



MANAGEMENT'S DISCUSSION AND ANALYSIS

Third Quarter, 2007

This Management's Discussion and Analysis ("MD&A") explains the financial condition and results of operations of Atlantis Systems Corp. ("our Company" or "Atlantis" or "we" or "our" or "us") as at and for the three and nine months ended September 30, 2007 with comparisons to the nine months ended September 30, 2006, the three months ended June 30, 2007, 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 interim unaudited Consolidated Financial Statements and the notes thereto as at and for the nine months ended September 30, 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 November 14, 2007 except where otherwise noted.

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1. HIGHLIGHTS

- On September 18, we attended the Air Medical Transport Conference in Tampa, Florida where we conducted market research on the Helicopter Virtual Task Trainer (“HVTT”) with a number of emergency response helicopter pilots. As a result of the positive feedback received at this conference we will be conducting more extensive field trials at a training centre of a major North American commercial aviation training company (“training company”). A memorandum of understanding was signed with the training company in October 2007 for the training company to contribute state of the art visual systems and engineering to augment the HVTT, and to assess the suitability and feasibility of the HVTT. The assessment is expected to begin in early 2008.
- On September 27, we completed the acquisition of the Eduplus Division (“Eduplus”) of Tecslut Inc. a Quebec-based engineering firm. Eduplus, based in Halifax, Nova Scotia is an e-learning provider to the aviation and naval defence sectors.

Revenue for the three months ended September 30, 2007 was \$6.8 million, a decrease of 41% from the \$11.5 million recognized in the third quarter of 2006, and a 56% decrease from the \$15.2 million reported for the second quarter of 2007.

We recorded a loss of \$1.6 million in the third quarter of 2007. This compared to a profit for the third quarter of 2006 of \$1.4 million and a profit of \$2.7 million for the second quarter of 2007.

We reported cash and cash equivalents of \$5.7 million at September 30, 2007 which was \$9.7 million lower than the balance reported at last year’s third quarter-end and \$2.0 million more than the reported balance of \$3.7 million reported at June 30, 2007.

As at September 30, 2007, the Company was in breach of two debt covenants. The breach of these covenants constitutes an event of default under the credit facility, with the bank having the right to demand repayment of the loan. As a result, the term loan is reported as a current liability. The covenants in breach were the maximum capital expenditure limit and the EBITDA ratio discussed in section 21 of this MD&A. The maximum capital expenditure limit was exceeded by \$10 as at September 30, 2007.

As of the date of this MD& A, we had 250,000 warrants to purchase common shares outstanding.

Our order backlog at September 30, 2007 was \$41.4 million (which includes \$18.4 million for the Contracted Flying Training and Support (“CFTS”) support services to be recognized over the twenty year contract period and \$9.3 million for the Eduplus contracts). Our order backlog at June 30, 2007 was \$38.9 million (which includes \$18.4 million for the CFTS support services to be recognized over the twenty year period). Our order backlog at September 30, 2006 was \$59.7 million (which includes \$18.4 million for the CFTS support services to be recognized over the twenty year period).

2. 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.

Throughout this MD&A, and in particular in the Business Outlook on page 25, you will find 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 CFTS program and the ability of subcontractors to meet deadlines on this program; the level of activity under the CFTS program; the proportion of CFTS to non-CFTS revenue; our ability to complete new and existing projects on time and on budget; our ability to win new projects and our ability to accurately forecast the timing of such wins; the performance of subcontractors generally; the number of stock options to be granted in the future; the completion date, development of applications, market and market share for our HVTT product; the level of capital programs to be completed; expected developments in the nuclear and aerospace industry; Atlantis Systems America Inc.’s (“ASA”) ability to deliver courseware and other programs on time and on budget; the level of spending on our direct U.S. market initiative; the fair value of our Company exceeding its carrying value in the financial statements including goodwill; the accuracy of our forecasts of spending and depreciation expenses; the accuracy of our projections of infrastructure spending at our facilities in Brampton, Ontario, Halifax, Nova Scotia and Orlando, Florida; our ability to source capital to fund our operations, growth and acquisition plans; our ability to repay bank debt on demand; our ability to operate as a going concern; the availability of appropriate acquisition targets; our ability to protect and exploit our intellectual property; the growth of markets for simulation-based training products; and the growth of military markets worldwide.

It is important to note that:

- Unless otherwise indicated, forward-looking statements in this MD&A describe our expectations as of November 13, 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.

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.

This report includes information we believe is material to investors after considering all circumstances. We consider information to be material if it significantly affects, or would reasonably be likely to have a significant effect on, the market price or value of our shares or could be considered by a reasonable investor to be important to an investment decision.

3. WHO WE ARE

Our Company was founded 29 years ago and is headquartered in Brampton, Ontario. In 2006, we opened a second facility in Orlando, Florida specifically targeted to the U.S. military and in 2007; we acquired Eduplus from Tecresult Inc. (“Tecresult”) in Halifax, Nova Scotia. Over the course of our history Atlantis has been recognized as a leading provider of simulation-based training technology, primarily targeted to the military and commercial aviation industry and we are known for our technological capabilities and innovative solutions.

In mid-2004, the Company underwent a major restructuring. The shareholders appointed a new board of directors and the new board in turn appointed a new President and Chief Executive Officer. Our Company continues to transform itself from a provider of flight and flight maintenance training products to a provider of integrated training systems and learning solutions.

Our current mix of competencies includes: simulation, e-learning and knowledge management systems and expertise, hardware and software integration and virtual reality. We are focused on performance outcomes and on the means for ensuring optimal performance enhancement that can be measured and sustained. Subject matter expertise in both training and learning ensures that we deliver the performance results expected by our customers.

Our Core Values

- Quality – we focus on our customers, their requirements and expectations.
- Innovation – we use responsible creativity to craft the best solutions.
- Integrity – we act ethically in our professional endeavours.
- Accountability – we are responsible and meet our commitments.
- Teamwork- we believe in spirited collaboration.

4. OUR MARKETS

Military

Our roots are in the military and we will continue to strengthen our position in this market. Globally, we expect this market to grow at a rate of 2% to 3% per year. However, there are significant differences amongst military organizations.

The Canadian Forces has an unprecedented number of programs underway or planned including new airframes, frigates, multi-purpose ships and the most recently announced arctic patrol boats as well as other recently announced programs. All of these programs will require performance critical learning systems. Our capabilities and our recent acquisition of Eduplus position us well to capture a significant share of the training dollars for these programs.

The U.S. military spends about \$U.S. 500 billion per year and accounts for about half of the global military spending. Our presence in this market is not only important because of the sheer size of the market but also because the U.S. military can dictate or strongly influence who can be a supplier of goods and services for U.S. military sales to foreign governments. To access this market directly it is essential to establish a presence in the U.S. and gain the required security clearances and meet U.S. government procurement policies. ASA was created for this purpose. It is fully staffed and this year has received full military clearance; it qualified as a prime contractor under the Seaport-e indefinite-delivery / indefinite-quantity (ID/IQ) procurement program for the U.S. Navy and Marine Corps and obtained its first third-party contract from a U.S. original equipment manufacturer.

In addition, there are a number of important trends that favour the services we provide:

- there is a trend towards outsourcing to better manage military budgets and to encourage more innovative training solutions;
- expected high levels of attrition across armed forces creates a requirement to train more qualified technicians and trainers in less time;
- the nature of warfare is changing and the use of sophisticated computer systems in communications, weapons delivery and networking lends itself perfectly to the use of synthetic training and performance based learning systems;
- with the advent of more powerful computers, more sophisticated peripheral technology and enhanced graphics, the realism in simulation is unprecedented resulting in an ever-increasing acceptance of this learning approach by the military; and
- the cost of simulation technology has been drastically reduced making it much more affordable to a wider base of applications and users.

Civil Aviation

Atlantis has been involved with the civil aviation industry since its inception, and we continue to view this market with interest. We expect the coming years will bring an unprecedented worldwide shortage of qualified commercial pilots due to the following trends:

- a healthy global growth in civil aviation that is expected to continue;
- a significant proportion of the pilot population is approaching retirement age; and
- fewer military pilots are transferring to civil aviation.

