



  
**csi wireless**<sup>TM</sup>  
Interim Report • Q1 • March 31, 2004

## **Message to Shareholders**

### **First Quarter ended March 31, 2004**

We are pleased to enclose our financial results for the first quarter of 2004, during which we reported record gross margins and the second-best quarterly earnings in the Company's history! This is a tremendous kick-off to what we anticipate will be a record year in terms of both revenues and earnings.

Our GPS Business Unit began the year with strong sell-through, and we enter the second quarter with a solid consolidated sales backlog. We have passed through our break-even point and we expect to see increasing profit in every quarter of this year. At this point, we see this strength continuing through 2004, and into 2005, as our GPS leadership grows and our Wireless business accelerates.

#### **GPS Business Unit**

Our GPS Business Unit posted near-record revenues and gross margins in the first quarter. The precision agriculture component, which experienced record orders during the quarter, is the largest source of revenue for our GPS business. We continue to produce the agricultural industry's leading GPS guidance products for aerial applications, and have now become a leading player in ground applications – for guiding tractors and sprayers.

We are also continuing to expand our precision guidance product offerings in the agricultural market, and are beginning to see traction with our recently released auto-steering products. RHS Inc. introduced our auto-steering technology to its customers during the first quarter, and reports that sales are well above expectations.

I recently experienced the auto-steering technology first-hand, on one of the largest tractors currently in production. It was truly awesome to see our technology accurately guide this monster tractor with incredible ease. It confirmed our belief that auto-steering will be a substantial new product category in the precision agriculture market – and a great opportunity for CSI as we are one of only a few companies in the world that own this technology.

#### **Wireless Business Unit**

Our Wireless Business Unit also had a good start to the year. Shipments of our leading TDMA fixed wireless telephone were up about 45% over the fourth quarter of 2003. Purchase orders received in the first quarter were higher than what we had budgeted for, and above what we could deliver, due to manufacturing lead-time requirements. Fixed wireless phone orders in hand today represent a further 75% growth in shipment volumes for the second quarter over the first quarter. Our plan is to continue growing this market, and we expect our 2004 TDMA volumes to be ahead of 2003 levels.

As announced last year, we are developing a new addition to our fixed wireless product line. The GSM version of our fixed wireless phone should be commercially available in the second half of 2004. With this new product addition, our addressable market for fixed wireless is increased by a factor of ten, as 70% of the world's wireless networks employ the GSM wireless protocol. We have achieved strong technical progress in developing our new GSM phone, and I was recently able to demonstrate this by making a call on a prototype. We are addressing immediate sales opportunities in Latin America, and have begun detailed discussions concerning several large opportunities in Asia and the Middle East.

Although telematics markets have not grown as quickly as we would have liked, we are still very optimistic about the opportunities in this market space and are very encouraged by what we are seeing this year. Solid customer performance, improved margins, and our introduction of a telematics product utilizing GSM in late 2004, will ensure this market continues to build.

Our newest telematics product category – Location Tags – has generated strong interest. Location Tags are portable, small, low-cost, battery-operated devices that can be easily tracked using the Internet. Our product will use highly sensitive GPS technology and be combined with low or bundled service costs. We have many new opportunities in this area, and hope to announce several sales agreements in the coming quarters.

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Overall, both of our business units achieved better-than-expected performance for the first quarter, and are reporting strong order backlogs through Q2 and early Q3. We are continuing to focus on the right customers and products, and expect strong revenues and record earnings for the full year.

Thank you, on behalf of all CSI Wireless employees, for your continued support.

A handwritten signature in black ink, appearing to read 'S. Verhoeff', is positioned above the typed name.

Stephen Verhoeff  
President and Chief Executive Officer  
April 27, 2004

## Interim Management Discussion and Analysis

The following discussion and analysis is effective as of May 7, 2004 and should be read together with our unaudited interim consolidated financial statements and the accompanying notes.

