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*strength through* **Diversification**



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*Our Mission is to sell technology services to industry  
and government in Canada and around the world.*



European Space Agency: 35 meter deep space antenna



Canadian Forces Base Kingston



Health Services Support Contract



Signal Operations (SigOps)



Gatineau Satellite Station



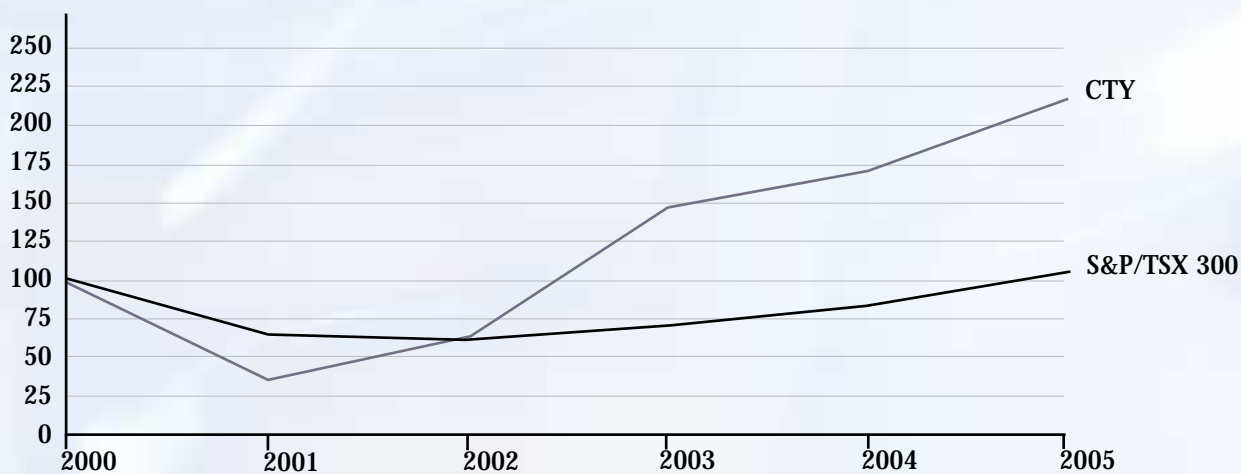
we've never been stronger.



(millions of dollars, except per share data)



Comparison of Cumulative Total Return





## Letter to Shareholders

Fiscal 2005 was yet another solid year of execution and performance for Calian.

The market diversity of our operating divisions provided the balance needed to accommodate significant swings in certain markets and to provide respectable returns to our shareholders. Last year's high level of revenue from the SEI MSTAR product, which was not repeated this year, was more than offset by a full year of Titan revenues and six months of revenues from our new Health Services Support contract. As a result, we ended the year with revenues increasing by almost 5%. More importantly, our backlog more than quadrupled during the past year to over \$1 billion, which bodes well for the sustainability of our revenue base.

There is no doubt that the diversity of our service offerings will continue to be a key part in achieving our plans for steady growth. In the short term, the prospects for the Business and Technology Services Division are encouraging and will provide balance as the Systems Engineering Division continues to cope with the ongoing consolidation and belt tightening in the commercial satellite sector. In the longer term, we are confident that we will meet our growth aspirations by successfully diversifying our divisional customer bases and service offerings, be it organically or through strategic acquisitions.

Management attention is devoted to running and building an excellent company in the long term regardless of short-term fluctuations in market conditions. Our management philosophy is to continue to focus on top line growth, cost containment and strict management of cash resources. As every business has risk, we endeavor to meet our growth and profitability objectives while at the same time attempting to keep risks to a manageable level. To that end, we have maintained a clean balance sheet with virtually no debt, allowing maximum flexibility to address future opportunities and to weather cyclical downturns in certain market segments. The payment of regular quarterly dividends is testament to our commitment to generate stable and sustainable cash flows.

Working to the standards of ISO and the National Quality Institute, we take great pride in our commitment to quality, delivery and customer satisfaction. Both divisions have earned the respect of a broad base of satisfied customers, and our stellar performance continues to attract new ones. As the future unfolds, we will face challenges as well as opportunities. We believe that our management team has the capability and depth to address both to the ultimate benefit of our shareholders.

Our Board of Directors has continued to provide sage advice on critical issues while at the same time affording management the latitude to execute. The board is committed and supports the company's efforts to maintain high standards of corporate governance.

This annual report describes in some detail, our achievements during the year, the associated financial results and our outlook for the future. Along with our senior management team and Board of Directors, we look forward to the opportunity to discuss these with you at this year's Annual General Meeting.



A handwritten signature in black ink that reads "R Basler".

Ray Basler  
*President and Chief Executive Officer*



A handwritten signature in black ink that reads "L O'Brien".

Larry O'Brien  
*Chairman*

## Report on Operations Systems Engineering



As predicted, the Systems Engineering Division experienced lower revenues in 2005, declining by 40% to \$50 million. In 2004, we saw an unusually large order from Systems Electronics Inc. (SEI) for MSTAR assemblies and, as expected, this level of business was not sustained in fiscal 2005. However, despite the decline in revenue, we were still able to achieve a respectable operating profit through efficient project execution and tight control of operating costs.

While the MSTAR business was nominal, we did see strong performance in other sectors. During the year, we made significant progress on a number of projects that are now nearing completion. For Inmarsat, we delivered various ground systems for their next generation satellites. The first satellite in this series was launched this year and the systems we provided performed flawlessly. For the European Space Agency, we are nearing completion of a three-year project to build and commission a 35-meter deep space antenna in Spain. We also completed the MEASAT 3 satellite ground stations in Malaysia under contract to Boeing Satellite Systems.

We continue to receive a steady flow of business from Worldspace and XM Satellite Radio for upgrades and enhancements to the Uplink Systems for Digital Audio Broadcasting we provided previously. We were also successful in winning a project with Worldspace to develop prototype terrestrial repeaters for a trial program in India.

We continue to provide satellite operations and support services to the Canadian Space Agency (CSA) for the Radarsat-1 and Scisat programs. During the year, we signed a renewal contract with CSA to provide our team of 50 people for an additional two years of operations support with options to extend for a further eighteen months.

Our manufacturing business continues to benefit from repeat orders from our key customers, Kidde Dual Spectrum, SEI and GDC. As well, we continue to design and build various test sets and fixtures for customers such as Agilent, Nortel and Powerwave. These projects continue to play a key role in our success as they provide a steady use of our manufacturing resources and capabilities.

Operationally, we maintained our focus on quality and continuous improvement. We continue to work to the ISO 9000:2000 quality standards and have introduced the fundamentals of LEAN manufacturing to enhance operational effectiveness.

As the commercial satellite market continues with reorganization and consolidation, we expect to see further constraints on capital spending. While this will certainly make for a more competitive environment in the short term, we are confident that our capabilities, combined with our solid history of performance and customer satisfaction, will put us on solid footing for the future. We remain confident in the security and surveillance market despite reduced MSTAR revenues during the year. The new order received from SEI at the end of the fiscal year is verification that their product will continue to play a role in this marketplace.

As a project driven business, SED continually deals with the peaks and valleys that are to be expected in this line of work. To cope with this environment and to expand revenues, we will continue to seek opportunities to leverage our core products and capabilities into adjacent markets, always building on our commitment to quality, delivery and customer satisfaction.