Boeing estimates that 29,000 new airliners are required by 2026, for a staggering market value of U.S. \$2.8 trillion. It estimates that these new planes will require an additional 18,000 new pilots every year for the next 20 years, for a total of 360,000 new pilots.

The demand for new pilots is even more pronounced in emerging markets like India and China where air traffic is growing at a much higher rate than in developed countries and the training infrastructure is not as well developed.

Our flight training devices, cockpit procedures trainers and flight simulators are installed and operating around the world, and we will continue to take a keen interest in the civil aviation industry worldwide.

Over the last two years, we have invested in developing the HVTT, our virtual-reality, full-motion helicopter simulator. By using virtual reality this product has the potential of providing full flight simulation training at a fraction of the cost of full flight simulators. During the year we made a number of technical improvements including new visuals and a wider virtual field of vision. We were very encouraged by the positive response we received from helicopter pilots who test “flew” the HVTT at the recent Air Medical Transport Conference in Tampa, Florida. As a result of this positive response, we have signed a memorandum of understanding with a major North American commercial aviation training company to conduct further field tests at one of its training facilities.

Nuclear

From the early 70s to the mid 80s nuclear energy in the U.S. grew from about 2% to 19% of electrical supply and has remained relatively constant since that time due to heightened societal concerns about nuclear energy. We believe that this fact has several interesting implications for us:

- a significant number of these facilities have reached an age where major retrofits and upgrades are required to serve existing power demand; and
- the societal concerns around nuclear safety and the subsequent reduction in capacity at existing plants, coupled with the lack of new plants being built since the mid 80s has resulted in both a lack of jobs and the reduction of formal training programs at many colleges and universities as fewer people were entering the nuclear industry.

The increased demand for more “green” power is prompting a renaissance of nuclear as a base power supply. This coupled with retrofits, major upgrades and the replacement of a significant portion of an aging workforce are expected to result in a significant training requirement.

In addition, there are number of other trends that also point to a rebirth of the nuclear sector. The need to reduce carbon emissions is generating significant interest in emission free generation of electricity. In 2006, nuclear energy and hydro accounted for 73% and 25% respectively of the U.S. sources of emission free generation. Other emission free sources such as solar, wind and geothermal accounted for only 2.6% of the emission free generation. While these other sources will continue to grow, it would appear to us that nuclear energy is the only viable cost effective vehicle to deliver substantial emission free power for the foreseeable future.

Today, there are 438 reactors operating worldwide, 75% of which are twenty years old or older, giving rise to a significant training potential in the nuclear retrofit market. In addition to this retrofit market, current estimates call for 60 new reactors worldwide over the next 15 years. We have received our first orders in this market, and we will continue to pursue growth in this area.

Other

We believe that there are numerous other markets that would benefit from our synthetic learning systems. These include the medical industry, complex industrial facilities and the transportation industry. We do not intend to actively pursue these industries at this time unless an opportunity arises.

5. OUR VALUE EQUATION

We believe that our integrated training systems and learning solutions provide the following benefits to our customers:

- the ability to train students cost-effectively;
- they allow for a significantly reduced instructor-to-student ratio;
- they significantly reduce the cost of training since sophisticated training tools such as simulation and virtual reality reduce the need to use expensive assets such as fighter planes or full flight simulators;
- they speed up the learning process and enhance the quality of learning through continuous performance assessment, feedback mechanisms and realism of the training simulation;
- they maintain training consistency amongst student groups that take the training at different times;
- they can be used to pre-screen students for their suitability in the operational roles;
- training programs can be easily and cost-effectively updated.

6. 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 decreased revenue and cost of revenue for the third quarter of 2006 by \$328 and \$224 respectively. For the nine months ended September 30, 2006, we decreased revenue and cost of revenue by \$262 and \$180 respectively. This correction did not change the basic and diluted net income per share for the first, second and third quarters of 2006. All amounts relating to the three and nine months ended September 30, 2006 presented herein have been adjusted to reflect this restatement, as applicable.

7. EDUPLUS ACQUISITION

On September 27, 2007, we completed the acquisition of Eduplus from Tecsalt, a Quebec-based engineering firm. Eduplus, based in Halifax, is an e-learning provider to the aviation and naval defence sectors. The agreement to purchase was originally announced in May 2007.

We acquired Learninglogics, Eduplus' learning management system, learning content management system and related intellectual property, as well as rights to execute and perform under current contracts valued at approximately \$10.0 million. Eduplus will be managed as a separate Atlantis division. In addition, we entered into a five-year teaming agreement with Tecsalt to pursue specific business opportunities. The teaming agreement also includes a non-competition covenant on all same and similar business conducted by Eduplus and a right of first refusal on any non-similar training opportunity identified by Tecsalt for a period of five years from the date of the agreement. Consideration for these assets included a cash payment of approximately \$2.5 million and the issuance of 1,294,498 common shares of Atlantis. The teaming agreement includes additional payments for the successful closing of currently identified business opportunities. The cash portion of the acquisition was financed through a \$2.8 million senior debt funding arrangement with a major Canadian chartered bank. The debt has a three-year term and will be amortized over five years.

8. COST REDUCTION PLAN

The Company has initiated a cost reduction plan in the fourth quarter of 2007. The cost reduction plan is aimed at reducing costs and overall operating expenses by approximately 15% annually. Workforce reductions and other cost cutting measures are expected to result in annual savings of approximately \$4.0 million beginning in fiscal 2008. This plan will result in one time termination benefits of approximately \$0.8 million, to be largely recorded in the fourth quarter of 2007.

The cost reduction plan is not expected to impact the Company's ability to service current contracts or pursue new opportunities that have been identified. Workforce reductions are primarily focused on non-revenue generating positions. While the Company plans to reduce costs at its ASA operations it will continue to maintain a presence in the U.S. and retain the security clearances required to meet U.S. government procurement policies.

9. RESULTS OF OPERATIONS

Following is a discussion of the material factors influencing the operating results and financial condition of our Company as at and for the three and nine months ended September 30, 2007, with comparisons to the three and nine months ended September 30, 2006, where applicable.

The Consolidated Statements of Operations, Comprehensive Income and Deficit for the three and nine months ended September 30, 2007, with comparative numbers for the three and nine months ended September 30, 2006, reflect the operations of our operating entities, Atlantis Systems International Inc. ("ASI") and ASA and corporate overheads.

10. REVENUE

Third Quarter

The components of revenue for the three months ended September 30, 2007 and 2006 are as follows:

	Three Months Ended September 30			
	2007		2006 Restated	
	\$	%	\$	%
CFTS	\$4,340	64%	8,202	71%
IMTS	371	6%	1,537	13%
RDAF	1,402	21%	1,019	9%
Nuclear Sector	91	1%	173	2%
Other	546	8%	578	5%
Total	\$6,750	100%	\$11,509	100%

We realized consolidated revenues of \$6,750 in the third quarter of 2007, versus revenues of \$11,509 for the same period in 2006, a decrease of 41 %. The major component of the decrease related to the CFTS program. For the third quarter of 2007, 64 % of revenues were generated from the CFTS program versus 71% for the third quarter of 2006. For the CFTS program, we recognize revenue based upon the proportion of work performed in-house (including by ASA), materials used and achievement of milestones by our subcontractors on the program. 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 most of 2008.

In the third quarter of 2007, revenues from integrated maintenance training systems (“IMTS”) projects amounted to 6% of total revenues (\$371) versus 13% (\$1,537) for the third 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 \$352 were recognized in the third 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 third quarter of 2006 on IMTS contracts were \$496 from the Royal Australian Air Force (“RAAF”) and \$979 from the CF. Revenues from the sales of IMTS units declined between the third quarter of 2006 and the same period in 2007 by \$1,166 (76%) as a result of 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 \$1,402 were recognized on this program in the third quarter of 2007.

Revenues from customers in the nuclear sector were \$91 for the third quarter of 2007. This compares to revenues of \$173 for the third quarter of 2006.

