivable will be null and void.

9. BANK INDEBTEDNESS

At December 31, 2003 and 2002, the Company had the following bank indebtedness:

	2003	2002
Operating line of credit	\$ 1,101,000	\$ 690,000
Demand loan	–	5,673,000
	\$ 1,101,000	\$ 6,363,000

On June 16, 2003, the Company entered into an agreement with its bank whereby the bank provided a temporary operating line of credit ("Bank Line") with an expiry date of September 30, 2003. This Bank Line was authorised at \$1,000,000, bearing interest at the bank's prime rate plus 7% per annum, and was due on demand. On November 25, 2003 this temporary agreement was extended until December 15, 2003. This facility was maintained on an informal basis until March 2, 2004 when it was re-paid in full. As at December 31, 2003, the bank's prime rate was 4.50%.

The demand loan was used to provide financing under the Canadian Commercial Corporation's "Progress Payment Program", and bore interest at the bank's prime rate plus 1% per annum ("Demand Loan"). This Demand Loan was re-paid in full during 2003.

The Bank Line and Demand Loan were collateralised by a general assignment of accounts receivable, a general security agreement covering all personal and real property of the Company presently owned or acquired in the future, a \$4,000,000 floating charge debenture over all business assets, and an assignment of fire and other perils insurance. The banking agreement underlying the Bank Line contained certain operating restrictions and required ASI to maintain certain financial covenants. Subsequent to year-end the Bank Line was repaid in full (see note 22).

10. LINE OF CREDIT

In February 2001, the Company signed an unsecured US\$500,000 (\$788,000) line of credit bearing interest at a rate of 12% per annum. As a term of the loan, the lender would receive one pre-consolidation common share purchase warrant for each US\$1.00 (\$1.59) of borrowed funds. On a pre-consolidation basis, each warrant would allow the lender to buy one common share at a price of \$0.12 per share for a period of five years. As a result of the acquisition of ASI in 2001, this line of credit was capped at US\$100,000 (\$129,000) and became due on demand. On April 24, 2001, the Company's shareholders approved a share consolidation whereby each shareholder would receive one new share for every 40 old shares held. The share consolidation was implemented after Articles of Amendment were filed with Industry Canada and approvals obtained on June 11, 2001. This affected the number of warrants issued and the exercise price of those warrants issued pursuant to this line of credit. As at December 31, 2003, US\$100,000 (\$129,000) was drawn down on this line plus accrued interest of US\$34,000 (\$44,000) and 2,500 warrants to purchase common shares at \$4.80 on a post-consolidation basis had been issued with an expiry date of March 1, 2006.

11. PROMISSORY NOTES

During 2001, the Company borrowed \$1,392,000 from Innovium Capital Corp. ("Innovium"), a company with which it shares three common directors, in the form of unsecured demand notes bearing interest at rates from 10% to 12% per annum. In December 2001, \$800,000 of the notes was converted to special shares (see note 12). During 2002, the Company borrowed additional funds from Innovium in the form of demand notes totalling \$1,160,000 and bearing interest at 12% per annum. During 2002, \$385,000 of these notes was repaid. On September 15, 2002, the Company reorganised its notes payable with Innovium by consolidating the various demand notes, plus accrued interest, into one note. Certain accounts payable due to Innovium were also included to bring the principal amount of the note to \$1,500,000, bearing interest at a rate of 18% per annum. All other terms remained the same. At December 31, 2003, the Company's note due to Innovium totalled \$1,500,000 plus accrued interest of \$349,000 (2002 – \$1,500,000 plus accrued interest of \$79,000). Subsequent to year-end, Innovium agreed to convert this note into equity of the Company (see note 22).

12. SPECIAL SHARES – SERIES 2

In December 2001, the Company completed a private placement of 1,500,000 special shares – Series 2 to existing Company shareholders and new investors. The financing resulted in \$700,000 of new equity and the conversion of \$800,000 of short-term obligations (see note 11). Each special share – Series 2 is convertible into 1.5 common shares and 0.75 of a warrant to purchase one common share at \$0.80 per share and carries a \$0.10 per special share annual dividend.

On February 19, 2002, 700,000 of these special shares – Series 2 were redeemed for 1,050,000 common shares and 525,000 common share purchase warrants with an exercise price of \$0.80 per share. On April 9, 2002, the 525,000 common share purchase warrants were exercised resulting in the issuance of 525,000 common shares and the raising of \$420,000.