**Brent McConnell**

*VP and General Manager, Systems Engineering*





## Report on Operations

### Business and Technology Services



The Business and Technology Services Division experienced an excellent year with revenues increasing by 50% to \$127 million. The integration of Titan Consulting at the beginning of the year and our winning of the Health Services Support contract with the Department of National Defence (DND), the largest contract win in the history of the company, combined to drive both our revenues and backlog to record levels. Our continued focus on execution and delivery has yielded excellent operating margins. As our back office was able to accommodate the additional revenue with only a marginal impact on costs, the additional margin flowed directly to the bottom line. Accordingly, we have achieved the highest level of operating profit in the division's history.

In 2005, we continued to expand our portfolio of DND training related services. We were the successful bidder on a multi-year contract at the Canadian Forces School of Aerospace Technology and Engineering, where we commenced the provision of instructors in October of 2004. We were also successful in adding six new long-term supply arrangements with the Canadian federal government; our US subsidiary's Content Management Services group continued their success in the interactive electronic technical manuals market by adding Boeing as a customer on the Future Combat Systems program and expanding work with Northrop Grumman Corporation in their Navigation Systems Division and on the Global Hawk program.

Our success was not limited to new contracts. Our excellent track record combined with our ability to offer competitively priced solutions again yielded a 100% renewal success rate. These renewals included contracts with the Canadian government at the Canada Centre for Remote Sensing, the Canadian Space Agency and the Department of National Defence. In the private sector, we were successful in renewing our contracts with two large telecommunications companies and a North American auto manufacturer. These renewals when added to our contract wins drove our backlog of business to record levels.

During the year we maintained an operations emphasis on our continuous improvement initiative. In the first quarter of the year, these efforts were recognized with the Canada Award of Excellence at the silver level from the National Quality Institute. In the coming year, we will continue to work towards achieving our Progressive Excellence Program certification at level 4, the highest level achievable under the program.

We have now solidified many of our long-term contract renewals and established a very healthy backlog. Our efficient back office has been thoroughly exercised and proven that it can accommodate substantial growth without incurring proportionate additional costs. These two factors will provide us with a very solid foundation from which we can aggressively pursue new opportunities to enhance both revenues and operating returns in the coming year.

A handwritten signature in black ink, appearing to read 'Tom Coates'.

**Tom Coates**  
*VP and General Manager, Business and Technology Services*



## Business of the Company

### **Calian sells technology services to industry and government.**

We operate through two autonomous divisions that complement each other and that share the vision and key tenet upon which Calian has emerged as a technology services leader — effective and prudent management with a focus on sustainable growth in carefully selected markets.

The diversity of our service offerings are at the heart of our success. By serving a number of customers in several different and geographically varied markets, we benefit from a diversity that helps us weather the downturns experienced in any one market and that allows us to take advantage of unique opportunities as they arise. This diversity is most evident when comparing the business of our two divisions.

**Systems Engineering** designs and manufactures systems. Our primary markets are the satellite communications arena and the defense and homeland security sectors. We are a relatively small niche player serving a handful of multinational organizations working on large worldwide projects. More than 75% of our annual revenues are derived from exports.

Our approach is simple. We tailor systems to meet individual customer needs, using advanced commercial equipment from reliable suppliers. This means less development, lower risk and cost, and faster delivery. Our customers value being able to delegate the development of large and complex systems to us, confident that our technical and management skills will deliver what we promised, when we promised it, and at the agreed price. Our core competencies make us stand out from our competitors — strong project management, systems engineering know-how, and software development. Our full-service approach addresses needs from design through long-term maintenance, helping our customers roll-out new services on time and manage them profitably. We routinely enjoy repeat business due to the strong relationships we have established with industry leaders.

**Business and Technology Services** provides people to help customers manage their changing workforce requirements. We provide ready access to an exceptional team of engineers, technology, administrative and health care professionals. The division caters mainly to the Canadian federal government, with a large presence in the Department of National Defense, and also has a well-established private sector customer base that is expanding. About 3% of annual revenues are derived from the USA.

The services we offer allow our customers to focus their vital internal resources on key priorities. The value we add lies in the breadth of services we offer and our ability to source sufficient and appropriate resources on a timely basis to meet our customers' requirements. This is due to our exceptional recruiting capabilities, effective management of our employees in the field, and competitive rates.

**A comparison of the business models and operating approaches** of the two divisions further illustrates the diversity between them.

Contracts in **Systems Engineering** are technically complex and are typically on a fixed-price basis with demanding requirements to meet delivery schedules. The division operates essentially under a fixed-cost structure, requiring the careful management of labour utilization. The majority of revenues are derived from international sources and contracts are often denominated in foreign currencies. While the risks are high, the margins are commensurate.

Contracts in **Business and Technology Services** are typically on a per-diem basis and can range from short-term assignments to multi-year operations and maintenance contracts. The cost structure of the division is variable as direct labour costs





are scalable to match contract requirements. The majority of revenues are derived from Canadian sources so there is little currency exposure. With a reduced risk profile, margins are correspondingly lower.

Systems Engineering's billings are based on achieving well-defined project milestones. These can be in advance of, or subsequent to the recognition of revenues. Milestone profiles vary depending on factors such as the customer, competition and pricing. Accordingly, cash flows and working capital requirements can vary significantly from project to project and over the life of any one project. In Business and Technology Services, cash flows are very predictable as most contracts call for monthly billings of work performed.

From the perspective of renewing business, Systems Engineering is awarded one project contract at a time, usually as a result of winning an open international competition. Constant marketing efforts are directed towards identifying and securing bid opportunities and a significant overhead effort is required to develop detailed proposals for new projects. The situation is similar for the short-term staffing component of the Business and Technology Services division which requires ongoing marketing and sales efforts to maintain the backlog. However, the longer-term outsourcing component of this division enjoys the benefit of multi-year contracts that often contain provisions for extensions, offering long-term visibility of future revenues.

Overall, the diversity in markets, customers and business models provides Calian with an enviable balance in its consolidated business.

## Management Team

**Ray Basler**  
*President and CEO*



**Tom Coates**  
*VP and General Manager, Business and Technology Services*



**Jacqueline Gauthier**  
*VP, CFO and Corporate Secretary*

**Brent McConnell**  
*VP and General Manager, Systems Engineering*

# Management's Discussion and Analysis of Financial Condition and Results of Operations

The following Management Discussion and Analysis, dated November 30, 2005 should be read in conjunction with the audited consolidated financial statements and notes included in this annual report. The Company's accounting policies are in accordance with Canadian generally accepted accounting principles (GAAP) of the Canadian Institute of Chartered Accountants. As in the consolidated financial statements, all dollar amounts in this Management Discussion and Analysis are expressed in thousands of Canadian dollars unless otherwise noted.

## Business Overview

Calian sells technology services to industry and government. For many years, industry and government have searched for and adopted new operating models and new technologies in an effort to improve the efficiency of their operations. Management expects that this trend will continue, and consequently the Company has built a unique combination of specialized skills and available capable resources in order to address the resulting market opportunities.

With these capable resources at the ready, Calian can quickly assemble and deploy teams of professionals with the requisite skills to promptly assist customers implement their diverse operating and technology needs, whether it is the design and integration of a complex satellite ground system or the provision of specialized training, project management and operations services.

