



Atlantis Systems Corp.

SECOND QUARTER REPORT

JUNE 30, 2004

MESSAGE TO SHAREHOLDERS

During the second quarter of 2004, Atlantis Systems Corp. continued to reap the benefits of its cost reductions and restructuring efforts. While total sales declined compared to the first half of 2003, profit margins increased to 36%, resulting in net income from continuing operations of \$0.8 million (or \$0.05 per share) for the first half of 2004. The Company's operating subsidiary, Atlantis Systems International (ASI), reported sales of \$9.8 million and net earnings of \$1.7 million.

During the second quarter, the Company completed a financing which resulted in the securing of \$6,000,000 of new equity and the conversion to equity of \$2,950,000 of current liabilities and \$800,000 of special shares - Series 2. On July 30, 2004 Atlantis re-paid its \$3,000,000 secured loan with proceeds from the financing. The financing resulted in a significant improvement in the Company's working capital and debt:equity ratios. With this financing completed, the Company can now focus on obtaining an operating bank credit facility to support its planned growth.

Atlantis' goal is sustained profitability and growth. During the past year the Management of ASI has successfully streamlined the organization to achieve profitability while continuing to successfully demonstrate its technical strengths, highlighted by the installation of the Naval Tactical Team Trainer (NTTT) in Saudi Arabia and completion of the program. In the same time period, Atlantis has completed the Cockpit Procedures Trainer (CPT) for the Canadian Forces, who deploy the CH-149 Cormorant version of the AgustaWestland EH-101, and the CPT for the Integrated Display System variant of the EH101 and substantially completed the F/A-18 Integrated Maintenance Training System (IMTS) development. Atlantis is well positioned to grow through the securing of new programs with, in addition to the Contracted Flight Training and Support program (CFTS), other pending proposals valued at approximately \$55 million, and invitations to bid on approximately another \$50 million of work during Q3 and Q4 of 2004. Organic growth is one element of the three-pronged growth strategy that will be pursued: the exploitation of new opportunities in both the commercial and military sectors; the identification of new simulation-related growth opportunities outside of the Company's traditional markets; and, the initiation of the process of identifying strategic acquisition candidates.

Revenues of \$9,675,000 for the first half of 2004 represent a 25% reduction from the \$12,963,000 of revenue reported in the same period of 2003. Despite this reduction, and a one-time charge of \$434,000 related to the successful re-financing, the Company was able to operate profitably. At the end of the quarter, the Company's order backlog was \$10.9 million from \$11.3 million at year-end.

Highlights of the First Six Months

- The Company was awarded a \$6.5 million contract to provide Student Aircraft Interface Trainer Stations (SAITS) for the US Navy's F/A-18 Visual Environment Maintenance Trainers.
- The Company was awarded a \$1.2 million contract to provide a major systems upgrade to the CC-130 aircraft trainers in service with the Canadian Forces.
- The \$32 million contract for the development of the F/A-18 Integrated Maintenance Training Systems (IMTS) for the air forces of Canada and Australia remains on schedule for delivery in the fall of 2004.

- The prime contractor on the US Navy's E-6B Tacamo aircraft trainer programme, on which Atlantis was a sub-contractor, decided to stop work on their contract in the fall of 2003. Atlantis was notified that it was to cease work. Atlantis will receive reimbursement for costs incurred. Resolution of this termination action is expected in 2004.
- The EH-101 CPT for the Canadian Forces Cormorant was shipped during the fourth quarter of 2003 and final acceptance was received subsequent to the end of the first quarter.
- As a member of the Allied Wings team, ASI successfully pre-qualified as a bidder for the Government of Canada's Contracted Flying Training and Support (CFTS) initiative, a programme with the potential to generate up to \$100 million in revenues for Atlantis over a 20-year period. During the first two years of this program it is anticipated that Atlantis would provide \$40 million of equipment to this programme.