Other revenues in the third quarter of 2007 of \$546 were derived from a number of small, short-duration contracts. Other revenues in the third quarter of 2006 of \$578 were also derived from a number of small, short-duration contracts.

During the three months ended September 30, 2007, while we had contracts with multiple customers, one customer, the CF, represented 70% of revenue (81% during the same period in 2006). In addition, as at September 30, 2007, the same customer represented 23% of combined accounts receivable and unbilled revenue (77% during the same period in 2006). Our second largest customer represented 21% of revenue (9% during the same period in 2006) and 45 % (3% during the same period in 2006) of the combined outstanding balance of accounts receivable and unbilled revenue at quarter end.

The order backlog at September 30, 2007 was \$41.4 million, consisting of \$26.1 million from the CFTS program (which includes \$18.4 million in support services to be recognized over the twenty-year support period), \$9.3 million from the Eduplus contracts and \$6.0 million from all other contracts.

At September 30, 2007, the order backlog of \$41.4 million decreased \$18.3 million from the comparable backlog of \$59.7 million at September 30, 2006. This decrease consists of a \$22 million net reduction on the CFTS program, a decrease of \$5 million in the RDAF CPT program, a decrease in other programs of \$1 million, offset by the \$9.3 million addition of Eduplus backlog. We expect between \$5 million to \$7 million of the order backlog to be realized as revenue over the remaining quarter of 2007.

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.

Nine months

The components of revenue for the nine months ended September 30, 2007 and 2006 are as follows:

	Nine months Ended September 30			
	2007		2006 Restated	
	\$	%	\$	%
CFTS	\$19,682	71%	\$17,546	68%
IMTS	1,783	6%	4,856	18%
RDAF	4,088	15%	1,019	4%
Nuclear Sector	273	1%	445	2%
Other	1,994	7%	2,097	8%
Total	\$27,820	100%	\$25,963	100%

Revenue for the nine months ended September 30, 2007 was \$27,820, a 7% increase over the \$25,963 recorded for the nine months ended September 30, 2006. Revenue for the CFTS program was \$19,682 for the nine months ended September 30, 2007, compared to \$17,546 for the comparable period in 2006, a \$2,136 increase. IMTS revenues were \$1,783 for the period in 2007, a reduction of \$3,073 versus the \$4,856 for the corresponding period in 2006.

The overall revenue increase of \$1,857 for the nine months year-over-year represents an increase of \$2,136 for the CFTS program, an increase of \$3,069 for the RDAF helicopter cockpit procedures trainer, offset by a reduction of \$3,023 for IMTS, a reduction of \$172 for the nuclear sector and a \$103 reduction from other short-duration contracts (included in Other revenue in the table above).

During the nine months ended September 30, 2007, while we had contracts with multiple customers, one customer, the CF represented 77% of revenue (2006 - 74%). Our second-largest customer represented 15% of revenue (2006 - 4%).

11. GROSS MARGIN

Third Quarter

Gross margin for the three months ended September 30, 2007 was \$1,081 (16% of revenue) versus \$3,794 (33% of revenue) for the three months ended September 30, 2006. The decrease in gross margin is due to the decrease in revenue of \$3,862 associated with the CFTS program as a result of reduced milestones in 2007 compared to 2006. There are several indirect overheads that are independent of projects that are included in cost of revenue. As a result, the gross margin percentage will fluctuate with revenues.

In addition, we recorded a foreign exchange gain of \$65 which was included in cost of sales in the third quarter of 2007, versus a foreign exchange gain of \$24 for the third quarter of 2006.

We expect gross margins to fluctuate going forward depending on the mix in ASI in a particular quarter between CFTS and non-CFTS revenue (including new orders) 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.

Nine months

Gross margin for the nine months ended September 30, 2007 was \$7,812 (28% of revenue) versus \$7,899 (30% of revenue) for the corresponding period in 2006. In the second quarter of 2007, additional revenue of \$1,815 was recognized for the CFTS program as a result of updated project cost estimates. For the nine months ended September 30, 2007, excluding the \$1,815 additional CFTS program revenues, gross margin for the nine months would have been 23%. We recorded a foreign exchange gain of \$208, which was included in cost of revenue versus a loss of \$190 for the same period in 2006. Also included in cost of revenue were \$1,051 of overhead costs incurred by ASA attributed to its CFTS courseware development activities and its initial external U.S. \$2.7 million contract in the U.S. defence sector.

12. OPERATING EXPENSES

Third Quarter

We incurred general and administrative (“G&A”) expenses of \$1,640 for the three months ended September 30, 2007, versus \$1,819 for the same period in 2006, a 10% decrease. The 2007 amount includes \$272 incurred by ASA, a reduction of \$281 from the \$553 incurred by ASA in the same period of 2006. This reduction is due primarily to increased start up costs in 2006 at ASA.

Sales and Marketing (“S&M”) expenses of \$745 for the three months ended September 30, 2007 represent a 5% decrease from the \$781 incurred in the same period in 2006. The 2007 amount includes \$117 incurred by ASA, a reduction of \$59 from the \$176 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 third quarter of 2007 versus the same period in 2006. S&M expenses at ASI of \$628 were approximately equal to those incurred in the same period in 2006.

We expect combined spending on G&A and S&M at ASA to decrease in 2007 over 2006 levels as start up costs were incurred in 2006.

We incurred stock option expenses of \$40 for the three months ended September 30, 2007 versus \$49 for the same period in 2006.

Research and development (“R&D”) expenses of approximately \$24 for the three months ended September 30, 2007 were included in cost of revenue, up from the \$11 incurred in the same period of 2006. These expenses represented an investment in the development of simulation-based training intellectual property. The development of new intellectual property is a core competency of our Company. This critical activity is not accurately reflected by the level of R&D spending as the development of the majority of our intellectual property is integrated into large learning system contracts and is expensed through cost of revenue. We are encouraged by the strong interest garnered by the HVIT at recent trade shows. There were no costs capitalized in the third quarter of 2007. We expect to recover this investment through market opportunities that are expected to arise from the introduction and commercialization of this technology in 2008. In the third quarter of 2007, we recorded \$105 of amortization of the HVIT.

Nine months

G&A expenses for the nine months ended September 30, 2007 were \$5,572 versus \$5,429 for the same period in 2006, an increase of 3%. The nine month amount includes \$933 incurred as a result of our direct expansion into the U.S. marketplace, a \$677 decrease from the amount incurred in the same period in 2006. The increase of \$820 at the Canadian operations is due primarily to increased personnel-related costs as a result of the hiring of additional management and finance personnel to support our anticipated future business activity and increased costs related to compliance with regulatory requirements.

S&M expenses for the nine months ended September 30, 2007 were \$2,392 versus \$2,320 for the same period in 2006, an increase of 3%. The nine month amount includes \$445 incurred as a result of our direct expansion into the U.S. marketplace, a \$353 decrease from the amount incurred in the same period in 2006. The increase of \$425 at the Canadian operations is due primarily to additional sales and marketing resources along with spending on specific marketing programs and conferences.

We incurred stock option expenses of \$142 for the nine month period versus \$168 in the same period last year. The stock option expense year over year reflects the reduction in the number of options granted to employees so far in 2007 versus 2006 as well as the significant number of options issued in 2006 with vesting periods of less than three years.

13. OTHER ITEMS

Third Quarter

We incurred depreciation and amortization expense of \$286 in the three months ended September 30, 2007 versus \$120 in the same period of 2006. The increase of \$166 primarily reflects the investment in capital assets in 2006 of \$1,266, the investment in capital assets of \$510 in the nine months of 2007 and the commencement of amortization of the HVIT development costs of \$105. Of the \$1,266 spent in 2006, \$441 is attributable to ASA and of the \$510 spent in 2007, \$135 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 investments made in 2007.

Interest and financing (income) costs resulted in income of \$38 in the three months ended September 30, 2007 versus income of \$124 in the same period of 2006. The third quarter 2007 income of \$38 primarily represents interest income of \$47 offset by interest paid on the remaining \$100 convertible debenture (due March 30, 2008) of \$1 and bank service charges, support fees and other costs of \$8. The 2006 third quarter amount of \$124 includes \$185 for interest income offset by debenture interest of \$44 (from the \$3.1 million convertible debentures (“Debentures”), due March 30, 2008) and bank service charges, support fees and other costs of \$17.