We believe that the timeliness and reliability of Calian's services often cannot be duplicated by Calian's larger mainstream competitors. Furthermore, efficient and flexible operating processes, combined with a strong financial condition allow Calian to profitably address lower margin business without compromising quality or performance, and this further distinguishes the Company from its competitors. Due to the Company's successful delivery and execution of projects, Calian experiences repeat business and a large number of contract renewals.

During 2005 Calian delivered its services through its wholly-owned operating subsidiaries Calian Ltd., Calian Inc., Calian Technology (US) Ltd. and Titan Consulting Group Ltd. (Titan). Calian amalgamated with Titan in October 2005. Calian currently operates in two reportable segments, defined by their primary type of service offerings:

Systems Engineering involves planning, designing and implementing solutions that meet a customer's specific business and technical needs, primarily in the satellite communications sector. The Systems Engineering Division, also known as SED, has its principal office in Saskatchewan.

Business and Technology Services involves both short and long-term placements of personnel to augment customers' workforces as well as the long-term management of projects, facilities and customer business processes. The Business and Technology Services Division has its principal Canadian offices in the Ottawa area and its US office in Virginia.

## Long-term Strategy

Calian's long-term strategy is to continue to focus on providing its current service offerings to industry and government in specialized niche areas outside the mainstream market, avoiding competition with larger competitors. Calian will concentrate on providing services that the Company believes its competitors either do not want to provide or cannot provide efficiently.

Calian's growth plans include building upon and expanding its current capabilities and addressing a wider range of customers with a broader range of services without compromising its commitment to quality and delivery.

Calian plans to continue augmenting its service offerings and capitalizing on its reputation for delivery, building on its satisfied base of blue-chip customers. In addition, the Company plans to continue to look for and acquire specialized companies that have also had success in profitably addressing niche markets and whose operating philosophies align with those of Calian. With growing revenues, an efficient back office, and the realization of economies of scale, the Company's objective is to enhance the returns to its shareholders and build an enterprise that excels in its selected markets.

## Management's Discussion and Analysis of Financial Condition and Results of Operations

For existing operations, the key is controlled profitable growth. The Company expects that growth will not only extract economies of scale and provide additional returns, but will also provide an environment for its people to grow and advance within the Company. Calian's strengths in delivering specialized services in niche markets have so far permitted the Company to excel in a difficult business environment where many mainstream competitors have faltered. With this backdrop of continuing to do what Calian does best, there are no plans to materially alter the business of the Company.

The Company plans to expand its service offerings and customer base through strategic acquisitions. Management has established the following criteria that are designed to identify candidates that best complement Calian's existing businesses:

- the candidate company must be highly specialized, providing a unique service to a specific and loyal customer base;
- the incumbent management team must be passionate and dedicated, and be interested in continuing to run the company as an autonomous division of Calian;
- the candidate must demonstrate consistent earning power;
- the candidate must yield solid returns and employ very little capital;
- the candidate must show audited results of a minimum of \$1.5 million EBITDA over the last year; and
- the owners must have a price in mind that can be expressed as a multiple of last year's EBITDA.

Careful review of candidates that meet these criteria will ensure that acquisitions are economically justified and can be expected to increase shareholder value.

### Fiscal 2005

Earnings before other income, interest and income taxes were \$13,572 in 2005 compared with \$15,870 in 2004 and net earnings were \$8,749 for the year compared with \$10,438 in the previous year. The Company completed the year with \$17,889 of cash and equivalents compared to \$30,997 at the end of 2004.

This year's results were well above management's initial expectations. The Company began the year relying on its recurring business and activity from several large contracts underway at the end of 2004, but knowing it could not count on the same level of business to be generated from the Manportable Surveillance and Target Acquisition Radar (MSTAR) product, having already completed this large contract that was won earlier in 2004. However, a new 10-year contract win by the Business and Technology Services Division coupled with excellent results from an acquisition made late in 2004, provided for a solid 2005 year.

### Systems Engineering Division

For the Systems Engineering Division (SED), work progressed on several large contracts such as the ground systems for Inmarsat's fourth generation satellites and the construction of the European Space Agency's second deep space antenna. Both of these projects are near completion with some work to be carried on into 2006.

As expected, revenues in 2005 decreased from the 2004 levels, which benefited from the large MSTAR contract. During 2004 SED successfully completed a large order for systems and assemblies used by Systems and Electronics Inc. (SEI) as part of their MSTAR system used in surveillance and security applications. SED has been manufacturing these components in small annual quantities as a sole source supplier to the same customer for more than 10 years. The contract awarded early in fiscal 2004 required SED to manufacture the assemblies in significantly increased volumes under a very compressed schedule. This contract combined with other previously awarded SEI contracts resulted in \$37 million in revenues for 2004 compared to nominal levels in 2005. By successfully delivering on this order, SED has not only maintained but has enhanced its preferred supplier status with this customer for future orders. In fact a small order was received late in 2005 as described below.



## Management's Discussion and Analysis of Financial Condition and Results of Operations

During 2005 SED signed several new contracts and renewals such as:

A contract renewal with the Canadian federal government for operations and maintenance services for the Canadian Space Agency's (CSA) Satellite Operations Directorate. The work, which supports CSA's Radarsat-1 and SciSat satellites, is a continuation of activities SED has performed for CSA since 1993. The contract was awarded for two years ending September 30, 2007 with three additional six-month options. The total value of the contract including option periods is \$16 million.

A purchase order valued at \$3.3 million from SEI for the delivery of various systems and components used by SEI to manufacture the MSTAR system used in surveillance and security applications. In addition to fulfilling existing orders, some units will be maintained as a base stock to effectively deliver against small orders on a timely basis or to be used for demonstration purposes.

SED also enjoys repeat business on a smaller scale from many of its long-term customers. For example, a number of follow-on orders were received from contract manufacturing customers such as KDS, Nortel and Powerwave for continued manufacturing of their products and test fixtures and a number of contracts were received from XM Satellite Radio and WorldSpace for upgrades and enhancements to previously provided systems to support their digital audio radio services.

In addition to its ongoing pursuit of opportunities in its traditional markets, the division continues to expand into complementary markets and look for new opportunities by adapting and marketing its current RF capabilities and expertise to terrestrial wireless applications. In addition, the division is looking at adjacent markets such as the broadcast industry to make use of its expertise in data compression and transmission that was derived from its work in digital satellite radio applications.

### Business and Technology Services Division

During 2004, the Business and Technology Services Division successfully secured over \$100 million of its existing revenue base by renewing many of its large long-term contracts with the federal government. In 2005, the division was able to further increase its annualized revenues by almost 50% as a result of winning a limitation of expenditure contract from the Department of National Defence (DND) for the provision and management of health service providers to supplement DND resources in Canada. The initial five-year contract is valued at more than \$400 million and also contains options for an additional five-year period, which if exercised could more than double the total value of the contract. Under the contract terms, the Business and Technology Services Division will manage and support healthcare service providers at 36 DND bases across Canada. Calian will supply a range of medical professionals including physicians, medical specialists, nurses, dentists, physiotherapists and psychologists.