In July 2004, Andrew Day joined the Company as President and Chief Executive Officer after working in a consulting capacity as Special Advisor to the Board since May 2004. Andrew brings an expertise in the tactical execution of growth-oriented initiatives to Atlantis through his positions as Director, Sales Solutions with TELUS Communications (ON) Inc., and Vice President, Sales, Marketing and Solutions Delivery with Daedalian eSolutions Inc. Prior to that time, Mr. Day was active in the banking sector including stints in commercial banking at Scotiabank and in investment banking at Sharwood and Company. Also in July, Paul Maasland was appointed to the position of Vice President, Corporate Development. Paul, a professional engineer, founded Daedalian Systems Group, which became Daedalian eSolutions Inc. From 1981 to 2001, he was the Chief Executive Officer with responsibility for the strategic direction, service delivery, and general operations of Daedalian. In 2001, following Daedalian's acquisition by TELUS, Paul joined TELUS as General Manager, eCommerce Division, TELUS Enterprise Solutions, overseeing the Applications and Professional Services practice.

On behalf of the Board of Directors,



Neil Raymond
Chairman of the Board
August 2004

MANAGEMENT'S DISCUSSION AND ANALYSIS

OVERVIEW

The following is a discussion of the material factors influencing the operating results and financial condition of Atlantis Systems Corp. (the "Company") as at, and for, the six months ended June 30, 2004. All figures are in Canadian dollars unless otherwise specified. This document should be read in conjunction with the Interim Consolidated Financial Statements of the Company and notes thereto as at, and for, the six months ended June 30, 2004 and 2003 and the Company's Consolidated Financial Statements and Management's Discussion and Analysis of Financial Condition and Operating Results as at, and for, the year ended December 31, 2003.

RESULTS OF OPERATIONS

During 2003, the Company completed the sale of its Intelligent Traffic Systems division, and the sale of the Vessel Traffic Systems division. The financial statements for 2003 have been restated to reflect the disposition of these operations. The Consolidated Statements of Operations and Deficit for 2004 with the comparative numbers for 2003 reflect the operations of its sole remaining operating entity, Atlantis Systems International Inc. (ASI), along with corporate overheads, as continuing operations.

ASI's operations represent 100% of the consolidated revenues. 65% of ASI's revenue is from one programme: the F/A-18 Integrated Maintenance Training System (IMTS) for the Canadian and Australian forces. We expect completion of this programme in October 2004.

Management continues to focus on reducing discretionary expenditures. Financing costs and interest expense is approximately \$300,000 higher during the six months ended June 30, 2004 as a result of a \$3,000,000, 12% secured loan outstanding since March 2004, and costs representing the break fee plus certain of the lender's out-of-pocket expenses related to the Shareholders rejecting the terms of a financing offer from Claymore Capital Management (see note 6 of the interim consolidated financial statements for details of this transaction). The secured loan was repaid on July 30, 2004 from the proceeds of an equity financing which closed on June 30, 2004. As a result of this transaction, interest expense and financing costs are expected to be substantially lower during the remainder of the year.

The Company is presently in the final stages of securing a "Progress Payment Program" (PPP) loan, secured by a guarantee from the Canadian Commercial Corporation (CCC). We anticipate that this loan will bear interest at prime plus 1% and will be used to purchase material and labour on the IMTS programme.

Revenues for the six months ended June 30, 2004 were \$9,675,000 versus \$12,963,000 for the six months ended June 30, 2003, a 25% decrease. This decrease reflects the completion of the NTTT contract and the termination of the E-6 contract in 2003. Revenues from naval contracts were \$1,625,000 lower for the six months ended June 30, 2004 versus the same period in 2003 while E-6 revenues were \$1,294,000 lower for the same comparative period.

The gross margin for the six months ended June 30, 2004 was \$3,519,000 or 36% versus \$3,302,000 or 25% for the same period in 2003. The higher gross margin achieved in 2004 reflects the higher gross margin realised on the F/A-18 IMTS programme. As well, all anticipated losses on the Westland contracts were written off during the fourth quarter of 2003 resulting in no adverse margin impact during the first six months of 2004.

The Company incurred general and administrative (G&A) expenses of \$1,258,000 for the six months ended June 30, 2004 versus \$1,916,000 for the same period in 2003, a 34% decrease. This reduction is the result of the streamlining completed in 2003.