The remaining \$100 convertible debenture was repaid during the third quarter of 2007.

Nine months

For the nine months ended September 30, 2007, we incurred depreciation and amortization expense of \$610 versus \$306 for the same period last year. This increase of \$304 primarily reflects the increase in investment in capital assets of \$1,266 in 2006, the investment in capital assets of \$510 in the first nine months of 2007 and commencement of amortization of the HVTI.

Interest and financing (income) costs resulted in income of \$207 for the nine months ended September 30, 2007 versus a net expense of \$1,187 for the same period of 2006. Net expense for the first nine months of 2006 of \$1,187 primarily represents interest income of \$374 offset by interest paid on the Debentures of \$1,443 and bank service charges, support fees and other costs of \$118.

For the nine months ended September 30, 2006, the interest expense of \$1,187 primarily represents interest income of \$374, bank service charges, support fees and other costs of \$118 and interest expense of \$1,443. The interest expense of \$1,443 consists of interest paid on the Debentures of \$196, other interest paid of \$6, accretion of the carrying amount of \$177 and \$1,064 incurred in the second quarter of 2006 as a result of the Company’s breach of a financial covenant contained in the Debentures as at June 30, 2006.

In August, 2006, the holder of the \$3.0 million convertible secured debenture requested accelerated repayment and was repaid on August 16, 2006. The consideration paid to the debenture holder was allocated to the liability and equity elements of the security on a basis consistent with the original allocation. The equity component was re-valued on the date of extinguishment using the Black-Scholes model. This resulted in a gain on extinguishment of the debenture of \$224 being recognized in the third quarter of 2006.

The \$100 convertible debenture holder did not request repayment in August 2006. In the third quarter of 2007, the remaining \$100 convertible debenture was repaid.

14. OTHER EXPENSES

There was no income tax (recovery) expense shown for either of the three months ended September 30, 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, second and third quarters of 2007 was not recognized and an income tax expense related to earnings in the first, second and third quarters of 2006 was offset by utilizing an

equal portion of the unrecognized operating loss carry-forwards from previous years. As at September 30, 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 \$12 million are used or expire. Likewise, there will be no income tax expense against earnings in the U.S. until all unrecognized operating loss carry forwards of approximately \$3.9 million are used or expire.

15. U.S. MARKETPLACE REVENUE, EXPENSES AND CHARGES INCURRED BY ASA

Third Quarter

For the three months ended September 30, 2007, ASA recognized an operating loss of \$67 before consolidation. This loss primarily reflects costs incurred on combined G&A and S&M expenses. In the second quarter, ASA was awarded its first external contract for \$2.7 million from a customer in the U.S. defence sector and recognized revenue of \$168. Revenue from this contract in the third quarter of 2007 was \$260. Revenues from this contract will be recognized over the balance of 2007 and into 2008.

For the three months ended September 30, 2006, costs incurred by ASA were \$764. These costs were primarily incurred on combined G&A and S&M expenses of \$729, depreciation of \$37 and net interest income of \$2. No revenue or order backlog was recognized in the third quarter of 2006 by ASA.

Nine months

For the nine months ended September 30, 2007, ASA recognized a loss of \$780. No external revenues were recognized by ASA in the first quarter of 2007 and external revenues of \$168 and \$260 were recognized in the second and third quarters respectively by ASA. Combined G&A and S&M expenses were \$1,378 and a further \$137 of depreciation expense was recognized.

For the nine months ended September 30, 2006, costs incurred by ASA were \$2,479. These costs were primarily incurred on combined G&A and S&M expenses of \$ 2,408 and depreciation of \$68. No revenue or order backlog was recognized in the nine months ended September 30, 2006 by ASA.

16. NET INCOME

Third Quarter

For the three months ended September 30, 2007, we recognized a loss of \$1,594 (\$(0.03) per share) compared to a profit of \$1,373 (\$0.03 per share) for the same period in 2006. The calculation of diluted net income (loss) per share for the third quarter of 2007 did not result in any dilution versus reported basic earnings per share, however, the third quarter of 2006 had diluted earnings per share of \$0.02.

Nine months

For the nine months ended September 30, 2007, we recognized a loss of \$698 (\$(0.01) per share) compared to a loss of \$1,287 (\$(0.02) per share) for the same period in 2006. The calculation of

diluted net income (loss) per share for the third quarter of 2007 and 2006 did not result in any dilution versus reported basic earnings per share.

Summary of Quarterly Results (unaudited)

	2007				2006			2005
	Sep 30	June 30	Mar 31	Dec 31	Sep 30 Restated	Jun 30 Restated	Mar 31 Restated	Dec 31 Restated
Revenue	\$6,750	\$15,241	\$5,829	\$11,152	\$11,509	\$5,923	\$8,531	\$7,137
Gross margin	\$1,081	\$5,505	\$1,226	\$2,964	\$3,794	\$1,589	\$2,516	\$3,067
Operating expenses*	\$2,425	\$2,730	\$2,951	\$3,056	\$2,649	\$3,028	\$2,240	\$2,216
Net income (loss)	\$(1,594)	\$2,671	\$(1,775)	\$(148)	\$1,373	\$(2,754)	\$94	\$569
Net income (loss) per share (basic)	\$(0.03)	\$0.05	\$(0.03)	\$(0.00)	\$0.03	\$(0.05)	\$0.00	\$0.01

*represents the sum of G&A, S&M and stock options expense

As previously mentioned, during the first quarter of 2007 we reviewed our revenue recognition for contracts with multiple deliverables and 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. CFTS revenue for the fourth quarter of 2005 was \$4,956. 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 revenues for the first, second and third quarters of 2007 were \$2,859, \$12,483 and \$4,340, respectively.

Gross margin over the eight quarter period reflects not only revenue changes in each quarter but also certain specific items. For the fourth quarter of 2005, this item included the additional \$1,300 included in revenue 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 third 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. The higher gross margin percentage in the second quarter of 2007 included approximately \$1.8 million of additional revenue as a result of the downward revision in total cost estimates for the CFTS program. The lower margin percentage in the third quarter of 2007 is due to lower revenues and a higher proportion of revenues attributable to the lower margin CFTS program.

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. Also, the second quarter of 2007 includes the positive effect of the revisions to total cost estimates on the CFTS program of approximately \$1.8 million in income.

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 December 31, 2006 to September 30, 2007 of approximately 3.9 million common shares issued over the period, to approximately 56 million common shares.

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 quarter of 2006, where diluted earnings per share was \$0.02 versus basic earnings per share of \$0.03.

17. CASH FLOW

Cash Flow

At September 30, 2007, we had cash and cash equivalents of \$5,656 compared with \$15,405 at the end of the third quarter of 2006. This cash balance is \$7,980 lower than at December 31, 2006 and \$2,004 higher than at June 30, 2007. The sources for the changes in cash and cash equivalents for the three and nine months ended September 30, 2007 and 2006 are as follows:

	Three Months Ended		Nine Months Ended	
	September 30, 2007	September 30, 2006	September 30, 2007	September 30, 2006
Cash flows provided by (used in)				
Operating activities	\$(468)	\$5,334	\$(11,079)	\$12,414
Investing activities	\$(228)	\$(2,143)	\$(582)	\$(2,871)
Financing activities	\$2,700	\$(3,000)	\$3,681	\$(2,893)
Increase (decrease) in cash and cash equivalents	\$2,004	\$191	\$(7,980)	\$6,650
Cash and cash equivalents at beginning of period	\$3,652	\$15,214	\$13,636	\$8,755
Cash and cash equivalents at end of period	\$5,656	\$15,405	\$5,656	\$15,405

18. OPERATING ACTIVITIES

Third Quarter

Cash outflow from operating activities of \$468 in the three months ended September 30, 2007 represented a \$5,802 decrease over cash flow in the comparable quarter of 2006. For the three months ended September 30, 2007, the cash outflows from operating activities of \$468 were primarily due to a net loss of \$1,594 which was decreased by non-cash charges included in the results for depreciation and amortization and stock options expenses for a total of \$328. This outflow was partially offset by the net change in non-cash working capital which generated \$792 of additional cash in the quarter. The \$792 cash inflow on account of net changes in non-cash working capital was primarily due to a reduction in Trade and Other Receivables, an increase in Accounts Payable and Accrued Liabilities partially offset by an increase in unbilled revenue and a decrease in deferred revenue.