13. SHARE CAPITAL

Authorised:

- An unlimited number of common shares; and
- An unlimited number of special shares issuable in series.

Issued:

	2003		2002	
	Number of shares	Stated capital	Number of shares	Stated capital
Common Shares				
Opening balance	13,987,008	\$ 71,818,000	12,092,557	\$ 70,460,000
Conversion of special shares				
– Series 2 (note 12)	–	–	1,050,000	700,000
Conversion of special shares				
– Series 1 (note 13(a))	–	–	319,451	238,000
Exercise of warrants (note 12)	–	–	525,000	420,000
Settlement of trade debt (note 13(c))	300,000	146,000	–	–
Closing balance	14,287,008	\$ 71,964,000	13,987,008	\$ 71,818,000
Warrants				
Opening balance	3,954,925	\$ 3,140,000	3,954,925	\$ 3,140,000
Settlement of trade debt (note 13(c))	75,000	4,000	–	–
Closing balance	4,029,925	\$ 3,144,000	3,954,925	\$ 3,140,000
		\$ 75,108,000		\$ 74,958,000
Special Shares – Series 1				
Opening balance	–	\$ –	215,252	\$ 215,000
Conversion of special shares				
– Series 1 (note 13(a))	–	–	(215,252)	(215,000)
Closing balance	–	\$ –	–	\$ –

a. The special shares – Series 1 issued in the acquisition of ASI accrued a quarterly dividend of \$0.025 per share until September 29, 2001 and \$0.04 thereafter; were retractable, at the Company's option, at \$1.00 per share plus accrued dividends at any time; were redeemable at the option of the holder at \$1.00 per share plus accrued dividends at any time after March 29, 2002; were convertible, at the option of the holder or Company, into common shares at their then market price, based on the 20-day weighted average closing price, at any time after March 29, 2002 or were automatically so converted should a redemption request be made by the holder and such request cannot be fulfilled by the Company; and were guaranteed by ASI. On April 5, 2002, the special shares – Series 1 were converted into 288,929 common shares. In addition, accrued interest on the special shares of \$23,000 was converted into 30,522 common shares.

b. The Company has an incentive stock option plan (the "Plan") pursuant to which it may grant options to purchase the Company's shares to directors, officers, employees, and consultants. Compensation expense is recognised when the options are issued (see note 3(i)).

The following chart summarises the changes in the options granted under the Plan:

	Number	Weighted average exercise price
Balance, December 31, 2001	1,016,500	\$ 2.22
Cancelled or expired	(336,500)	\$ 2.24
Balance, December 31, 2002	680,000	\$ 2.17
Granted	150,000	\$ 0.40
Cancelled or expired	(72,500)	\$ 3.55
Balance, December 31, 2003	757,500	\$ 1.61

The following table summarises stock option information outstanding at December 31, 2003.

Options Outstanding and Exercisable			
Exercise prices of options	Number outstanding	Weighted average remaining contractual life	Weighted average exercise price
\$ 0.40	150,000	0.76 yrs	\$ 0.40
\$ 2.00	605,000	2.58 yrs	\$ 2.00
\$ 4.00	2,500	1.55 yrs	\$ 4.00
\$0.40 – \$4.00	757,500	2.21 yrs	\$ 1.61

The following table summarises stock option information outstanding at December 31, 2002.

Options Outstanding				Options Exercisable		
Exercise prices of option	Number outstanding	Weighted average remaining contractual life	Weighted average exercise prices	Number outstanding	Weighted average remaining contractual life	Weighted average exercise price
\$ 2.00	670,000	3.58 yrs	\$ 2.00	541,250	3.58 yrs	\$ 2.00
\$ 4.00	2,500	2.55 yrs	\$ 4.00	2,500	2.55 yrs	\$ 4.00
\$ 6.80	3,750	0.19 yrs	\$ 6.80	3,750	0.19 yrs	\$ 6.80
\$ 27.20	3,750	0.50 yrs	\$ 27.20	3,750	0.50 yrs	\$ 27.20
\$2.00 – 27.20	680,000	3.55 yrs	\$ 2.17	551,250	3.53 yrs	\$ 2.21

As at December 31, 2003, there remained available for issuance under the Plan, 2,242,500 options to acquire Common Shares of the Company. Under the Plan, the vesting of options can vary from grant to grant, at the discretion of the Board. The Plan allows the Board to determine vesting. However, the options generally vest at 50% at the time of the grant, 25% on the first anniversary of the grant, and 25% on the second anniversary of the grant. The exercise price of each option must not be less than the closing market price of the Company's Common Shares on the Toronto Stock Exchange on the day prior to the date of grant. The total proceeds that would be generated upon exercise of all issued and outstanding options is approximately \$1,280,000.