Selling and marketing expenses for the six months ended June 30, 2004 were \$549,000 as compared to \$793,000 during the same period in 2003, a 31% reduction. Savings were realised as a result of reducing sales and marketing personnel in the international marketplace.

No research & development (R&D) expenses were incurred in the six months ended June 30, 2004 versus \$180,000 for the comparable period in 2003. The decrease in R&D charges reflects the significant R&D that is now integrated into ASI's large simulation contracts, such costs being expensed through cost of sales.

Atlantis achieved operating income, before depreciation, amortization, financing costs and interest expense of \$1,739,000 for the six months ended June 30, 2004 compared to \$440,000 during the same period in 2003, a 295% increase.

Finance costs incurred during the first six months of 2004 were higher than in the same period of 2003 due to one-time expenses of \$434,000 related to the strategic re-financing of the Company. This was partially offset by a decrease in finance costs related to reduced project financing costs.

The Company incurred interest expense of \$364,000 for the six months ended June 30, 2004 as compared to \$342,000 in the same period in 2003. The interest expense in 2004 included interest on the \$3,000,000 secured loan provided to the Company in March 2004, interest on the promissory notes, as well as interest on the bank loan outstanding during January and February of 2004. As a result of the repayment of the secured loan on July 30, 2004, and the conversion of the promissory notes to common shares, interest expense will be reduced significantly during the second half of 2004.

During the first quarter of 2004, the Company announced that it had been awarded a \$6.5 million contract to provide Student Aircraft Interface Trainer Stations (SAITS) for the US Navy's F/A-18 Visual Environment Maintenance Trainers. A proposal was submitted for the planning phase for follow-on work for the RAAF F/A-18 IMTS. This upgrade work is expected to commence following the completion of the current program. A similar upgrade is expected for the CF F/A-18 IMTS.

ASI's order backlog at June 30, 2004 was \$10.9 million, more than 60% of which is expected to be realised as revenue during the remainder of the 2004.

The Company reported net income for the six months ended June 30, 2004 of \$753,000 (or \$0.05 per share) versus a net loss of \$352,000 (or (\$0.03) per share) in 2003.

LIQUIDITY AND CAPITAL RESOURCES

Share Capital

As of June 30, 2004, the Company had 36,787,008 common shares outstanding. The number of common shares outstanding increased by 22,500,000 on June 30, 2004

resulting in gross proceeds of \$6,000,000 to the Company (the "Equity Financing"), and \$3,750,000 of liabilities being converted to common equity, consisting of \$2,950,000 of current liabilities and \$800,000 of special shares - Series 2 (the "Debt Conversion"). A total of 9,780,750 common share purchase warrants were issued as part of the Equity Financing and the Debt Conversion with exercise prices from \$0.50 to \$0.60 and expiries ranging from June 30, 2006 to June 30, 2007. There are currently 567,500 incentive stock options outstanding at exercise prices ranging from \$0.40 to \$4.00 with expiry dates ranging from July 19, 2005 to July 31, 2006.

Working Capital

(in '\$000's)	31-Dec-03	30-Mar-04	30-Jun-04
Working capital	(\$9,147)	(\$8,740)	\$113
Current ratio	0.27	0.28	1.01
Debt : Equity ratio	4.42 : 1	3.86 : 1	0.74 : 1

At June 30, 2004, the Company had a working capital surplus of \$113,000 that represents an improvement of \$9,260,000 from December 31, 2003. On June 30, 2004, the Company completed the \$6.0 million Equity Financing and the \$3.75 million Debt Conversion. This improved working capital by \$8,950,000. During the first six months of 2004, deferred revenue was reduced by \$925,000 indicating that work performed on contracts exceeded the invoicing on the contracts. The accrued costs on percentage of completion of \$2,034,000 requires immediate funding. The majority of this accrual relates to material purchases on the F/A-18 IMTS programme, which is scheduled for completion in October 2004. We anticipate securing a "Progress Payment Program" (PPP) loan from the Canadian Commercial Corporation (CCC) to provide the funds required to extinguish this obligation.