Cash outflow from operating activities for the three months ended September 30, 2007 of \$468 represented a \$5,802 decrease in cash flows from operating activities from the comparable period in 2006. This decrease was primarily due to significantly lower contributions from operating results of \$2,584 (including non cash charges therein) and lower cash flows from non-cash working capital items of \$3,214 in the three months ended September 30, 2007 versus the same period in 2006.

Nine months

For the nine months ended September 30, 2007, cash outflow from operating activities was \$11,079 representing a \$23,493 decrease over cash inflow in the comparable period of 2006. For the nine months ended September 30, 2007, the cash outflows from operating activities of \$11,079 were primarily due to a net loss of \$698 which was decreased by non-cash charges included in the results for depreciation and amortization and stock options expenses for a total of \$753. This outflow was increased by the net change in non-cash working capital which used \$10,995 of additional cash in the quarter. The \$10,995 cash outflow on account of net changes in non-cash working capital was primarily due to a reduction in deferred revenue as a result of revenue recognized on the CFTS project, an increase in unbilled revenue attributable to the contract with AgustaWestland to provide cockpit procedures trainers to the RDAF, and a reduction in accounts payable, partially offset by a reduction in accounts receivable.

Cash outflow from operating activities for the nine months ended September 30, 2007 of \$11,079 represented a \$ 23,493 decrease in cash flows from operating activities from the comparable period in 2006. This decrease was primarily due to a reduction in non-cash working capital items of \$23,329 and other long-term assets of \$111, in the nine months ended September 30, 2007 versus the same period in 2006.

19. INVESTING ACTIVITIES

Third Quarter

Cash used in investing activities was \$(228) for the three months ended September 30, 2007 versus \$2,143 received for the comparable period in 2006. The 2007 amount includes investment in capital assets as follows: \$14 investment in computer hardware, software, leasehold improvements and

furniture and fixtures in ASA, and \$141 primarily represented purchases of computer hardware, software and leasehold improvements in our Brampton, Ontario operating facility. The 2006 amount for the comparable period consisted primarily of \$33 for ASA with the balance of \$59 incurred as a result of infrastructure improvements at our Brampton, Ontario facility.

During the quarter, a performance security guarantee was purchased toward an outstanding letter of credit. As a result, the previously restricted cash of \$2,051 became unrestricted.

On September 27, 2007, the Company acquired Eduplus. The total purchase price was \$2,658 comprised of a cash payment of \$2,076, the issuance of 1,294,498 common shares with a value of \$500 and acquisition related costs of \$82.

Nine months

For the nine months ended September 30, 2007, cash used in investing activities was \$582 versus \$2,871 received for the comparable period in 2006. The 2007 amount included investment in capital assets as follows: \$135 investment in computer hardware, software, leasehold improvements and furniture and fixtures in ASA and \$375 primarily represented purchases of computer hardware, software, communications equipment and leasehold improvements in our Brampton, Ontario operating facility. The 2006 amount for the comparable period consisted primarily of \$341 for ASA with the balance of \$479 incurred as a result of infrastructure improvements at our Brampton, Ontario facility.

20. FINANCING ACTIVITIES

Third Quarter

For the three months ended September 30, 2007, cash inflow from financing activities was \$2,700 compared to a cash outflow of \$3,000 for the comparable period in 2006. The \$2,700 inflow represented proceeds from a bank term loan of \$2,800, and the repayment of the convertible debenture of \$100. The outflow of \$3,000 in 2006 represented the repayment of the \$3,000 convertible debenture.

Nine months

For the nine months ended September 30, 2007, cash inflow from financing activities was \$3,681, compared to a cash outflow of \$2,893 for the comparable period in 2006. The \$3,681 inflow represented the proceeds from the exercise of common share purchase warrants of \$873, proceeds from the exercise of stock options of \$108, proceeds from a bank term loan of \$2,800, reduced by the repayment of the convertible debenture of \$100. The outflow of \$2,893 for the comparable period in 2006 represented net proceeds from the exercise of stock options of \$107 and the repayment of the \$3,000 convertible debenture.

21. LIQUIDITY

No funds were raised through the issuance of debt or equity in 2006 or the first six months of 2007, other than proceeds from the exercise of stock options and common share purchase warrants.

During the third quarter of 2007, we obtained a \$2.8 million term loan from a major Canadian bank. Also during the quarter, the remaining \$100 convertible debenture was repaid.

We maintain a committed secured bank operating line of credit of up to \$4.0 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 based on the prior month accounts receivable balance, a minimum current ratio, minimum earnings before interest, tax, depreciation, amortization (EBITDA) to interest expense plus the current portion of long term debt and capital leases (EBITDA ratio), an annual maximum capital expenditure limit and a minimum tangible net worth. Any advances are repayable on demand.

As at September 30, 2007 our net working capital was \$3,757 (December 31, 2006 - \$4,026).

During the quarter the remaining \$100 convertible debenture was repaid.

Also, as at September 30, 2007, the Company was in compliance with all financial covenants included in this facility except the EBITDA ratio and the annual maximum capital expenditure limit. The Company has not received a waiver for the breach of these covenants, which constitutes an event of default under the credit facility, with the bank having the right to demand repayment of the loan. As a result, the entire loan is classified as a current liability. The maximum capital expenditure limit was exceeded by \$10 as at September 30, 2007. All bank credit facilities are secured against all of the assets of the Company. As of the date of the MD&A, the bank has not demanded payment of the loan. The Company currently has sufficient cash on hand to repay the loan. The Company expects to be compliant with the covenants in the third quarter of 2008.

The Company is currently in discussions with the bank to remedy the covenant breaches and is investigating alternate sources of financing should the need arise. There is no guarantee the Company will secure alternate sources of financing or remedy the covenant breaches with the bank.

22. CAPITAL RESOURCES

Third Quarter

At the annual and special meeting of shareholders held in May of 2007, shareholders approved a revised stock option plan (the "Plan") which modified the method by which the exercise price of our stock options is determined, and to allow the exercise of stock options that would otherwise expire in a blackout period. These changes update our Plan to conform to current standards and practices.

During the third quarter of 2007, there were no options issued to employees. During the third quarter of 2007, the combination of vesting of existing options, the grant of new options and the recognition of options cancelled (39,333) resulted in net compensation cost of \$40. The remaining compensation-related costs will be expensed over a three-year period at the rate of approximately \$50 for the remainder of 2007, \$154 for 2008, \$88 for 2009 and \$37 for 2010. However, this expected expense for 2007 of \$192 does not take into account any future grants or cancellations for the balance of the year. In addition, during the three months ended September 30, 2007, no

options were exercised to purchase common shares, 39,333 options were cancelled and a further 88,500 options expired.

As at September 30, 2007, based on the actual number of common shares outstanding, the Plan would allow for the issuance of a total of 8,399,089 options to purchase common shares of our Company. There are currently 6,476,041 options to purchase common shares outstanding, leaving 1,923,048 options available for issuance under the Plan. 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 September 30, 2007, the Company had 250,000 common share purchase warrants outstanding.

We increased our contributed surplus from \$8,860 to \$8,900 for the three months ended September 30, 2007 as a result of the inclusion as an equity item the increase of \$40 recognized as stock option compensation costs in the consolidated statement of operations, comprehensive income and deficit.

Nine months

During the first nine months of 2007, 965,500 options were granted to employees (all in the second quarter) to purchase shares of our Company as described above. During the first nine months of 2007, the combination of vesting of existing options, the grant of new options and the recognition of options cancelled (347,584) resulted in net compensation cost of \$142. In addition, during the first nine months of the year, 265,834 options were exercised to purchase common shares, 215,751 options were cancelled and a further 131,833 options expired.