### Overview

CSI Wireless Inc. ("CSI" or "the Company") designs and manufactures innovative, cost-effective, Wireless and GPS products for mobile and fixed applications in the Consumer, Agriculture, Marine, Automotive and other related markets. Through the integration of GPS and Wireless technologies, CSI serves several emerging high-growth markets including Precision Guidance in Agriculture, Consumer-based Fixed Wireless Telephones and Commercial and Consumer Telematics.

### Results of Operations

#### Summary of quarterly results

	For the Quarters Ended							
	Jun 30 2002	Sep 30 2002	Dec 31 2002	Mar 31 2003	Jun 30 2003	Sep 30 2003	Dec 31 2003	Mar 31 2004
Revenue	\$10,761	\$ 8,784	\$20,633	\$24,070	\$21,895	\$15,134	\$ 9,948	\$15,146
Gross margin	4,733	2,268	3,403	5,140	5,226	4,839	3,555	5,575
Expenses								
Research & development	2,187	2,207	1,743	1,898	1,795	1,592	1,732	2,026
Selling	1,049	1,150	1,138	1,001	1,057	1,003	1,039	1,027
General & administrative	1,364	1,254	1,213	1,180	1,183	980	952	1,128
Stock-based compensation	-	-	-	-	-	-	-	134
Depreciation & amortization	272	294	301	334	235	288	296	261
	4,872	4,905	4,395	4,413	4,270	3,863	4,019	4,576
Earnings (loss) before the following	(139)	(2,637)	(992)	727	956	976	(464)	999
Interest expense	229	163	312	198	171	141	168	103
Foreign exchange (gain) loss	210	(84)	(13)	211	(86)	42	52	108
Premium on preferred shares	-	-	322	46	74	51	40	62
	(578)	(2,716)	(1,613)	272	797	742	(724)	726
Loss (recovery) from arbitration	-	-	-	168	292	1,154	(135)	-
Restructuring costs	-	-	-	-	-	160	-	-
Net income (loss) for the period	\$ (578)	\$ (2,716)	\$ (1,613)	\$ 104	\$ 505	\$ (572)	\$ (589)	\$ 726
Income (loss) per share - basic	\$ (0.03)	\$ (0.14)	\$ (0.08)	\$ 0.01	\$ 0.02	\$ (0.02)	\$ (0.02)	\$ 0.03

## **Quarter Ended March 31, 2004 versus Quarter Ended December 31, 2003**

### **Revenues**

First quarter revenues of \$15.1 million were a 52% increase from fourth quarter revenue of \$9.9 million. Revenue growth exceeded 50% in both the Company's GPS and the Wireless Business Units. In the GPS Business Unit, strong sales of our ground and aerial guidance products led this growth. In the Wireless Business Unit, we saw growth in both the telematics and fixed wireless product lines, with fixed wireless volumes up 45% from the fourth quarter of 2003.

### **Gross Margins**

Gross margins of 37% in the first quarter were an improvement from 36% in the fourth quarter resulting from higher GPS margins due to strong sales of high-margin ground agricultural guidance products. In dollar terms, gross margins improved by \$2 million to \$5.6 million from \$3.6 million in the fourth quarter. The March 31, 2004 quarterly gross margin was a record for the Company.

### **Operating Expenses**

Operating expenses increased by 14% over the fourth quarter due to the following primary factors:

- (a) The implementation of the new accounting standard for stock-based compensation resulted in an increase in expenses of \$134 thousand.
- (b) Wireless research and development costs increased, primarily due to the ramp-up in development of the Company's GSM-based fixed wireless telephone.

### **Interest and Other**

Interest expense was \$103 thousand in the first quarter of 2004 compared to \$168 thousand in the fourth quarter of 2003 due to the payout of long-term debt and the operating line, following the completion of the equity financing on March 3.

The Company incurred a foreign exchange loss in the quarter of \$108 thousand dollar, compared to a loss of \$52 thousand in the previous quarter. This loss arose primarily from the translation of U.S. dollar working capital components at quarter end, as a result of significant strengthening in the Canadian dollar just prior to quarter end.