In March 2004, the Company signed a letter of commitment whereby the lender would provide a \$5,000,000 convertible credit facility. During the first quarter, in anticipation of closing this financing, the lender provided Atlantis with a \$3,000,000 secured loan as a bridge facility, bearing interest at 12% per annum. Shareholders rejected the conditions of this facility and the full loan amount was repaid on July 30, 2004 from cash received from the Equity Financing.

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

- \$4,286,000 of cash is retained and some was used to repay the secured loan of \$3,000,000 on July 30, 2004.
- \$1,318,000 represents accounts receivable.
- \$2,528,000 represents unbilled revenue on the F/A-18 IMTS programme. This represents work completed that is not scheduled to be invoiced to the customer until a later date.
- \$1,558,000 represents inventory. The Company is engaged in the final stages of negotiation on the sale of inventory with a carrying cost of \$1,183,000.
- \$3,777,000 represents accounts payable and accrued liabilities.
- \$718,000 relates to deferred revenues. This represents invoicing in excess of work performed on the US Navy Virtual Environment Maintenance Trainer. During the first six months of 2004, revenues in the amount of \$925,000 were recognized in excess of invoicing resulting in a reduction in deferred revenue.
- The accrued costs on percentage of completion represents a working capital deficiency of \$2,034,000. The majority of this accrual relates to the F/A-18 IMTS programme and cash is required in the short term in order to extinguish this liability and complete the programme. The Company is in the process of obtaining a PPP loan from the Canadian Commercial Corporation (CCC).

Bank indebtedness was \$3,000,000 at June 30, 2004. This indebtedness was a temporary facility provided by the lender. See Note 6 of the Consolidated Financial Statements for details of this temporary facility, and see Note 11 for a detailed discussion of the financing status. The full amount of this secured loan was repaid on July 30, 2004.

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

OUTLOOK

The Company is committed to securing an operating line of credit. The Company is in the final stages of securing a PPP loan from the CCC through a major Canadian banking institution. During 2004, the Company plans to complete the IMTS programme, the CPT for the Canadian Forces CH-149 Cormorant and the CPT for the Integrated Display System variant of the AgustaWestland EH-101 helicopter.

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

The order backlog at June 30, 2004 was \$10.9 million compared to \$11.3 million as at December 31, 2003. During the first quarter, the Company announced a \$1.2 million contract to provide a major systems upgrade to the CC-130 aircraft trainers in service with the Canadian Forces, and a \$6.5 million contract to provide Student Aircraft Interface Trainer Stations (SAITS) for the US Navy's F/A-18 Visual Environment Maintenance Trainers.

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

Atlantis currently derives approximately 90% of its revenues from military contracts. Atlantis' advantage is its ability to modify its product line and adjust to current realities with high fidelity systems that meet market needs, are reasonably priced, and are delivered in a timely fashion.

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

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

The Company's operating results have been positively affected by eliminating the losses relating to the ITS and VTS divisions of Denbridge Digital sold in 2003.

BUSINESS RISK FACTORS

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

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

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

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


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

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

ATLANTIS SYSTEMS CORP.
Consolidated Balance Sheets
as at June 30, 2004 and December 31, 2003
(unaudited)

	2004	2003
ASSETS		
Current assets		
Cash and cash equivalents	\$ 4,286,000	\$ 4,000
Accounts receivable (note 5)	1,318,000	846,000
Unbilled revenue	2,528,000	589,000
Inventory	1,558,000	1,830,000
Income taxes receivable	--	78,000
	9,690,000	3,347,000
Capital assets, net	475,000	563,000
Mortgage receivable	352,000	347,000
Investment (note 4)	310,000	310,000
Goodwill	11,735,000	11,735,000
	12,872,000	12,955,000
	\$ 22,562,000	\$ 16,302,000
LIABILITIES		
Current liabilities		
Bank indebtedness (note 6)	\$ 3,000,000	\$ 1,101,000
Accounts payable and accrued liabilities	3,777,000	4,134,000
Accrued costs on percentage completion	2,034,000	3,546,000
Line of credit	--	173,000
Promissory notes	--	1,849,000
Deferred revenue	718,000	1,643,000
Liabilities of discontinued operations	48,000	48,000
	9,577,000	12,494,000
Special shares -- Series 2	--	800,000
SHAREHOLDERS' EQUITY		
Share capital	84,332,000	75,108,000
Contributed surplus	3,112,000	3,112,000
Deficit	(74,459,000)	(75,212,000)
	12,985,000	3,008,000
	\$ 22,562,000	\$ 16,302,000