During the nine months ended September 30, 2007, 1,456,121 warrants to purchase common shares were exercised at a price of \$0.60. In addition, 2,065,879 warrants expired in the second quarter which had exercise prices of either \$0.60 or \$1.00.

We increased our contributed surplus from \$8,574 to \$8,900 for the nine months ended September 30, 2007 as a result of the inclusion as an equity item the net of the following three items: first, an increase of \$142 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 share capital, and third, an increase of \$211 as a result of the expiration and cancellation of warrants to purchase common shares whose value was transferred from share capital.

23. 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 nine months ended September 30, 2007.

	Common Shares	Warrants	Options
Outstanding at December 31, 2006	52,977,476	3,772,000	6,123,959
Issued / Exercised	3,016,453	(1,456,121)	(265,834)
Granted	-	-	965,500
Cancelled / Expired	-	(2,065,879)	(347,584)
Outstanding at September 30, 2007	55,993,929	250,000	6,476,041

On September 27, 2007, the Company issued 1,294,498 common shares with a value of \$500 as part of the purchase price consideration for the Eduplus acquisition.

As at September 30, 2007, there were 6,476,041 stock options outstanding at exercise prices ranging from \$0.42 to \$0.68 with expiry dates from January 20, 2010 through June 28, 2012.

As at September 30, 2007, we had 250,000 common share purchase warrants outstanding at an exercise price of \$0.60, which expire on March 30, 2008.

24. COMMITMENTS AND CONTINGENCIES

As a condition for a license agreement to a Canadian government agency for technology that has been used to help develop our HVTT 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.

25. LETTER OF CREDIT

In the normal course of business, we may be required to issue letters of credit or performance guarantees. As at September 30, 2007, we had one outstanding letter of credit with a Canadian financial institution in the amount of \$1,436 (2006 – 2,051). As discussed above in Liquidity, this

relates to our contract to provide a cockpit procedures trainer to the RDAF via prime contractor AgustaWestland. The collateral on the letter of credit was changed in August 2007 from cash to a guarantee issued by Export Development of Canada.

26. FINANCIAL INSTRUMENTS

We may use foreign exchange forward contracts to manage exposures created when sales and purchases are made in foreign currencies. As at September 30, 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 floats on the credit facility (which is not currently drawn) and on the term loan.

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, the term loan 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.

27. RELATED-PARTY TRANSACTIONS

In the first nine months of 2007, the following amounts were incurred for an entity in which a director of our Company is an owner, partner or principal: \$377 (2006 - \$211) for legal services. The amount included in accounts payable as due to related parties as at September 30, 2007 was \$49 (2006 \$54).

28. 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 4. 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.

Our profitability has been and will continue to be negatively affected in the short term by our investment in activities to fuel the long term growth of our Company and the predictive variability of military contracts. 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 are investing funds to enter new markets in the nuclear industry, in civil aviation and we are continuing to invest funds developing and marketing the HVTT program. We believe that these investments, coupled with judicious investment in acquisitions or mergers will position us for strong growth, a more consistent revenue stream and superior returns in the future.

We expect that:

- Approximately \$5 million to \$7 million of our order backlog as at September 30, 2007 of \$41million (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. Our ability to replenish our backlog in the last quarter of 2007 and the first quarter of 2008 will be a key determinant of our outlook for 2008.
- 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 continue to result in marginal additional revenue in 2007. We believe that the CFTS program has contributed significantly to our intellectual property and has enhanced our ability to handle large and complex learning systems. In addition, our participation in the program greatly enhances our ability to capture significant new business that will flow from the CFTS program in the form of enhancements to the existing program and new procurement programs. As a result, we believe that the CFTS program and related spin-offs will continue to be a significant contributor to the Company’s revenue base for the foreseeable future.

- 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.
- The timing and amount of other contract revenue (for contracts without significant materials and/or subcontract costs) 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.
- CFTS revenue will continue to fluctuate in the fourth quarter of 2007 and into 2008 depending upon the proportion of work performed in house in any given period, materials consumed and the billing of milestones by our subcontractors on the program.
- Gross margin percentages in 2007 will continue to fluctuate 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.
- Depreciation and amortization expense will increase in 2007 versus 2006 due to the level of investment in 2006 and 2007, including the acquisition of the Eduplus assets.
- 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 historical level of customer deposits.
- ASA will continue to develop and deliver courseware for the CFTS program through most of 2008
- Capital expenditures will be higher than 2006 levels.
- Due to our covenant breaches with our bank and our anticipated outflows for the remainder of 2007 and into 2008, we may complete other financings on commercial terms appropriate for a company of our size and status.

29. [REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING](#)

During the three months ended September 30, 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.

30. 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.

November 14, 2007

Interim Consolidated Financial Statements of

ATLANTIS SYSTEMS CORP.

September 30, 2007 and 2006
(unaudited)

ATLANTIS SYSTEMS CORP.

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ATLANTIS SYSTEMS CORP.
Consolidated Balance Sheets

(Expressed in thousands of Canadian dollars)

	<u>September 30, 2007</u> (unaudited)	<u>December 31, 2006</u>
ASSETS		
Current assets		
Cash and cash equivalents	\$ 5,656	\$ 13,636
Trade and other receivables (Note 6)	2,199	6,459
Unbilled revenue	3,407	524
Inventory	563	427
	<u>11,825</u>	<u>21,046</u>
Restricted cash (Note 9)	-	2,051
Capital assets, net	1,775	1,747
Other long-term assets	235	111
Mortgage receivable	395	384
Deferred development costs (Note 7)	1,564	1,669
Core technology (Note 5)	3,187	-
Goodwill	11,735	11,735
	<u>18,891</u>	<u>17,697</u>
	<u>\$ 30,716</u>	<u>\$ 38,743</u>
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities	\$ 3,870	\$ 7,024
Accrued costs on percentage completion	132	444
Deferred revenue	1,266	9,452
Term debt (Note 9)	2,800	-
Convertible debenture	-	100
	<u>8,068</u>	<u>17,020</u>
SHAREHOLDERS' EQUITY		
Share capital (Note 10)	89,377	88,080
Contributed surplus	8,900	8,574
Deficit	(75,629)	(74,931)
	<u>22,648</u>	<u>21,723</u>
	<u>\$ 30,716</u>	<u>\$ 38,743</u>

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 and nine months ended September 30

(unaudited)

(Expressed in thousands of Canadian dollars except per share amounts)

	For the three months ended September 30		For the nine months ended September 30	
	2007	2006 (Restated - Note2)	2007	2006 (Restated - Note2)
Revenue (Note 6)	\$ 6,750	\$ 11,509	\$ 27,820	\$ 25,963
Cost of revenue	5,669	7,715	20,008	18,064
Gross margin	1,081	3,794	7,812	7,899
Expenses				
General and administrative	1,640	1,819	5,572	5,429
Selling and marketing	745	781	2,392	2,320
Stock options	40	49	142	168
	2,425	2,649	8,106	7,917
Operating (loss) income before the undernoted items	(1,344)	1,145	(294)	(18)
Depreciation and amortization	286	120	610	306
Interest and financing costs, net (Note 8)	(38)	(124)	(207)	1,187
Gain on extinguishment of debenture	-	(224)	-	(224)
Loss on disposal of capital assets	2	-	1	
Net (loss) income and comprehensive income	(1,594)	1,373	(698)	(1,287)
Deficit, beginning of period	(74,035)	(76,156)	(74,931)	(73,496)
Deficit, end of period	\$ (75,629)	\$ (74,783)	\$ (75,629)	\$ (74,783)
Net (loss) income per share (Note 12)				
Basic	\$ (0.03)	\$ 0.03	\$ (0.01)	\$ (0.02)
Diluted	\$ (0.03)	\$ 0.02	\$ (0.01)	\$ (0.02)
Weighted average number of shares				
Basic	54,741,643	52,842,476	54,351,362	52,767,628
Diluted	54,741,643	55,925,545	54,351,362	52,767,628