In addition, the Business and Technology Services Division was successful in renewing all of its existing contracts that were up for renewal in 2005. These include:

A limitation of expenditure renewal contract by the Department of National Defence (DND) for the provision and delivery of technical training to supplement DND resources at the Canadian Forces School of Communications and Electronics located on CFB Kingston, Ontario. Under the terms of the contract, the division will provide training for approximately 1,000 students per year in various disciplines. This contract is for an initial one-year period and is valued at more than \$4 million. The contract also contains options for an additional three one-year periods, which if exercised, could see the total value of the contract exceed \$15 million. Calian has been providing these services to DND for over 4 years.

A contract with Natural Resources Canada (NRCan) for the provision of operations and maintenance services for the Prince Albert Station in Prince Albert, Saskatchewan. Under this contract, the Company provides management, technical, administrative and other staff to fully support the world-class remote sensing satellite data reception station owned by NRCan's Canada Centre for Remote Sensing. This contract has an estimated value of \$3.5 million over a three-year period. This represents the Company's eighth consecutive contract, having provided these services to NRCan since 1985.

## Management's Discussion and Analysis of Financial Condition and Results of Operations

At the same time, the division made progress in developing relationships with other departments of the Canadian federal government and various large private companies and obtained several new standing agreements and preferred vendor status arrangements, which position the division for future business with these new customers.

In September 2004, the Company acquired Titan Consulting Group Ltd., (Titan) which specializes in delivering skilled SAP, PeopleSoft, Oracle and Siebel professionals to industry and government. Titan uses the same economic business model as the Business and Technology Services Division with a complementary customer base and consultant database. The combined group is now able to provide a wider range of services than ever before to its public and private sector clients. Titan has an impressive database of IT professionals that is an ideal match for the needs emerging within the Company's existing marketplace. The Titan business was very productive in 2005 meeting all expectations for its first year of operation as part of the Calian group. In October 2005, Titan amalgamated with Calian Ltd., another wholly-owned subsidiary of the Company.

### Backlog

The Company's backlog at September 30, 2005 was \$1,098 million with terms extending to fiscal 2014. This compares to \$257 million reported at the end of September 2004. Contracted Backlog represents revenues remaining to be earned on signed contracts, whereas Option Renewals represent customers' options to further extend existing contracts under similar terms and conditions. Most contracts provide the customer with the ability to adjust the timing and level of effort throughout the contract life and as such the following represents management's best estimate of the ultimate backlog and related consumption profile. As described above, during the year the Company won a number of contract renewals in competitive bidding situations thereby maintaining the Company's excellent track record of securing repeat business.

<u>(dollars in millions)</u>	<u>TOTAL</u>	<u>2006</u>	<u>2007</u>	<u>Beyond</u>
Contracted Backlog	\$ 494	\$ 135	\$ 94	\$ 265
Option Renewals	604	3	23	578
<b>TOTAL</b>	<b>\$ 1,098</b>	<b>\$ 138</b>	<b>\$ 117</b>	<b>\$ 843</b>
Business and Technology Services	\$ 1,062	\$ 114	\$ 112	\$ 836
Systems Engineering	36	24	5	7
<b>TOTAL</b>	<b>\$ 1,098</b>	<b>\$ 138</b>	<b>\$ 117</b>	<b>\$ 843</b>

### Selected Annual Information

(dollars in millions, except per share data)

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Revenues	\$ 177.8	\$ 169.7	\$ 141.0
Earnings from continuing operations	\$ 8.7	\$ 11.2	\$ 5.3
Net earnings	\$ 8.7	\$ 10.4	\$ 4.8
Earnings per share from continuing operations	\$ 1.04	\$ 1.33	\$ 0.66
Net earnings per share	\$ 1.04	\$ 1.24	\$ 0.60
Total assets	\$ 74.8	\$ 68.5	\$ 64.1
Dividend per share	\$ 0.32	\$ 0.22	\$ 0.17

# Management's Discussion and Analysis of Financial Condition and Results of Operations

## Results of Operations

### Revenues

Total revenues for the year ended September 30, 2005 were \$177,777, a 5% increase over 2004 revenues of \$169,707. This increase is attributable to the inclusion of six months of revenues on the Health Services Support contract and twelve months of revenues relating to the Titan acquisition, offset by a decrease in MSTAR related revenues.

The general business environment in 2005 continued to be very competitive. The Company began the year with \$97 million of its backlog to be earned in 2005. This base of work combined with the win of several large contracts during 2005 resulted in a solid revenue stream for the year.

Calian's Systems Engineering Division accounted for revenues of \$50,303 or 28% of total revenues compared to \$83,942 or 49% of revenues a year earlier, representing a 40% decrease over the prior year. Although the revenue mix varies significantly from year to year, the decrease during 2005 was the result of lower MSTAR revenues as activity on contracts performed for SEI in 2004 generated in excess of \$37 million compared to only nominal follow-on activity in 2005.

The Business and Technology Services Division accounted for the balance of \$127,474 or 72% of revenues compared to \$85,765 or 51% a year earlier. This increase of almost 50% over the prior year is attributed to a modest improvement in demand for its traditional services, the inclusion of twelve months of revenues from Titan and six months of revenues from the Health Services Support contract won earlier in 2005.

The Company derives a significant portion of its revenues from the Government of Canada. During the year, 43% of revenues were related to contracts with various departments and agencies of the Government of Canada, compared to 28% in 2004. Both of the Company's divisions conduct business with this major customer. The Company also derived 16% of its revenues from a call center services contract with a major telecommunications customer compared with 17% in 2004. Revenue from SEI accounted for only 1% of the Company's total revenues in 2005 compared to 22% in 2004. Future levels of activity with this customer are ultimately dependent on the timing and magnitude of demand for their product.

Management expects the marketplace in 2006 to be similar to the one experienced in 2005. For 2006, the Systems Engineering Division will be completing work on several large contracts awarded in previous years. The division will continue to operate in an environment characterized by stiff competition for limited opportunities. Although the environment for the Business and Technology Services Division is showing signs of modest recovery, we do not expect a significant increase in additional government spending in 2006. However, the Health Services Support contract will represent a full year of activity, which will have a significant impact on the overall growth for this division next year. The Company begins 2006 with \$138 million of backlog to be earned over the next 12 months. With its stable source of recurring work coupled with the inclusion of a full year of revenues from the Health Services Support contract, management expects continued revenue growth in 2006 over the level of business experienced in 2005.

### Cost of revenues and Gross profit

The Company's cost of revenues includes all direct costs incurred in the provision of its products and services. These costs include all expenses associated with direct full-time staff, contract staff and subcontractors. They also include other direct costs including the landed cost of hardware and software sold as components of a solution, travel and living expenses necessary in the delivery of the services, and provision for warranty where applicable.

For the year ended September 30, 2005, the Company reported a gross profit of \$32,569 or 18.3% of revenues, which compares to \$34,039 or 20.1% a year earlier. The overall gross margin for the Company decreased as a result of the change in revenue mix, which was impacted by the addition of the Health Services Support contract, the Titan acquisition and a reduction in MSTAR activities.



## Management's Discussion and Analysis of Financial Condition and Results of Operations

Gross margin was 24.8% in the Systems Engineering Division during 2005 compared to 24.9% the previous year. A high labour component in revenues, which generally attracts higher margins, along with exceptional labour utilization rates and excellent project control once again provided for excellent margins.