On behalf of the Board:



Vanessa Morgan
Director



Jamie Macintosh
Director

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

ATLANTIS SYSTEMS CORP.
Consolidated Statements of Operations and Deficit
(unaudited)

	For the three months ended June 30		For the six months ended June 30	
	2004	2003 <i>(note 4)</i>	2004	2003 <i>(note 4)</i>
Revenue from commercial operations	\$ 4,871,000	\$ 6,312,000	\$ 9,675,000	\$ 12,963,000
Cost of sales	<u>3,262,000</u>	4,733,000	<u>6,156,000</u>	9,661,000
Gross margin	1,609,000	1,579,000	3,519,000	3,302,000
Other income	<u>19,000</u>	11,000	<u>27,000</u>	27,000
	<u>1,628,000</u>	1,590,000	<u>3,546,000</u>	3,329,000
Expenses				
General and administrative	705,000	1,240,000	1,258,000	1,916,000
Selling and marketing	238,000	358,000	549,000	793,000
Research and development	--	31,000	--	180,000
Operating income before depreciation, amortization, financing costs, and interest expense	<u>685,000</u>	(39,000)	<u>1,739,000</u>	440,000
Depreciation and amortization	44,000	57,000	88,000	114,000
Financing costs	53,000	85,000	534,000	252,000
Interest expense	200,000	188,000	364,000	342,000
Operating income (loss) before the undernoted	<u>388,000</u>	(369,000)	<u>753,000</u>	(268,000)
Sale of technology	--	400,000	--	400,000
Net income from continuing operations	<u>388,000</u>	31,000	<u>753,000</u>	132,000
Results of discontinued operations <i>(note 4)</i>	--	(645,000)	--	(484,000)
Net income (loss)	<u>\$ 388,000</u>	<u>\$ (614,000)</u>	<u>\$ 753,000</u>	<u>\$ (352,000)</u>
Deficit, beginning of period	<u>(74,847,000)</u>	(75,937,000)	<u>(75,212,000)</u>	(76,199,000)
Deficit, end of period	<u>\$ (74,459,000)</u>	<u>\$ (76,551,000)</u>	<u>\$ (74,459,000)</u>	<u>\$ (76,551,000)</u>
Net income from continuing operations per common share <i>(note 7)</i>	<u>\$ 0.03</u>	<u>\$ 0.00</u>	<u>\$ 0.05</u>	<u>\$ 0.01</u>
Net income (loss) per common share <i>(note 7)</i>	<u>\$ 0.03</u>	<u>(\$ 0.04)</u>	<u>\$ 0.05</u>	<u>(\$ 0.03)</u>

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

ATLANTIS SYSTEMS CORP.
Consolidated Statements of Cash Flows
(unaudited)