For the twelve months ended December 31, 2003, the Company issued 150,000 stock options under the Company's Stock Option Plan resulting in a compensation cost of \$7,000 being reflected in the statement of earnings for 2003. For fiscal 2002, the reported net loss and loss per share equal the pro-forma loss and loss per share amounts under the fair value method as no options were granted.

c. In October 2003, the Company settled certain trade debt of \$150,000 by issuing 300,000 common shares and 75,000 common share purchase warrants with an exercise price of \$0.50 and an expiry date of October 1, 2006.

d. The breakdown of warrants outstanding at December 31, 2003 is as follows:

Expiry Date	Number of Warrants	Exercise Price
February 20, 2006	27,500	\$3.60
March 1, 2006	2,500	\$4.80
May 15, 2006	3,424,925	\$3.60
May 15, 2006	500,000	\$3.00
October 1, 2006	75,000	\$0.50

14. INCOME TAXES

The provision for (recovery of) income taxes reflects an effective tax rate that differs from the statutory tax rate for the following reasons:

	2003	2002
Statutory rate	36.6%	38.6%
Non-deductible amounts	0.0%	(5.2%)
Increase in valuation allowances and other differences	(36.6%)	(33.4%)
	0.0%	0.0%

The Company has unutilised Canadian non-capital tax loss carryforwards of \$10,565,000 (2002 – \$ 21,100,000) that are available for carryforward against taxable income in future years. These tax losses expire in various years beginning in 2004 through 2010.

The Company's future income tax assets comprise the following:

	2003	2002
Future income tax assets resulting from operating loss carryforwards	\$ 3,867,000	\$ 8,145,000
Future income tax assets resulting from capital loss carryforwards	1,237,000	1,470,000
Future income tax assets resulting from temporary differences and other items	1,840,000	265,000
	6,944,000	9,880,000
Less valuation allowance	(6,944,000)	(9,880,000)
Future income tax asset	\$ –	\$ –

The Company has recorded a full valuation allowance related to tax loss carryforwards and temporary differences as it believes there is uncertainty in realising the full benefit of the tax loss carryforwards and temporary differences.

15. NET INCOME (LOSS) PER SHARE

Basic earnings (loss) per share figures are calculated using the weighted average number of common shares outstanding during the year. Diluted earnings (loss) per share reflects the dilution that would occur if outstanding special shares, stock options and share purchase warrants were exercised or converted into common shares using the treasury stock method. For the years ended December 31, 2003 and 2002, the inclusion of the Company's special shares, stock options and share purchase warrants in the computation of diluted earnings (loss) per share had an anti-dilutive effect on earnings (loss) per share and, therefore, were excluded from the computation. The weighted average number of shares outstanding used in the computation of basic and diluted earnings per share for the year ended December 31, 2003 was 14,062,832 (2002 – 13,619,187).

16. SEGMENTED INFORMATION

During 2003 and 2002, the Company's operations were conducted in Canada, the United Kingdom, the United States, and Barbados. See note 2 for the nature of these operations. The amounts listed under Denbridge Digital represent the discontinued operations (see note 4) of the United Kingdom, United States, and Barbados. The results of the operations and the amounts invested in these segments are as follows:

(000s of Cdn \$)	ASI		Denbridge Digital		Corporate		Total	
as at and for the years ended December 31st	2003	2002	2003	2002	2003	2002	2003	2002
Revenue								
Canada	\$ 23,432	\$ 27,449	\$ -	\$ -	\$ -	\$ -	\$ 23,432	\$ 27,449
Net Earnings (Loss)								
Canada	2,313	969	-	(268)	(842)	(671)	1,471	30
Discontinued operations	-	-	(484)	(1,151)	-	-	(484)	(1,151)
Depreciation & Amortisation								
Canada	205	287	-	-	-	-	205	287
Capital Expenditures, net								
Canada	68	118	-	-	-	-	68	118
Total Identifiable Assets								
Canada	15,958	23,424	-	-	344	5	16,302	23,429
Discontinued operations	-	-	-	2,530	-	-	-	2,530