In the Business and Technology Services Division, the gross margin was 15.8% in 2005 compared with 15.3% in 2004. This improvement in margin was a result of adding twelve months of Titan business, which attracts margin above this division's traditional average offset partially by the addition of the Health Services Support contract, which attracts margins below the traditional average.

Because of the significant difference in gross margins between each of the two divisions, the overall gross margin of the Company is dependent on the relative level of revenue generated from each division. The prolonged downturn in some of the Company's markets and the uncertainty regarding federal government spending will continue to produce a very competitive marketplace for new business in the near future. Likewise, the strengthening of the Canadian dollar coupled with the expectation that health services will become a larger part of revenues in the future, will result in a further decrease in margins.

### Selling, administration and other expenses

The Company separately identifies five principal expense categories in its consolidated financial statements—selling and marketing, general and administration, facilities, amortization of capital assets and amortization of intangibles. These are referred to in the Management Discussion and Analysis as selling, administration and other expenses.

Selling, administration and other expenses totaled \$19,981 or 11.2% of revenues in 2005. This compares to \$18,169 or 10.7% of revenues in 2004. The inclusion of six months of the Health Services Support contract and twelve months of Titan's operating expenses represents the majority of the increase in absolute dollars. Operating expenses as a percentage of revenue increased primarily as a result of a change in revenue mix; revenues generated from MSTAR in 2004 which attracted only marginal operating expenses, was replaced in 2005 with revenues from the Health Services Support contract and the Titan acquisition which attracted additional dedicated operating expenses. Management believes that, for the foreseeable future, operating costs will remain in line with future growth.

#### Selling and marketing

Selling and marketing expenses reflect all direct selling costs including salaries, commissions, travel and living expenses, the costs of proposal development and submission, and the costs of account management activities conducted by sales personnel. The costs of the recruiting department are also classified as selling and marketing expenses as this sales support role is key in obtaining resources for customers.

Selling and marketing expenses totaled \$5,180 compared to 2004 when they were \$4,508. The increase is mostly attributable to the inclusion of a full year of Titan costs. Selling and marketing expenses as a percentage of revenues were 2.9% in 2005 compared to 2.7% in 2004. Selling and marketing expenses are expected to increase slightly over the 2005 level as the Company concentrates on broadening its customer base and expanding its service offerings to new markets.

#### General and administration

The Company's general and administration expenses include all overhead-related expenses except facilities. General and administration expenses were \$10,568 in 2005, compared with \$9,664 the previous year. The inclusion of six months of the Health Services Support contract and twelve months of Titan's operating expenses represents the majority of the increase in absolute dollars. As a result of the Company's continuous cost control activities, all other expenditures remained stable. General and administration expenses as a percentage of revenues of 5.9% was similar to the 5.7% reported in 2004. For 2006, general and administration costs will include a full year of costs related to the Health Services Support contract. In addition, non-operational factors, such as the escalating cost of compliance with new requirements for public companies, will serve

## Management's Discussion and Analysis of Financial Condition and Results of Operations

to increase general and administration costs in the near term. Management believes that the Company has the capacity for an increased level of business without proportionately affecting general and administration costs.

### Facilities

Facility expenses, which include costs associated with office space, have been relatively stable over the past two years. Facility costs during 2005 were \$2,698 compared to \$2,691 in 2004. Commensurate with the exit of the Company's e-business division in May 2001, Calian consolidated its Ottawa-based personnel into one building while subletting another building that it had begun to lease in June 2000. As explained further in the Discontinued Operation section of this discussion, the Company's facility costs exclude lease and operating costs related to the excess space. Management believes that the existing facilities will be sufficient for the foreseeable future.

### Amortization of capital assets

Amortization of capital assets totaled \$1,139, compared with \$1,236 in the previous year. The amortization level in the future is not expected to vary significantly from current levels.

### Amortization of intangibles

During 2004, the Company acquired the following intangibles as a result of its acquisition of Titan: customer relationships, non-competition agreements entered into with the prior owners of Titan, order backlog and consultants database. These intangibles are amortized over their expected useful life, not exceeding five years. During 2005, the Company amortized \$396, representing a full year of amortization compared to \$70 or one month of amortization in 2004. The amortization in 2006 is expected to be \$312.

### Gain on sale of investment

On September 30, 2004, the Company disposed of its 18% interest in Square Peg Communications Inc. for an amount of \$825, net of costs. The Company received \$250 on closing and a note receivable for \$600 as indicated in Note 3 of the Company's financial statements. On September 30, 2005, the Company received the first payment of \$200 on the note receivable with the balance to be received equally on September 30, 2006 and 2007. After discounting the non-interest bearing note to its fair value, income of \$741 was recorded in 2004.

### Prior year investment tax credits

As indicated in Note 4 of the Company's consolidated financial statements, during the year the Company was allowed additional investment tax credits (ITC) of \$984 net of costs with respect to 2003. The ITC recovered were applied against income tax otherwise payable. The Company also intends to re-file its R&D claim with respect to 2004. However, the level of qualified R&D activity was significantly lower than 2003 and therefore, the Company is expecting only minimal recoveries for 2004. The investment tax credits for the 2004 R&D claim will be recorded once the Company has been reassessed by the Canada Revenue Agency.

### Interest income, net

Interest income is earned on the Company's cash and cash equivalents and is shown net of the Company's interest expense. Imputed interest on the note receivable aided the increase in interest income to \$545 during the year, compared to \$467 recorded in 2004.

### Earnings from continuing operations before income tax expense

The above factors have resulted in a decrease of 17% in earnings before taxes and amortization to \$14,117 for the year, compared to \$17,078 in 2004.

# Management's Discussion and Analysis of Financial Condition and Results of Operations

## Income tax expense

Calian reports its results on a fully taxed basis. The provision for income taxes during 2005 was \$5,368 or 38% of earnings before income taxes compared to \$5,884 or 35% of earnings before income taxes in 2004. The income tax expense for 2004 was positively impacted by an increase in the effective income tax rate applied to the valuation of future income tax assets and by the non-taxable nature of the gain on investment. The income tax expense as a percentage of earnings before income taxes for 2006 is expected to be similar to 2005.

## Earnings from continuing operations

The Company reported earnings from continuing operations of \$8,749 or \$1.04 per share basic and \$1.03 per share diluted for 2005 compared to \$11,194 or \$1.33 per share basic and \$1.31 per share diluted for 2004.

## Discontinued operation

As indicated in Note 17 of the Company's consolidated financial statements, during 2004, the Company revised its estimate of the provision for future costs relating to the Company's discontinued e-business division and recorded an additional charge of \$1,200 (\$756 after tax). During 2005, the Company renegotiated its lease with the sub-tenant for a significant portion of its excess space at current market rates. As a result, the Company will be required to assume a portion of the costs associated with this facility. Management believes that the current provision of \$2,100 will be sufficient to cover the Company's share of the costs.

## Net earnings

The Company reported net earnings of \$8,749 or \$1.04 per share basic and \$1.03 per share diluted for 2005 compared to \$10,438 or \$1.24 per share basic and \$1.22 per share diluted in 2004.