	For the three months ended June 30		For the six months ended June 30	
	2004	2003 <i>(note 4)</i>	2004	2003 <i>(note 4)</i>
Cash flows provided by (used in) :				
Operating activities :				
Net income from continuing operations	\$ 388,000	\$ 31,000	\$ 753,000	\$ 132,000
Items not affecting cash:				
Depreciation and amortization	44,000	57,000	88,000	114,000
Accrued interest on special shares	9,000	20,000	28,000	41,000
Interest on mortgage receivable	(3,000)	(6,000)	(5,000)	(11,000)
	<u>438,000</u>	<u>102,000</u>	<u>864,000</u>	<u>276,000</u>
Net change in non-cash working capital of continued operations <i>(note 9)</i>	<u>(1,254,000)</u>	<u>(672,000)</u>	<u>(3,587,000)</u>	<u>1,865,000</u>
	<u>(816,000)</u>	<u>(570,000)</u>	<u>(2,723,000)</u>	<u>2,141,000</u>
Results of discontinued operations	--	(645,000)	--	(484,000)
Items not affecting cash :				
Investments	--	--	--	(310,000)
Loss on disposal of assets	--	401,000	--	407,000
	<u>--</u>	<u>(244,000)</u>	<u>--</u>	<u>(387,000)</u>
Net change in non-cash working capital of discontinued operations <i>(note 9)</i>	<u>--</u>	<u>190,000</u>	<u>--</u>	<u>(37,000)</u>
	<u>--</u>	<u>(54,000)</u>	<u>--</u>	<u>(424,000)</u>
Investing activities :				
Investment in capital assets	<u>--</u>	<u>--</u>	<u>--</u>	<u>4,000</u>
	<u>--</u>	<u>--</u>	<u>--</u>	<u>4,000</u>
Financing activities :				
Common share issuing	9,750,000	--	9,750,000	--
Share issuing costs	(526,000)	--	(526,000)	--
Conversion of special shares & accrued dividends	(1,000,000)	--	(1,000,000)	--
Conversion of promissory notes	(1,912,000)	--	(1,912,000)	--
Conversion of line of credit	(188,000)	--	(188,000)	--
Conversion of accounts payables	(1,025,000)	--	(1,025,000)	--
Bank indebtedness	(2,000)	633,000	(1,101,000)	(1,703,000)
Secured loan <i>(note 11)</i>	--	--	3,000,000	--
Line of credit	--	(11,000)	7,000	(20,000)
	<u>5,097,000</u>	<u>622,000</u>	<u>7,005,000</u>	<u>(1,723,000)</u>
Net increase (decrease) in cash and cash equivalents	4,281,000	(2,000)	4,282,000	(2,000)
Cash and cash equivalents, beginning of period	5,000	4,000	4,000	4,000
Cash and cash equivalents, end of period	<u>\$ 4,286,000</u>	<u>\$ 2,000</u>	<u>\$ 4,286,000</u>	<u>\$ 2,000</u>
Supplemental information				
Interest paid	\$ 102,000	\$ 96,000	\$ 145,000	\$ 168,000

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

ATLANTIS SYSTEMS CORP.
Notes to the Interim (Unaudited) Consolidated Financial Statements
June 30, 2004 and 2003

Expressed in Canadian dollars unless otherwise indicated

1. NATURE OF OPERATIONS

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

2. INTERIM CONSOLIDATED FINANCIAL STATEMENT PREPARATION

The disclosures in these interim financial statements do not meet all disclosure requirements of Canadian generally accepted accounting principles for annual financial statements. These interim financial statements should be read in conjunction with the annual financial statements of the Company and the notes thereto. Certain comparative figures have been reclassified due to discontinued operations (see *note 4*).

3. SIGNIFICANT ACCOUNTING POLICIES

These interim financial statements have been prepared by the Company in accordance with Canadian generally accepted accounting principles used for the annual financial statements for the year ended December 31, 2003. There have been no changes to the Company's accounting policies since December 31, 2003.

4. DISCONTINUED OPERATIONS

On March 19, 2003, the Company completed the sale of its Intelligent Traffic Systems ("ITS") division, Denbridge Digital, Ltd., based in Hayward, California recording a gain of \$1,005,000. In return for the business assets, the Company received 440,000 publicly traded shares of the CNE Group, Inc. ("CNE"), an AMEX traded Company. The preferred shares of CNE are redeemable for 440,000 publicly traded common shares of CNE on the fifth anniversary of the closing. The preferred shares are recorded on the financial statements at \$310,000.

The Company recorded an operating loss from the ITS division prior to the sale in 2003 of \$96,000.

During the second quarter of 2003, the Company announced the sale of the Vessel Traffics Systems ("VTS") division, Denbridge Digital Ltd. (United Kingdom) to its United Kingdom-based management group. This resulted in a write-off of \$645,000. The Company reported an operating loss during the first quarter of 2003 from the VTS business of \$748,000.