### **Net Income**

Net income in the first quarter was \$726 thousand, or \$0.03 per share (basic), representing an improvement of \$1.3 million, or \$0.05 per share (basic), from the fourth quarter results.

## **Quarter Ended March 31, 2004 versus Quarter Ended March 31, 2003**

### **Revenues**

On a year-over-year quarterly basis, revenues of \$15.1 million decreased from \$24.1 million for the first quarter of 2003. The first quarter of 2003 was unusually strong due to the initial ramp-up of sales of our fixed wireless telephone in Mexico. As previously reported, inventory issues in the Mexican distribution channel resulted in a reduction in fixed wireless volumes midway through 2003. These inventories have now been drawn down and new purchase orders have been received for 2004.

A second factor impacting comparative revenues in the first quarter is the Canada-US foreign currency rate which was about 13% lower in the first quarter of 2004 relative to the first quarter of 2003. As the company's revenues are almost entirely denominated in US dollars, the impact of this change is a reduction in revenues of

approximately \$2 million. The 2004 first quarter foreign currency rate was relatively flat compared with the fourth quarter of 2003.

### **Gross Margins**

Gross margins of 37% in the first quarter of 2004 were up 16% from margins of 21% in the first quarter of 2003. Margin improvements were realized in both the GPS and Wireless Business Units. In spite of the decline in revenue from the first quarter of 2003, record quarterly gross margins of \$5.6 million were achieved, up from \$5.1 million in the first quarter of 2003, due to both product cost reductions and changes in the product mix.

### **Operating Expenses**

Operating expenses of \$4.6 million in the first quarter of 2004 were up 4% from \$4.4 million in the first quarter of 2003 as a result of the implementation of the new accounting standard for stock-based compensation and an increase in research and development costs associated with the GSM fixed wireless telephone development.

### **Net Income**

Net income of \$726 million increased from net income of \$104 thousand in the first quarter of 2003, due primarily to improved gross margins as previously outlined.

### **Liquidity and Capital Resources**

Inventories consist of components, work in process and finished goods related to the products manufactured and sold by the Company. Inventory levels decreased from \$8.2 million at December 31, 2003 to \$6.5 million at the end of March 2004.

Long-term debt declined \$0.8 million from December 31, 2003, and was paid out during the quarter using the proceeds from the equity financing.

In March 2004, the Company completed a private placement of 5 million common shares for gross proceeds of \$16.25 million. The Company has used a portion of these funds to pay out the bank operating line and long-term debt. In addition, it is expected that the preferred shares will be repurchased by CSI during 2004. The remainder of the proceeds will be used for working capital, resulting in a significant strengthening of the Company's financial condition and liquidity. The repayment of debt will result in a reduction in interest expense in 2004 and a positive cash balance will also result in the generation of interest income.

During the quarter, warrants and options were exercised to acquire 714,779 common shares, resulting in proceeds of \$1.4 million.

CSI has an unused bank operating line of credit with its bank with a maximum borrowing limit of \$6,000,000. The available borrowing limit under this operating line is determined based on trade receivables and inventory levels. This operating line of credit bears an interest rate of prime plus 3.5%. The Corporation has entered into a general security agreement with its bank to secure such indebtedness.

### **Cash Flow**

At March 31, 2004, the Company had a positive cash balance of \$12.5 million. During the first quarter of 2004, CSI generated \$1.2 million of positive cash flow from operations, prior to working capital changes. Net proceeds from the common shares issued during the quarter were \$16.2 million.

## **Critical Accounting Policies and Estimates**

CSI prepares its consolidated financial statements in Canadian dollars and in accordance with accounting principles generally accepted in Canada.

Effective January 1, 2004, the Company adopted the new Canadian accounting standard requiring the use of the fair value method in accounting for stock-based compensation. Under the fair value method, the Company calculates the fair value of stock option grants or direct awards of stock at the date of granting, and amortizes that fair value as compensation expense over the vesting period of those grants and awards. During the first quarter of 2004, stock-based compensation expense was \$134 thousand.