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

ATLANTIS SYSTEMS CORP.
Consolidated Statements of Cash Flows
For the three and nine months ended September 30
(unaudited)
(Expressed in thousands of Canadian dollars)

	For the three months ended September 30		For the nine months ended September 30	
	2007	2006	2007	2006 (Restated - Note2)
Cash flows provided by (used in) :				
Operating activities :				
Net (loss) income	\$ (1,594)	\$ 1,373	\$ (698)	\$ (1,287)
Items not affecting cash:				
Depreciation and amortization	286	120	610	306
Loss on disposal of capital assets	2	-	1	-
Stock options expensed	40	49	142	168
Accretion on debentures	-	-	-	1,065
Amortization of deferred financing costs	-	-	-	223
Gain on extinguishment of debenture	-	(224)	-	(224)
	(1,266)	1,318	55	251
Interest on mortgage receivable	(4)	(4)	(11)	(11)
Deferred development costs	-	(4)	-	(143)
Other long-term assets	10	18	(128)	(17)
Net change in non-cash working capital (Note 16)	792	4,006	(10,995)	12,334
	(468)	5,334	(11,079)	12,414
Investing activities :				
Investment in capital assets	(155)	(92)	(510)	(820)
Proceeds from disposal of capital assets	-	-	1	-
Eduplus acquisition	(2,124)	-	(2,124)	-
Restricted cash	2,051	(2,051)	2,051	(2,051)
	(228)	(2,143)	(582)	(2,871)
Financing activities :				
Term debt (Note 9)	2,800	-	2,800	-
Exercise of common share purchase warrants	-	-	873	-
Exercise of options to common shares	-	-	108	107
(Repayment) issuance of convertible debenture	(100)	(3,000)	(100)	(3,000)
	2,700	(3,000)	3,681	(2,893)
Net (decrease) increase in cash and cash equivalents	2,004	191	(7,980)	6,650
Cash and cash equivalents, beginning of period	3,652	15,214	13,636	8,755
Cash and cash equivalents, end of period	\$ 5,656	\$ 15,405	\$ 5,656	\$ 15,405

SUPPLEMENTAL INFORMATION

Cash and cash equivalents are comprised of:

Cash	\$ 5,656	\$ 12,022	\$ 5,656	\$ 12,022
Cash equivalents	-	3,383	-	3,383
	\$ 5,656	\$ 15,405	\$ 5,656	\$ 15,405

Interest paid	\$ 1	\$ 44	\$ 6	\$ 202
Income taxes paid	\$ -	\$ -	\$ -	\$ -

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

ATLANTIS SYSTEMS CORP.

Notes to the Interim Consolidated Financial Statements

September 30, 2007 and 2006

(unaudited)

(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 and nine months ended September 30, 2006 was incorrect. The restatement required to correct this error was a decrease in revenue and cost of revenue of \$328 and \$224, respectively for the three months ended September 30, 2006 and \$262 and \$180 respectively for the nine months ended September 30, 2006. The correction of this error had no impact on net income per share for the three months or nine months ended September 30, 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.

ATLANTIS SYSTEMS CORP.

Notes to the Interim Consolidated Financial Statements

September 30, 2007 and 2006

(unaudited)

(Expressed in thousands of Canadian dollars except per share amounts, unless otherwise indicated)

4. SIGNIFICANT ACCOUNTING POLICIES (continued)

(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.

ATLANTIS SYSTEMS CORP.

Notes to the Interim Consolidated Financial Statements

September 30, 2007 and 2006

(unaudited)

(Expressed in thousands of Canadian dollars except per share amounts, unless otherwise indicated)

4. SIGNIFICANT ACCOUNTING POLICIES (continued)

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, material and sub-contract costs to complete the various contracts. Should total actual labour, material 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

ATLANTIS SYSTEMS CORP.

Notes to the Interim Consolidated Financial Statements

September 30, 2007 and 2006

(unaudited)

(Expressed in thousands of Canadian dollars except per share amounts, unless otherwise indicated)

4. SIGNIFICANT ACCOUNTING POLICIES (continued)

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. ACQUISITION

On September 27, 2007, the Company acquired the Eduplus division (“Eduplus”) of Tecstart Inc.. The total purchase price was \$2,658 comprised of a cash payment of \$2,076, the issuance of 1,294,498 common shares with a value of \$500 and acquisition related costs of \$82.

The acquired core technology is software and is being amortized over three years. The valuation of the core technology is preliminary. These estimates may differ from the final purchase price allocation and may result in changes in the estimated amortization expensed in the statements of operations, comprehensive income and deficit. The Company expects the valuation process to be completed during the fourth quarter of 2007. The following table summarizes the estimated fair value of assets acquired and liabilities assumed:

Current assets	\$	28
Capital assets		76
Core technology		3,187
Liabilities		(633)
	\$	2,658
<hr/>		
Purchase price consideration:		
Cash	\$	2,076
Common shares		500
Acquisition costs		82
	\$	2,658

ATLANTIS SYSTEMS CORP.

Notes to the Interim Consolidated Financial Statements

September 30, 2007 and 2006

(unaudited)

(Expressed in thousands of Canadian dollars except per share amounts, unless otherwise indicated)

6. CONCENTRATION OF CREDIT RISK

The Company has contracts with many customers; however, as at September 30, 2007 two customers each represented 45% and 23% of the accounts receivable and unbilled revenue (December 31, 2006 – 3% and 77%) and each represented 21% and 70% of revenue for the three months ended September 30, 2007 (2006 – 9% and 81%) and 15% and 77% of revenues for the nine months ended September 30, 2007 (2006 – 4% and 74%).

7. DEFERRED DEVELOPMENT COSTS

In 2006, the Company continued to fund a specific development project focused on the Helicopter Virtual Task Trainer (HVTT) concept. No development costs have been capitalized in the first nine months of 2007 (2006 - \$143). There are sufficient identified markets and forecasted sales of the HVTT product to recover the costs capitalized and generate profits. Amortization for the HVTT commenced in the third quarter ended September 30, 2007. Amortization for the three months ended September 30, 2007 was \$105 (2006 – nil).

8. INTEREST AND FINANCING (INCOME) COSTS

	For three months ended September 30		For nine months ended September 30	
	2007	2006	2007	2006
Interest expense	\$ 1	\$ 44	\$ 6	\$ 1,443
Finance and bank charges	8	17	14	118
Interest income	(47)	(185)	(227)	(374)
	<u>\$ (38)</u>	<u>\$ (124)</u>	<u>\$ (207)</u>	<u>\$ 1,187</u>

9. OPERATING LINE OF CREDIT, TERM DEBT AND RESTRICTED CASH

The Company has available a general operating line of credit up to \$4,000. 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 collateral on the letter of credit was changed in August 2007 from cash to a guarantee issued by Export Development Canada. The value of this letter of credit will decline as the contract milestones are achieved through June 2008.

The Company's term debt consists of a bank term loan of \$2,800 at September 30, 2007, bearing interest at the Canadian prime rate plus 1.5% per annum (7.75% at September 30, 2007) with monthly repayments of \$47. The term loan is due September 26, 2010.

The Company was in breach of two of the bank covenants at September 30, 2007. As a result, the entire amount of the loan is reported as a current liability at September 30, 2007.

ATLANTIS SYSTEMS CORP.

Notes to the Interim Consolidated Financial Statements

September 30, 2007 and 2006

(unaudited)

(Expressed in thousands of Canadian dollars except per share amounts, unless otherwise indicated)

10. SHARE CAPITAL

On September 27, 2007, the Company issued 1,294,498 common shares with a value of \$500 as part of the purchase price consideration for the Eduplus acquisition (Note 5).

In the three and nine months ended September 30, 2007, the Company expensed \$40 and \$142 respectively (2006 - \$49 and \$168), relating to the fair value of options granted in fiscal 2007, 2006 and 2005, as is reflected in the Consolidated Statements of Operations, Comprehensive Income and Deficit.

In the nine months ended September 30, 2007, the Company awarded 965,500 options to purchase shares of the Company under the incentive stock option plan.