Comparative numbers for the second quarter and the six months ended June 30, 2003 have been restated to reflect the effect of the two above-noted discontinued operations.

5. CONCENTRATION OF CREDIT RISK

The Company has contracts with many customers. However, as of June 30, 2004 one customer represents 32% (December 31, 2003 - 23% and June 30, 2003 - 71%) of the accounts receivable and 65% of sales for the first six months of 2004 (2003 - 61%).

6. BANK INDEBTEDNESS

At June 30, 2004 and December 31, 2003, ASI had the following bank indebtedness:

	<u>June 30, 2004</u>	<u>December 31, 2003</u>
Bank line	\$ --	\$ 1,101,000
Secured loan	<u>3,000,000</u>	<u>--</u>
	<u>\$ 3,000,000</u>	<u>\$ 1,101,000</u>

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

In March 2004, the Company signed a commitment letter for a \$5,000,000 convertible operating term facility ("Credit Facility"). In anticipation of receiving shareholder approval, \$3,000,000 was advanced to the Company in the form of a secured loan ("Secured Loan"). This Secured Loan bears interest at 12% per annum and is collateralised by a \$5,000,000 Joint Secured Grid Note in favour of the lender issued by the Company and ASI, a General Security Agreement covering all personal and real property presently owned or acquired in the future, and an assignment of fire and other perils insurance.

In May 2004, the shareholders of the Company voted against proceeding with the Credit Facility. Under the terms of the credit facility agreement, the full amount of the Secured Loan was repayable on or before July 30, 2004. In addition, the commitment letter requires the payment by the Company of a break fee of \$250,000 and certain of the lender's out-of-pocket expenses. On July 30, 2004, the Secured Loan, break fee, and expenses were repaid in full.

7. NET INCOME PER SHARE

Basic earnings per share figures are calculated using the weighted average number of common shares outstanding during the quarter. Diluted earnings per share reflects the dilution that would occur if outstanding special shares, stock options and share purchase warrants were exercised or converted into common shares using the treasury stock method. For the quarters ended June 30, 2004 and 2003 and the six months ended June 30, 2004 and 2003, the inclusion of the Company's special shares, stock options and share purchase warrants in the computation of diluted earnings per share has an anti-dilutive effect on earnings per share and, therefore, were excluded from the computation. The weighted average number of shares outstanding used in the computation of basic and diluted earnings per share for the quarter ended June 30, 2004 was 14,287,008 (2003 - 13,987,008), for the six months ended June 30, 2004 was 14,287,008 (2003 - 13,987,008).

8. SEGMENTED INFORMATION

During the first quarter of 2004, the Company's operations were conducted in Canada only. During the first quarter of 2003, the Company's operations were conducted in the United Kingdom, the United States, and Barbados. See note 1 for the nature of these operations. During the second quarter of 2004 and 2003, the Company's operations were conducted in Canada only. The amounts listed under Denbridge Digital represent the discontinued operations (see note 4) of the United Kingdom, United States, and Barbados. The results of the operations and the amounts invested in these segments are as follows:

(000s of Cdn\$)	ASI		Denbridge Digital		Corporate		Total	
	2004	2003	2004	2003	2004	2003	2004	2003
For the quarter ended June 30 th								
Revenue	\$ 4,871	\$ 6,312	\$ --	\$ --	\$ --	\$ --	\$ 4,871	\$ 6,312
Net Earnings (Loss)								
Continuing operations	708	468	--	--	(320)	(437)	388	31
Discontinued operations	--	--	--	(645)	--	--	--	(645)
Depreciation & Amortization								
Continuing operations	44	57	--	--	--	--	44	57
For the six months ended June 30 th								
Revenue	\$ 9,675	\$ 12,963	\$ --	\$ --	\$ --	\$ --	\$ 9,675	\$ 12,963
Net Earnings (Loss)								
Continuing operations	1,725	629	--	--	(972)	(497)	753	132
Discontinued operations	--	--	--	(484)	--	--	--	(484)
Depreciation & Amortization								
Continuing operations	88	114	--	--	--	--	88	114
Capital Expenditures, net								
Continuing operations	--	(4)	--	--	--	--	--	(4)
As at June 30, 2004 and December 31, 2003								
Total Identifiable Assets	22,175	15,958	--	--	387	344	22,562	16,302