## Selected Quarterly Financial Data

(dollars in millions, except per share data)

	<u>Q4/05</u>	<u>Q3/05</u>	<u>Q2/05</u>	<u>Q1/05</u>	<u>Q4/04</u>	<u>Q3/04</u>	<u>Q2/04</u>	<u>Q1/04</u>
Revenues	\$ 50.4	\$ 50.6	\$ 38.7	\$ 38.0	\$ 37.7	\$ 45.4	\$ 49.2	\$ 37.3
Earnings from continuing operations	\$ 3.1	\$ 2.4	\$ 1.8	\$ 1.5	\$ 2.9	\$ 3.4	\$ 3.2	\$ 1.7
Net earnings	\$ 3.1	\$ 2.4	\$ 1.8	\$ 1.5	\$ 2.1	\$ 3.4	\$ 3.2	\$ 1.7
Earnings from continuing operations per share								
Basic	\$ 0.37	\$ 0.28	\$ 0.21	\$ 0.18	\$ 0.34	\$ 0.41	\$ 0.38	\$ 0.20
Diluted	\$ 0.36	\$ 0.28	\$ 0.21	\$ 0.18	\$ 0.34	\$ 0.40	\$ 0.37	\$ 0.20
Net earnings per share								
Basic	\$ 0.37	\$ 0.28	\$ 0.21	\$ 0.18	\$ 0.25	\$ 0.41	\$ 0.38	\$ 0.20
Diluted	\$ 0.36	\$ 0.28	\$ 0.21	\$ 0.18	\$ 0.25	\$ 0.40	\$ 0.37	\$ 0.20

The second and third quarter 2004 revenues and profitability were positively impacted by the large MSTAR contract performed during these two quarters with some carry-over into the fourth quarter of 2004. The fourth quarter 2004 was also impacted by a gain on sale of investment and negatively impacted by an additional loss from discontinued operation. The third and fourth quarter 2005 revenues and profitability were positively impacted by activity related to the win in 2005 of the Health Services Support contract. In addition, the fourth quarter of 2005 was positively impacted by a one-time recovery of prior years investment tax credits.

The Company's operations are subject to some quarterly seasonality due to the timing of vacation periods and statutory holidays. Typically the Company's first and last quarters will be negatively impacted as a result of the Christmas season and



# Management's Discussion and Analysis of Financial Condition and Results of Operations

summer vacation period. During these periods, the Company can only invoice for work performed and is also required to pay employees for statutory holidays. This may result in reduced levels of revenues and in a decline in gross margins. However, due to the impact of the realized sales mix of its various projects, this quarterly seasonality may not be apparent in the overall results of the Company.

## Liquidity and Capital Resources

Calian's net cash position was \$17,889 at September 30, 2005, compared to \$30,997 at September 30, 2004.

### Operating activities

Cash flows used in operating activities during fiscal 2005 were \$10,616 as compared with a cash inflow of \$15,221 in 2004. Cash flows from earnings decreased by \$4,002 and as expected, working capital requirements increased by \$21,835 over 2004 mainly due to requirements associated with the Health Services Support contract, significant milestone billings near year-end and a decrease in unearned contract revenues as the Company performed the work associated with upfront customer advances. The market for the Systems Engineering Division is characterized by long-term contracts with billings tied to milestones achieved, which often results in significant working capital requirements. Conversely, given the nature of this business, it is sometimes possible to negotiate advance payments on contracts. Such advance payments give rise to unearned revenue that will be realized as revenue over the course of the contract. As at September 30, 2005, the Company's total unearned revenue amounted to \$7,312. This compares to \$14,094 one year earlier.

### Acquisition

As indicated in Note 16 of the Company's consolidated financial statements, on September 7, 2004 the Company acquired all of the outstanding shares of Titan. The total value of the acquisition was \$7,897 and will be satisfied with 90% cash and the balance through the issuance of Calian common shares. On closing, the Company paid \$4,302 in cash. The final cash payment will be made on or before November 30, 2005 and the Calian common shares will be issued on February 28, 2006 at the then-prevailing market prices.

### Capital assets

Calian acquired \$817 in capital assets during 2005, compared to \$928 during 2004. Assets purchased in 2005 are in line with normal requirements for asset replacement. During 2006, capital expenditures are expected to be in line with past years. At September 30, 2005 there were no significant commitments to expend capital.

### Dividend

As a result of continuing earnings and a strong cash position, the Company introduced a dividend in 2003. During 2005 the Company paid \$2,682 in dividends or \$0.32 cents per share and during 2004 paid a dividend of \$1,848 or \$0.22 cents per share. The Company intends to continue with its current dividend policy for the foreseeable future and expects to pay quarterly dividends of \$0.08 per share to shareholders.

### Shares

During 2005, the Company issued 193,880 shares for cash as a result of options being exercised during the year at an average price of \$3.02. There are 24,245 options outstanding at an average price of \$2.73 expiring at different dates through December 2006.

During 2004, the Company acquired 214,900 common shares under normal course issuer bids at an average price of \$11.50 and 290,559 shares were issued for cash at an average price of \$3.73 per share.

At September 30, 2005 there were 8,503,313 common shares outstanding and as of the date of this Management Discussion and Analysis, there were 8,505,233 common shares outstanding.

# Management's Discussion and Analysis of Financial Condition and Results of Operations

## Capital resources

At September 30, 2005 the Company had a short-term credit facility of \$10,000 with a Canadian chartered bank that bears interest at prime and is secured by assets of the Company. An outstanding letter of credit in the amount of \$650 was applied against the available line.

Over the course of the next several quarters, management expects cash balances will be negatively affected by a decrease in unearned contract revenue and the final payment for the Titan acquisition. However, this cash outflow will be partially offset by positive cash flows from earnings. Management believes that Calian has sufficient cash resources to continue to finance its working capital requirements and pay a quarterly dividend.

## Contractual obligations

	<u>Total</u>	<u>Less than 1 year</u>	<u>1-3 years</u>	<u>4-5 years</u>	<u>After 5 years</u>
Capital lease obligations	\$ 75	\$ 53	\$ 22	\$ -	-
Operating leases	13,850	3,226	6,187	4,437	-
Purchase obligations	2,757	2,757	-	-	-
Other long-term obligations	-	-	-	-	-
<b>Total contractual obligations</b>	<b>\$ 16,682</b>	<b>\$ 6,036</b>	<b>\$ 6,209</b>	<b>\$ 4,437</b>	<b>-</b>

Purchase obligations include agreements to purchase goods and services that are enforceable and legally binding. They do not include agreements that are cancelable without penalty.

## Off-Balance Sheet Arrangements

### Financial instruments

The Company is exposed to foreign currency fluctuations on its cash balance, accounts receivable, accounts payable and future cash flows related to contracts denominated in a foreign currency. Future cash flows will be realized over the life of the contracts. The Company uses financial instruments, principally in the form of forward exchange contracts, in its management of foreign currency exposures. These contracts primarily require the Company to purchase or sell certain foreign currencies with or for Canadian dollars at contractual rates. At September 30, 2005, the Company had forward sell contracts valued at \$18,424 equivalent Canadian dollars and forward buy contracts valued at \$7,430 equivalent Canadian dollars, which represents 100% of the Company's foreign currency exposure. All foreign denominated transactions are recorded at the associated hedged value at the time it is earned.

### Operating leases

The Company leases various office equipment through operating leases.

### Related party transactions

There were no transactions with related parties during 2005 and 2004.