17. COMMITMENTS AND CONTINGENCIES

Certain funding from Canadian Network for the Advancement of Research, Industry and Education Inc. recognised in prior years related to development activities is contingently repayable if the resulting products are commercially successful. Contributions recognised in prior years that may be repayable total \$3,749,000, of which \$1,877,000 may be repayable based on a percentage of sales over an unlimited period and \$1,872,000 may be repayable based on a percentage of sales over a limited period. During 2003 and 2002, nothing was due or repaid. Any subsequent repayments will be recorded as an expense in the period the Company becomes liable to make the payments.

As at December 31, 2003, the Company had received \$355,000 in funding under an agreement with Technology Partnerships Canada to design, develop and commercialise a Simulation Based Interactive Training System ("SBITS"). Under the terms of the agreement, the Company may receive up to \$1,236,000 as a contribution to certain costs incurred up to May 2001 and is required to pay a royalty based on gross revenues from SBITS to a maximum of \$1,858,000. The Company is not currently working on the project. Should the project continue, the contributions and the royalties will be recorded in the period the Company becomes entitled to the contributions and liable for the royalty payments.

The Company has entered into the following operating lease commitments for its office space and other leased equipment:

Year	Amount
2004	\$ 714,000
2005	714,000
2006	714,000
2007	714,000
2008	723,000
	<hr/>
	3,579,000
Thereafter	4,075,000
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	\$ 7,654,000

18. FINANCIAL INSTRUMENTS

a. Foreign exchange

As at December 31, 2003 and 2002, the Company had no foreign exchange contracts outstanding.

b. Interest rate

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.

c. Fair values

The carrying values of cash and cash equivalents, accounts receivable, unbilled revenue, income taxes receivable, bank indebtedness, accounts payable and accrued liabilities, and operating line of credit approximate their fair values due to their current nature.

Carrying values of the mortgage receivable, investment and promissory note approximate their fair value.

19. NET CHANGE IN NON-CASH WORKING CAPITAL

	2003	2002
Net change in non-cash working capital of continuing operations :		
Accounts receivable	\$ 7,320,000	\$ (5,813,000)
Unbilled revenue	(501,000)	431,000
Income taxes receivable	94,000	10,000
Inventory	(376,000)	5,000
Mortgage receivable	250,000	-
Accounts payable and accrued liabilities	(823,000)	(2,278,000)
Accrued costs on percentage completion	(810,000)	1,261,000
Promissory notes	270,000	79,000
Deferred revenue	(1,928,000)	3,571,000
	\$ 3,496,000	\$ (2,734,000)
	2003	2002
Net change in non-cash working capital of discontinued operations :		
Assets of discontinued operations	\$ 2,123,000	\$ (658,000)
Liabilities of discontinued operations	(2,310,000)	1,056,000
	\$ (187,000)	\$ 398,000

20. RELATED PARTY TRANSACTIONS

During 2003 and 2002, the Company had three common directors with, and received certain management services from, Innovium. During 2003, Innovium billed the Company \$206,000 (2002 – \$140,000) for costs incurred on the Company's behalf in the normal course of operations. These amounts are included in accounts payable as at December 31, 2003 and 2002. At December 31, 2003, \$242,000 (2002 – \$36,000) due to Innovium was included in accounts payable. During 2003, Innovium received stock options expiring October 2, 2004, allowing Innovium to purchase 150,000 common shares at a price of \$0.40 per common share.

In addition to Innovium, the Company also accrued expenses owing to shareholders relating to reimbursable costs for shared office space and administrative services paid on the Company's behalf. For 2003, these costs totalled \$138,000 (2002 – \$138,000), none of which have been paid. At December 31, 2003, the amount owing to these shareholders was \$247,000 (2002 – \$117,000).

During the second quarter of 2003, the Company announced the sale of the Vessel Traffics Systems (“VTS”) division to its United Kingdom-based management group (see note 4). Given the financial duress that this division was under, the Company was unable to find a purchaser. The Company decided to close this business when presented with a purchase offer from the VTS management. The Company determined this to be the most economically advantageous option and agreed to the sale.