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Certain statements in Management's Discussion and Analysis, other than statements of historical fact, are forward-looking in nature and involve various risks and uncertainties. These can include, without limitations, statements concerning possible or assumed future results of operations of the Company preceded by, followed by or that include words and phrases such as "believes," "plans," "intends," "expects," "anticipates," "estimates" or similar expressions. Forward-looking statements are not guarantees of future performance. They involve risks, uncertainties and assumptions related to all aspects of the GPS and Wireless industries and the global economy. As a result, the Company's actual results may differ materially from those anticipated in the forward-looking statements and there can be no assurance that such statements will prove to be accurate. Factors that may cause such differences include, but are not limited to, those set forth under the section labeled "Business Risks". The Company assumes no obligation to update forward-looking statements should circumstances or Management's estimates or opinions change.

# CSI WIRELESS INC.

## Consolidated Balance Sheets

	March 31 2004 (unaudited)	December 31 2003 (audited)
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 12,520,323	\$ —
Accounts receivable	10,683,927	9,606,485
Inventories	6,520,465	8,174,568
Prepaid expenses and deposits	451,582	422,604
	<u>30,176,297</u>	<u>18,203,657</u>
Capital assets	4,258,445	4,188,697
Goodwill	18,818,176	18,624,676
	<u>\$ 53,252,918</u>	<u>\$ 41,017,030</u>
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities:		
Bank indebtedness	\$ —	\$ 2,557,939
Accounts payable and accrued liabilities	6,288,746	8,041,181
Current portion of capital leases	159,196	156,904
Current portion of senior long-term debt	—	761,672
Preferred shares	2,531,882	2,242,154
	<u>8,979,824</u>	<u>13,759,850</u>
Capital lease obligations	377,542	387,674
Shareholders' equity:		
Common shares (note 3)	65,717,533	49,551,086
Contributed surplus (note 3)	688,265	156,049
Deficit	(22,510,246)	(22,837,629)
	<u>43,895,552</u>	<u>26,869,506</u>
	<u>\$ 53,252,918</u>	<u>\$ 41,017,030</u>

# CSI WIRELESS INC.

## Consolidated Statements of Operations and Deficit

Three Month Periods Ended March 31  
(unaudited)

	2004	2003
Sales	\$ 15,146,467	\$ 24,069,785
Cost of sales	9,571,090	18,929,473
	5,575,377	5,140,312
Expenses:		
Research and development	2,026,333	1,898,304
Selling	1,026,981	1,001,157
General and administrative	1,128,205	1,179,425
Stock based compensation (note 3(e))	134,082	—
Depreciation and amortization	260,744	334,301
	4,576,345	4,413,187
Earnings before undernoted	999,032	727,125
Redemption premium on preferred shares	62,096	46,381
Foreign exchange loss	108,420	210,764
Interest expense	102,999	198,030
	725,517	271,950
Loss from unsuccessful arbitration	—	168,000
Net income	725,517	103,950
Deficit, beginning of period	(22,837,629)	(22,285,020)
Adjustment to reflect change in accounting policy (note 2)	(398,134)	—
Deficit, end of period	\$ (22,510,246)	\$ (22,181,070)
Earnings per common share		
Basic	\$ 0.03	\$ 0.01
Diluted	0.02	0.01
Weighted average shares outstanding		
Basic	28,832,978	21,748,452
Diluted	31,609,927	21,804,803

See accompanying notes to consolidated financial statements.