9. NET CHANGE IN NON-CASH WORKING CAPITAL

	For the three months ended June 30		For the six months ended June 30	
	2004	2003	2004	2003
Net change in non-cash working capital of				
Accounts receivable	\$ (542,000)	\$ (198,000)	\$ (472,000)	\$ 1,523,000
Unbilled revenue	(1,802,000)	504,000	(1,939,000)	64,000
Income taxes receivable	--	--	78,000	--
Inventory	402,000	(198,000)	272,000	(327,000)
Others assets	--	112,000	--	--
Accounts payable and accrued liabilities	1,036,000	123,000	840,000	(1,335,000)
Accrued costs on percentage completion	(837,000)	(8,000)	(1,512,000)	(88,000)
Promissory notes / line of credit	4,000	68,000	71,000	134,000
Deferred revenue	485,000	(1,075,000)	(925,000)	1,894,000
	\$ (1,254,000)	\$ (672,000)	\$ (3,587,000)	\$ 1,865,000
	2004	2003	2004	2003
Net change in non-cash working capital				
Assets of discontinued operations	\$ --	\$ 1,596,000	\$ --	\$ 2,123,000
Liabilities of discontinued operations	--	(1,406,000)	--	(2,160,000)
	\$ --	\$ 190,000	\$ --	\$ (37,000)

10. RELATED PARTY TRANSACTIONS

During the first half of 2004 and 2003, the Company had three common directors with, and received certain management services from Innovium Capital Corp. ("Innovium"). During the second quarter of 2004, Innovium billed the Company \$33,000 (2003 - \$33,000) for costs incurred on the Company's behalf in the normal course of operations. At June 30, 2004, \$6,000 (2003 - \$133,000) of these amounts was included in accounts payable after \$393,000 were converted to equity (*note 11*).

In addition to Innovium, the Company also accrued expenses owing to shareholders relating to reimbursable costs for shared office space and administrative services paid on the Company's behalf. For the second quarter of 2004, these costs totalled \$35,000 (2003 - \$35,000), none of which have been paid. At June 30, 2004, the amount owing to these shareholders was \$nil (2003 - \$170,000) after \$266,000 were converted to equity (*note 11*).

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

11. FINANCING

In May 2004, the Board of Directors and shareholders of the Company accepted an offer of financing from Falcon Corporation. The financing, which closed on June 30, 2004, consisted of \$6 million in equity units and a commitment to provide a term debt facility. The equity units, priced at \$0.40, consist of one common share and one half of a common share purchase warrant. Each full common share purchase warrant is exercisable until June 30, 2006 and the exercise price will be \$0.50 per share until June 30, 2005 and \$0.60 per share from July 1, 2005 until June 30, 2006 (the "Equity Financing"). As a condition of the financing, \$2,750,000 of the Company's existing current liabilities (including promissory notes, the line of credit, accounts payable and accrued interest costs) have been converted into 5,500,000 common shares at \$0.50 per share and 1,050,000 common share purchase warrants exercisable at \$0.60 per share with an expiry date of June 30, 2007. The financing also required the conversion of the Company's outstanding special shares - Series 2 in the amount of \$800,000, plus accrued dividends of \$200,000. They were converted into 2,000,000 common shares at a price of \$0.50 per share and 500,000 common share purchase warrants exercisable at \$0.60 per share with an expiry date of June 30, 2007 (collectively known as the "Debt Conversion"). An additional 730,750 common share purchase warrants were also issued on June 30, 2004 relating to the structuring of the financing, each warrant is exercisable until June 30, 2006 and the exercise price will be \$0.50 per share until June 30, 2005 and \$0.60 per share from July 1, 2005 until June 30, 2006.

12. PRIOR YEAR FINANCIAL STATEMENTS

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



Atlantis Systems Corp.
1 Kenview Blvd. Brampton, Ontario L6T 5E6