## Critical Accounting Estimates

The preparation of financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions that affect the Company's financial condition and results of operations. On an on-going basis, management reviews its estimates and assumptions, including those related to revenue recognition on fixed-price projects, contingencies, estimated amounts for income taxes, allowance for doubtful accounts, valuation of goodwill and valuation of intangibles. Management bases its estimates and assumptions on historical experience and on various other factors that it believes to be reasonable under the circumstances; actual results could differ from those estimates.

# Management's Discussion and Analysis of Financial Condition and Results of Operations

## Revenue recognition

The Business and Technology Services Division's revenue is derived primarily from per-diem contracts where revenue is recognized when the services are provided. However, a significant portion of the Systems Engineering Division's revenue is derived from fixed-price contracts. Revenue from these fixed-price projects is recognized using the percentage of completion method using management's best estimate of the costs and related risks associated with completing the projects. The greatest risk on fixed-price contracts is the possibility of cost overruns. Management's approach to revenue recognition is tightly linked to detailed project management processes and controls. The information provided by the project management system combined with a knowledgeable assessment of technical complexities and risks are used in estimating the percentage completion.

## Contingencies

From time to time the Company is involved in claims in the normal course of business. Management assesses such claims and where considered likely to result in a material exposure and, where the amount of the claim is quantifiable, provisions for loss are made based on management's assessment of the likely outcome. The Company does not provide for claims that are considered unlikely to result in a significant loss, claims for which the outcome is not determinable or claims where the amount of the loss cannot be reasonably estimated. Any settlements or awards under such claims are provided for when reasonably determinable.

## Income taxes

The Company records future income tax assets and liabilities related to deductible temporary differences. The Company assesses the value of these assets and liabilities based on their realizability given management assessments of future taxable income.

## Allowance for doubtful accounts

The Company has extensive commercial history upon which to base its provision for doubtful accounts. Due to the nature of the industry in which the Company operates, the Company does not create a general provision for bad debts but rather determines bad debts on a specific account basis. Due to the blue-chip list of customers, the Company's allowance for doubtful accounts at September 30, 2005 and 2004 was minimal.

## Goodwill

Goodwill is tested for impairment annually or more frequently when events occur or circumstances arise that could indicate a reduction in its fair value. Testing for impairment is accomplished by determining whether the fair value of the reporting unit exceeds the net carrying value as of the assessment date. If the fair value is greater than the carrying amount, no impairment is necessary. In the event the carrying amount exceeds the fair value, an impairment charge may be required. The determination of fair value is based on management's estimate of future results of operations of the reporting unit using reasonable assumptions relating to growth levels, expected costs, expected business environment and the Company's weighted average cost of capital.

## Intangibles

Intangible assets are tested for recoverability whenever events or circumstances indicate that the carrying amounts may not be recoverable. Testing for impairment is accomplished by determining whether the fair value of the intangibles exceeds the net carrying value as of the assessment date. In order to allocate the cost of intangible assets over their useful lives, estimates of the duration of their useful lives must be carried out.



# Management's Discussion and Analysis of Financial Condition and Results of Operations

## Adoption of New Accounting Policies During The Year

For the year ended September 30, 2005, there were no new accounting policies adopted by the Company during the year.

## Impact of Accounting Pronouncements Not Yet Implemented

For the year beginning October 1, 2005, there are no new accounting recommendations that the Company is required to adopt.

## Management's Conclusion on the Effectiveness of Disclosure Controls

The Chief Executive Officer and the Chief Financial Officer of the Company, after evaluating the effectiveness of the Company's disclosure controls and procedures as of September 30, 2005, have concluded that the Company's disclosure controls and procedures were adequate and effective to ensure that material information relating to the Company and its consolidated subsidiaries would have been known to them.

## Risk Factors

The Company is subject to a number of risks and uncertainties that could significantly affect the Company's financial condition and future results of operations. The Company has a comprehensive planning process where risks are identified and plans initiated to minimize risks wherever possible. The Systems Engineering and Business and Technology Services divisions face some or all of the following risks and uncertainties:

### Competition for contracts within key markets

The markets for the Company's services are intensely competitive, rapidly evolving and subject to technological changes. The principal competitive factors in the Company's markets are quality, performance, price, timeliness, customer support and reputation. Calian has a disciplined approach to management of all aspects of its business. The Company is a proponent of quality management and its Systems Engineering Division is registered under ISO 9001-2000 standards while its Business and Technology Services Division is accredited at Level 3 of the Progressive Excellence Program by the National Quality Institute. This approach to management was developed to help the Company ensure that its employees deliver services consistently according to the Company's high standards and based on strong values underlying its client-focused culture.

### The availability of qualified professionals

Competition from other firms has a two-fold impact on the Company. Calian must not only vie for qualified employees for its own operations but must have ready access to a large pool of qualified professionals to satisfy contractual arrangements with customers. Calian mitigates these factors through a number of means. Calian's performance driven remuneration policies and its favourable working environment are conducive to attracting ambitious, qualified professionals. As a supplier of professional employees through outsourcing contracts, Calian regularly establishes relationships with a significant number of professionals in key markets.

### Performance on fixed-price contracts

A large percentage of the Systems Engineering Division's contracts are based on a fixed price for the provision of a specified service against an agreed delivery schedule. These fixed-price contracts at times involve the completion of large-scale system engineering projects. There is a risk in all fixed-price contracts that the Company will be unable to deliver the system within the time specified and at the expected cost. The Company employs sophisticated design and testing processes and practices, which include a range of stringent factory and on-site acceptance tests with criteria and requirements jointly developed with the customer. However, non-performance could result in a customer being in a position to terminate the

## Management's Discussion and Analysis of Financial Condition and Results of Operations

contract for default, or to demand repayments or penalties. Program management methodologies have been implemented to adequately manage each project and any customer changes, and to identify and mitigate potential technical risks and related cost overruns. In addition, Calian employs procedures to ensure accurate estimating of costs and performs regular detailed reviews of progress on each project.

### Non-performance of a key supplier or contractor

The Company's business is often dependent on performance by third parties and subcontractors for completion of contracts for which Calian is the prime contractor. Subcontractors for large systems are selected in concurrence with the customer's requirements, and if not directed by the customer, are selected through a competitive bid or negotiated process. Most major development subcontracts are established as fixed-price contracts. The Company believes that these subcontractors have an economic incentive to perform such subcontracts for the Company. However, no company can protect itself against all material breaches, particularly those related to financial insolvency of the subcontractors or to cost overruns by subcontractors. Risks include a significant price increase in those few subcontracts that are not fixed-price, delay in performance, a failure of any major subcontractor to perform or the inability of the Company to obtain replacement subcontractors at a reasonable price. The performance of key subcontracts is closely monitored as part of the Company's project management process to promptly identify potential issues and develop remedial actions.

### Rapidly changing technologies and customer demands

The markets in which Calian operates are characterized by changing technology and evolving industry standards. Calian keeps pace with developments in the industries it serves and actively monitors the evolution of these markets, thus ensuring that it can meet the evolving needs of its clients. The Company achieves this by continually recruiting professionals in high demand positions and providing regular training to ensure employee skills remain current. The Company's ability to anticipate changes in technology, technical standards and service offerings will be a significant factor in the Company's ability to compete or expand into new markets.