# CSI WIRELESS INC.

## Consolidated Statements of Cash Flows

Three Month Periods Ended March 31  
(unaudited)

	2004	2003
Cash flows from (used in) operating activities:		
Net income	\$ 725,517	\$ 103,950
Items not involving cash:		
Depreciation and amortization	260,744	334,301
Redemption premium on preferred shares	62,096	46,381
Foreign exchange loss on preferred shares	34,132	—
Stock based compensation	134,082	21,355
	1,216,571	505,987
Change in non-cash operating working capital:		
Accounts receivable	(1,077,442)	(6,105,329)
Inventories	1,654,103	(1,470,841)
Prepaid expenses and deposits	(28,978)	(11,712)
Accounts payable and accrued liabilities	(1,752,435)	6,821,016
	11,819	(260,879)
Cash flows from (used in) financing activities:		
Increase (decrease) in bank indebtedness	(2,557,939)	1,479,397
Senior long-term debt	(761,672)	(476,463)
Other long-term debt	—	(237,347)
Capital leases	(7,840)	(265,416)
Issue of share capital, net of share issue costs	16,166,447	281
	12,838,996	500,452
Cash flows used in investing activities:		
Purchase of capital assets	(330,492)	(239,573)
Increase in cash position	12,520,323	—
Cash and cash equivalents, beginning of period	—	—
Cash and cash equivalents, end of period	\$ 12,520,323	\$ —
Supplemental disclosure:		
Interest paid	\$ 112,462	\$ 177,930

See accompanying notes to consolidated financial statements.

# CSI WIRELESS INC.

Notes to Consolidated Financial Statements

Three Month Periods Ended March 31, 2004 and 2003  
(unaudited)

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## **1. Basis of Presentation:**

The accompanying unaudited consolidated financial statements for CSI Wireless Inc. (the "Company") have been prepared in accordance with Canadian generally accepted accounting principles for interim financial statements. The financial information included herein is unaudited. These interim financial statements follow the same accounting policies and methods of application as the most recent annual audited financial statements dated December 31, 2003, except where noted below. The disclosures herein are incremental to those included within the annual financial statements. These interim financial statements should be read in conjunction with the annual statements.

## **2. Change in accounting policy:**

Prior to January 1, 2004, the Company applied the fair value based method of accounting prescribed by CICA Handbook Section 3870, *Stock-based Compensation and Other Stock-based Payments*, only to stock options granted to non-employees, and applied the intrinsic value method of accounting to employee stock options. Under the intrinsic value method, any consideration paid by employees on the exercise of stock options or purchase of stock was credited to share capital and no compensation expense was recognized.

The CICA Accounting Standards Board has amended CICA Handbook Section 3870 – *Stock-based Compensation and Other Stock-based Payments* – to require entities to account for employee stock options using the fair value based method, beginning January 1, 2004. Under the fair value based method, compensation cost is measured at fair value at the date of grant and is expensed over the award's vesting period. In accordance with one of the transitional provisions permitted, the Company has retroactively applied the fair value based method to all employee stock options granted on or after January 1, 2002 and prior to January 1, 2004. The Company has not restated prior year's reported amounts, and accordingly, has adjusted 2004 opening retained earnings at January 1, 2004 by \$398,134, and contributed surplus by the same amount. Options granted in 2004 are expensed in the current financial statements in accordance with the standard previously described.

# CSI WIRELESS INC.

Notes to Consolidated Financial Statements, Page 2

Three Month Periods Ended March 31, 2004 and 2003  
(unaudited)

### 3. Share capital:

(a) Authorized:

Unlimited number of common shares

(b) Issued:

	Number of Shares	Amount
Balance, December 31, 2003	26,916,691	\$ 49,551,086
Issued on exercise of stock options	161,562	321,505
Exercise of share purchase warrants	232,693	458,847
Exercise of agents warrants	320,524	587,264
Issued on private placement (note 3(d))	5,000,000	16,250,000
Share issue costs	–	(1,451,169)
Balance, March 31, 2004	32,631,470	\$ 65,717,533

(c) At March 31, 2004 the following stock options and share purchase warrants are outstanding:

Share Option Plan	2,419,598
Wireless Link Acquisition Share Option Plan	235,593
Total Options outstanding	2,655,191
Share Purchase Warrants – Exercise price of \$2.00, expiring August 8, 2005	2,997,500
Agents Warrants – Exercise prices of \$1.60 & \$2.00, expiring in August 2004 & August 2005	376,030
Bankers Warrants – Exercise price of \$2.50, expiring September 30, 2005	250,000
Total Warrants outstanding	3,623,530

(d) Special warrants:

On March 3, 2004, the Company completed a fully subscribed underwritten private placement of 5,000,000 special warrants, which included 1,000,000 special warrants pursuant to the exercise of the underwriters' option. The special warrants were purchased at a price of \$3.25 per special warrant, for gross proceeds of approximately \$16.25 million. Each special warrant entitles the holder to acquire one common share for no additional consideration. Final receipt of the short form prospectus was received on March 29, 2004, and the special warrants were converted into common shares on April 8, 2004.