21. SALE OF TECHNOLOGY

In June 2003, the Company completed the sale of certain non-core naval technology for proceeds of \$400,000, and reported a gain of \$400,000 in the Consolidated Statement of Operations.

22. SUBSEQUENT EVENTS

In March 2004, the Company signed a commitment letter with Claymore Capital Management Inc. (“Claymore”) of Toronto, whereby Claymore was to provide Atlantis with a \$5,000,000 convertible operating term facility (“Credit Facility”), subject to regulatory and shareholder approvals. In anticipation of receiving shareholder approval, Claymore advanced \$3,000,000 to Atlantis. This advance was used to retire the bank operating line of credit and provide additional working capital. As a result, Claymore took the security previously controlled by the bank. This credit facility bears interest at 12% per annum and is collateralised by a \$5,000,000 Joint Secured Grid Note in favour of Claymore issued by the Company and ASI, a General Security Agreement covering all personal and real property presently owned or acquired in the future, and an assignment of fire and other perils insurance. In May 2004, the shareholders of the Company voted against proceeding with the Claymore financing proposal. Under the terms of the credit facility agreement, the full amount of the Credit Facility is repayable on or before July 30, 2004. In addition, the commitment letter requires the payment by the Company to Claymore of a break fee of \$250,000 and certain of Claymore’s out-of-pocket expenses.

In May 2004, the Board of Directors of the Company accepted an offer of financing received from Falcon Corporation (“Falcon”). Falcon’s financing offer consists of up to \$6 million in equity units and a commitment to provide a \$2 million term debt facility. The equity units, priced at \$0.40, will consist of one common share and one half of a common share purchase warrant. Each full common share purchase warrant will be exercisable for two years following the closing of the financing and the exercise price will be \$0.50 per share for the first twelve months following the closing and \$0.60 per share for the second twelve months following the closing. As a condition of the Falcon financing offer, up to \$2,750,000 of the Company’s existing current liabilities (including accrued dividends on special shares, line of credit, and promissory notes) will be converted into: (i) common shares at \$0.50 per share; and (ii) up to an additional 1,050,000 common share purchase warrants exercisable at \$0.60 per share with an expiry date of three years from the closing of the financing. It is also a condition of the Falcon financing offer that the Company’s outstanding Series 2 Special Shares in the amount of \$800,000, plus accrued dividends, will be converted to common shares at a price of \$0.50 per share and up to an additional 500,000 common share purchase warrants exercisable at \$0.60 per share with an expiry date of three years from the closing of the financing. On June 14, 2004, the Company reported that it had received shareholder approval to proceed with the closing of this financing.

23. PRIOR YEAR FINANCIAL STATEMENTS

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

Corporate Directory

Nominees for Board Of Directors:

Julio DiGirolamo, CA
Chief Financial Officer and Corporate Secretary,
Innovium Capital Corp.

Terence Donnelly
Executive Vice President,
Mandrake Management Consultants Inc.

Donald B. Green
Founder and former Chairman,
Menu Foods Ltd.

Tom Griffis
President,
Griffis International Limited

Donald Hathaway
Nominee Chairman of the Board, and
President and Chief Executive Officer,
Ontario Centres for Excellence Inc.

David J. McFadden, Q.C.
Chair, National Energy and Infrastructure Industry Group
Gowling Lafleur Henderson LLP

David Williams
President,
Roxborough Holding Limited

Current Board of Directors:

Vincent A. Henry

Terrance King

Jamie Macintosh

Vanessa Morgan

R. Neil Raymond

Officers of Atlantis Systems Corp.:

Andrew Day
President and Chief Executive Officer

Julio DiGirolamo
Corporate Secretary

Paul Maasland
Vice President, Corporate Development

Officers of Atlantis Systems International Inc.:

Andrew Day
President and Chief Executive Officer

Martyn Exon
Vice President and General Manager

Paul Maasland
Vice President, Corporate Development

Wayne Moni
Vice President, Marketing and Sales

Thomas Wallace
Vice President, Finance and Administration

Transfer Agent:

Computershare Trust Company of Canada

Stock Exchange Listing:

Toronto Stock Exchange - AIQ

Corporate Head Office:

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