In the nine months ended September 30, 2007, 265,834 common share stock options were exercised for proceeds of \$108 resulting in additional share capital in the amount of \$134, while there were 347,584 common share stock options that either expired or were cancelled. As at September 30, 2007, the Company had 6,476,041 common share options outstanding.

The estimated fair value of the options is amortized to income over the vesting period, on a straight-line basis, and was determined using the Black-Scholes option pricing model with the following weighted average assumptions:

	2007	2006
Risk-free rate	3.9%	3.9%
Dividend yield	0%	0%
Volatility factor of expected market price of the Company's shares	66%	53%
Expected option life (in years)	3	3
Weighted-average grant date fair values of options granted	\$ 0.23	\$ 0.24

In the three months ended September 30, 2007 there was no activity in the common share warrants.

In the three months ended September 30, 2007, no common share stock options were exercised, while there were 127,833 common share stock options that either expired or were cancelled.

In the nine months ended September 30, 2007, 1,456,121 common share warrants were exercised resulting in additional share capital in the amount of \$873 while there were 2,065,879 common share warrants that expired resulting in a decrease in share capital of \$210. As at September 30, 2007 the Company had 250,000 common share warrants outstanding.

11. RESEARCH AND DEVELOPMENT

Research and development expenditures included in cost of revenue for the three and nine months ended September 30, 2007 were \$25 and \$95 respectively (2006 - \$11 and \$44).

ATLANTIS SYSTEMS CORP.

Notes to the Interim Consolidated Financial Statements

September 30, 2007 and 2006

(unaudited)

(Expressed in thousands of Canadian dollars except per share amounts, unless otherwise indicated)

12. NET INCOME (LOSS) 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 stock 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 are 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 and nine months ended September 30, 2007 was 54,741,643 and 54,351,362 respectively (2006 – 52,842,476 and 52,767,628).

The weighted average number of shares outstanding used in the calculation of the diluted earnings per share using the treasury stock method for the periods ended September 30, 2007 and 2006 were as follows:

	For three months ended September 30		For nine months ended September 30	
	2007	2006	2007	2006
Weighted average common shares outstanding	54,741,643	52,842,476	54,351,362	52,767,628
Weighted average potential common shares	-	3,083,069	-	-
Share purchase warrants	-	-	-	-
Stock options	-	-	-	-
	54,741,643	55,925,545	54,351,362	52,767,628

Conversion of the convertible debenture for the periods, using the “if-converted” method, had no effect on income per share and, therefore, was excluded from the computation.

ATLANTIS SYSTEMS CORP.

Notes to the Interim Consolidated Financial Statements

September 30, 2007 and 2006

(unaudited)

(Expressed in thousands of Canadian dollars except per share amounts, unless otherwise indicated)

13. SEGMENTED INFORMATION

	Three months ended September 30, 2007			Three months September 30, 2006		
	Canada	USA	Total	Canada	USA	Total
Revenue from external customers	\$ 6,520	\$ 230	\$ 6,750	\$ 11,509	\$ -	\$ 11,509
Inter-segment revenues	\$ -	\$ 1,301	\$ 1,301	\$ -	\$ 438	\$ 438
Interest revenue	\$ 47	\$ -	\$ 47	\$ 185	\$ -	\$ 185
Interest expense	\$ 1	\$ -	\$ 1	\$ 44	\$ -	\$ 44
Amortization of capital assets	\$ 129	\$ 48	\$ 177	\$ 83	\$ 37	\$ 120
Amortization of deferred costs	\$ 109	\$ -	\$ 109	\$ -	\$ -	\$ -
Segment profit (loss)	\$ (1,527)	\$ (67)	\$ (1,594)	\$ 2,200	\$ (827)	\$ 1,373
Segment assets	\$ 29,593	\$ 1,123	\$ 30,716	\$ 41,356	\$ 401	\$ 41,757
Expenditures for segment capital assets	\$ 141	\$ 14	\$ 155	\$ 60	\$ 32	\$ 92

	Nine months ended September 30, 2007			Nine months ended September 30, 2006		
	Canada	USA	Total	Canada	USA	Total
Revenue from external customers	\$ 27,422	\$ 398	\$ 27,820	\$ 25,963	\$ -	\$ 25,963
Inter-segment revenues	\$ -	\$ 3,551	\$ 3,551	\$ -	\$ 775	\$ 775
Interest revenue	\$ 227	\$ -	\$ 227	\$ 374	\$ -	\$ 374
Interest expense	\$ 6	\$ -	\$ 6	\$ 1,443	\$ -	\$ 1,443
Amortization of capital assets	\$ 364	\$ 137	\$ 501	\$ 238	\$ 68	\$ 306
Amortization of deferred costs	\$ 109	\$ -	\$ 109	\$ -	\$ -	\$ -
Segment profit (loss)	\$ 82	\$ (780)	\$ (698)	\$ 1,068	\$ (2,355)	\$ (1,287)
Segment assets	\$ 29,593	\$ 1,123	\$ 30,716	\$ 41,343	\$ 414	\$ 41,757
Expenditures for segment capital assets	\$ 375	\$ 135	\$ 510	\$ 480	\$ 340	\$ 820

ATLANTIS SYSTEMS CORP.

Notes to the Interim Consolidated Financial Statements

September 30, 2007 and 2006

(unaudited)

(Expressed in thousands of Canadian dollars except per share amounts, unless otherwise indicated)

13. SEGMENTED INFORMATION (continued)

GEOGRAPHIC INFORMATION

	Revenue				Capital Assets and Goodwill	
	For three months ended September 30		For nine months ended September 30		September 30	
	2007	2006 (restated - Note 2)	2007	2006 (restated - Note 2)	2007	2006
Canada	\$ 4,989	\$ 9,789	\$ 22,880	\$ 21,030	\$ 13,153	\$ 12,863
International	1,761	1,720	4,940	4,933	357	272
	\$ 6,750	\$ 11,509	\$ 27,820	\$ 25,963	\$ 13,510	\$ 13,135

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

14. CONTINGENCIES

The Eduplus purchase agreement provides for a conditional fee payable to Tecsuit Inc. The fee is payable to Tecsuit Inc. if specified outstanding bids, at the time of the acquisition, materialize into a contract on or before December 31, 2008. The fee is based on the gross margin of the contract. The cumulative maximum of the fees is \$1,000.

The Eduplus purchase agreement provides for a fee if a specific bid materializes into a contract on or before December 31, 2008 and meets several conditions. The fee is \$1,000.

15. FINANCIAL INSTRUMENTS

The reported values of financial instruments which consist of cash and cash equivalents, trade and other receivables and accounts payable and accrued liabilities 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.

ATLANTIS SYSTEMS CORP.

Notes to the Interim Consolidated Financial Statements

September 30, 2007 and 2006

(unaudited)

(Expressed in thousands of Canadian dollars except per share amounts, unless otherwise indicated)

16. NET CHANGE IN NON-CASH WORKING CAPITAL

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

	For three months ended September 30		For nine months ended September 30	
	2007	2006	2007	2006
		(Restated - Note 2)		(Restated - Note 2)
Trade and other receivables	\$ 1,732	\$ (3,457)	\$ 4,288	\$ 52
Unbilled revenue	(738)	593	(2,883)	3,265
Inventory	(36)	21	(136)	(56)
Accounts payable and accrued liabilities	605	1,465	(3,766)	388
Accrued costs on percentage completion	15	(313)	(312)	(335)
Deferred revenue	(786)	5,697	(8,186)	9,020
	<u>\$ 792</u>	<u>\$ 4,006</u>	<u>\$ (10,995)</u>	<u>\$ 12,334</u>

17. 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 the three months and nine months ended September 30, 2007, the Company paid the following amounts to firms in which a director of the Company is an owner, partner or principal: \$61 and \$377 respectively (2006 - \$43 and \$211) for legal services. The cost of these services was allocated between acquisition costs regarding the purchase of Eduplus and general and administrative expenses. The amount due to related parties included in accounts payable and accrued liabilities as at September 30, 2007 was \$49 (December 31, 2006 - \$54).

18. PRIOR PERIOD FINANCIAL STATEMENTS

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