# CSI WIRELESS INC.

Notes to Consolidated Financial Statements, Page 3

Three Month Periods Ended March 31, 2004 and 2003  
(unaudited)

### 3. Share capital (continued):

(e) Stock based compensation:

The fair value of each stock option granted is estimated on the date of grant using the Black-Sholes option pricing model with the following weighted average assumptions used for options granted in the first quarter of 2004: zero dividend yield; expected volatility of 65%; risk-free rates of 5%; and expected lives of 5 years. For the quarter ended March 31, 2004, the Company recorded \$134,082 as compensation expense.

### 4. Preferred Shares:

	March 31, 2004		December 31, 2003	
	Number of Shares	Amount	Number of Shares	Amount
Preferred shares issued	1,511,000	\$ 2,531,882	1,361,000	\$ 2,335,154

The terms of the preferred shares allows for the holder of the shares to demand retraction in the form of either shares or cash at any time after April 1, 2004, and accordingly the shares are shown as a current liability. On January 1, 2004, and additional 150,000 preferred shares were issued to the holder as the defined performance criteria was met for 2003. This represents the final required performance-related issuance of preferred shares in accordance with the agreement under which the Company acquired certain business assets from the holder.

### 5. Segmented information:

(a) Operating segments:

The Company determines the information to report about operating segments based upon the structure in which management has organized the operating segments within the Company for making operating decisions and assessing financial performance.

Periods ended March 31:

	GPS Business Unit		Wireless Business Unit		Corporate		Total	
	2004	2003	2004	2003	2004	2003	2004	2003
Sales	\$ 8,292,000	\$ 7,091,000	\$ 6,854,000	\$ 16,979,000	\$ -	\$ -	\$ 15,146,000	\$ 24,070,000
Interest expense	-	-	-	-	103,000	198,000	103,000	198,000
Depreciation and amortization	171,000	221,000	90,000	113,000	-	-	261,000	334,000
Net earnings (loss)	2,509,000	1,164,000	(990,000)	175,000	(793,000)	(1,235,000)	726,000	104,000
Capital assets and goodwill	7,473,000	7,375,000	15,604,000	15,645,000	-	-	23,077,000	23,020,000
Total assets	30,809,000	18,999,000	22,444,000	30,765,000	-	-	53,253,000	49,763,000
Capital expenditures	177,000	174,000	153,000	66,000	-	-	330,000	240,000

# CSI WIRELESS INC.

Notes to Consolidated Financial Statements, Page 4

Three Month Periods Ended March 31, 2004 and 2003  
(unaudited)

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## 5. Segmented information (continued):

(b) Assets and sales by geographic segment:

	Assets		Sales	
	2004	2003	2004	2003
U.S.A.	\$ 27,778,000	\$ 38,586,000	\$ 12,485,000	\$ 21,881,000
Canada	25,475,000	11,177,000	1,278,000	1,136,000
Europe	—	—	388,000	391,000
Other	—	—	995,000	662,000

Sales are attributed to geographic segments based on the location of the customer.

(c) Major customers:

Of the Company's sales for the three-month period ended March 31, 2004, 73% (2003 - 80%) were to 5 customers. The Wireless Business Unit had sales to one customer totaling \$4,781,000 (2003 - \$14,286,000), and the GPS Business Unit had sales to one customer totaling \$3,626,000 (2003 - \$1,798,000). Both of these customers are located in the United States.

**For more information, please contact:**

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