### Government contracts

During 2005, approximately 43% of the Company's total revenues were derived from contracts with the Canadian government and its agencies. The government may change its policies, priorities or funding levels through agency or program budget reductions or impose budgetary constraints. Furthermore, contracts with governments, including the Canadian government, may be terminated or suspended by the government at any time, with or without cause. Although in the past the Company has not experienced any significant cancellations of previously awarded contracts by the Canadian government, there can be no assurance that any contract with the government will not be terminated or suspended in the future.

### Contract with major customers

During 2005, approximately 16% of the Company's total revenues were derived from a call center services contract with a major telecommunications customer. This contract is renewed annually and can be cancelled by the customer with four months notice. The Company monitors the quality of its services to this customer to ensure long-term viability of the contract.

### Credit risk concentration with respect to trade receivables

As the Company grows, it monitors the concentration of its business in its various segments and with particular customers. In management's opinion, the fact that the Company operates in two segments that provide some diversification of its customer base mitigates the potential impact on earnings and cash flow of problems related to an individual sector or customer. The Company does extensive in-bound call center business with a large private sector customer. Processes have been established to mitigate the Company's credit exposure with this customer.

## Management's Discussion and Analysis of Financial Condition and Results of Operations

Insufficient or inappropriate mix of work for fixed labour resources

Virtually all employees of the Systems Engineering Division are full time staff and represent a broad spectrum of unique skill sets. Accordingly, the division strives to secure sufficient labour sales that adequately match the skill sets. The division's business development practices are designed to dynamically adjust pursuits of contracts to address the sufficiency and mix of available resources.

Operational risk

Operational risk is managed through the establishment of effective infrastructure and controls. Key elements of the infrastructure are qualified, well-trained personnel, clear authorization levels and reliable technology. Controls established by documented policies and procedures include the regular examination of internal controls by our auditors, segregation of duties, and financial management and reporting. In addition, the Company maintains insurance coverage and contingency plans for systems failures or catastrophic events.

Foreign currency risk

The Company operates internationally with approximately 25% of its business derived from non-Canadian sources. A substantial portion of this international business is denominated in major foreign currencies and therefore the Company's results from operations are affected by exchange rate fluctuations of these currencies relative to the Canadian dollar. The Company uses financial instruments, principally in the form of forward exchange contracts, in its management of foreign currency exposures. At September 30, 2005 the Company had various forward exchange contracts, which are explained in Note 14 to the Company's consolidated financial statements for the year ended September 30, 2005. The strengthening of the Canadian dollar relative to other foreign currencies may negatively impact the Company's competitiveness and increase pressure on margins for new work.

Legal proceedings

As indicated in Note 10 of the Company's consolidated financial statements, the Company was served with a civil lawsuit by way of a Statement of Claim, claiming \$100 million in damages from the Company and an employee of the Company related to a contract won by the Company. The Company intends to vigorously defend the claim, including the basis of the claim and the amounts being sought. The plaintiff also filed a complaint with the Canadian International Trade Tribunal (CITT) related to this contract award. In June 2005, the CITT issued its determination, confirming Calian as the successful bidder. On July 15, 2005, the plaintiff applied to the Federal Court of Appeal seeking to set aside the decision of the CITT by seeking a judicial review of that decision. The likely outcomes of the judicial review of the CITT decision and the civil lawsuit cannot be determined at this time.

Discontinued operation

As indicated in Note 17 of the Company's consolidated financial statements, during 2004, the Company revised its estimate of the provision for future costs relating to the Company's discontinued e-business division and recorded an additional charge of \$1,200 (\$756 after tax). During 2005, the Company renegotiated a new lease with a sub-tenant of the Company at its premises in Kanata, Ontario for a significant portion of the Company's excess space at current market rates. As a result, the Company will be required to assume a portion of the costs associated with this facility. Management believes that the current provision of \$2,100 will be sufficient to cover the Company's share of such costs.

Sufficiency of insurance

The Company carries various forms of insurance to protect itself from a variety of insurable risks. However, such coverage may not be sufficient in extreme circumstances and accordingly there exists a risk to the Company. While the company cannot reasonably insure itself for all events, it regularly reviews the availability, scope and amounts of coverage with its pro-

# Management's Discussion and Analysis of Financial Condition and Results of Operations

professional advisors and implements an approach balancing both cost and risk.

## Medical malpractice

As a result of the Company winning the Health Services Support contract from DND, the Company will be subject to additional risks associated with the medical profession. In order to mitigate such risks to the degree possible, the Company has obtained medical malpractice and professional liability insurance in accordance with the terms of this contract. In addition, it is a condition of employment for doctors, dentists and other medical professionals to maintain appropriate credentials, be in good standing with their medical associations and obtain medical malpractice insurance from their respective association.

## Political and trade barriers

Revenues on certain projects are derived from customers in foreign jurisdictions and are subject to trade and political barriers relating to the protection of national interests. These barriers could have an adverse effect on our ability to win repeat business and attract new customers.

## Consolidation of customer base

The satellite industry has experienced both restructuring and consolidation. As the newly formed entities focus on optimizing cash flows and gaining economies of scale, opportunities for systems integrators will be diminished thereby creating a very competitive environment with commensurate pressure on margins.

## Long-term Outlook

Management believes the Company is well positioned for sustained growth in the long term. The Company operates in markets that will continue to require the services that the Company delivers. To further assure itself of a stable source of revenues, the Company will focus on increasing the percentage of its revenues derived from recurring business. Its acquisition strategy, focused on adding complementary businesses to the Company's mix, will also be a potential source of growth.

The Systems Engineering Division (SED) has been working within a depressed satellite sector for the last few years with no significant rebound expected in the near-term. In addition, several large satellite operators have recently been purchased using highly leveraged financial structures and industry consolidation continues. We believe this may impact capital spending, which in turn may reduce new opportunities in the near term. However, management believes that new systems adopting the latest technologies will be required in the medium term to maintain and improve service offerings. Although management is confident that systems such as MSTAR will continue to be in demand in the security and surveillance market it cannot predict the timing and extent of future orders. The continued strengthening of the Canadian dollar will impact SED's competitiveness when bidding against foreign competition on projects denominated in US dollars and EUROS.

The Business and Technology Services Division's (BTS) services are adaptable to many different markets. Currently, its strength lies in providing program management and delivery services to the Department of National Defence. Management believes that this department and many others within the federal government will continue to require more support services from private enterprises to supplement their current workforce. Although the division has experienced delays during the last few years, management believes that the types of service the division offers will continue to be attractive to government agencies going forward. The acquisition of Titan coupled with existing standing agreements for SAP and Peoplesoft resources, positions BTS to take advantage of the expected growth in government ERP requirements.

Due to significant signings in the past year in the BTS division coupled with a few large contracts nearing completion in the SED division, our backlog is heavily weighted towards BTS. The market environment for SED is expected to remain difficult in the short term whereas BTS enjoys a more favourable outlook. Accordingly, the Company expects to experience a shift in both revenue and profitability proportions towards the Business and Technology Services division. As the BTS division traditionally earns lower margins, the changing mix will have a further dampening effect on operating profit percentages.



## Management's Discussion and Analysis of Financial Condition and Results of Operations

As indicated in Note 10 of the Company's consolidated financial statements, the Company was served with a civil lawsuit by way of a Statement of Claim, claiming \$100 million in damages from the Company and an employee of the Company related to a contract won by the Company. The Company intends to vigorously defend the claim, including the basis of the claim and the amounts being sought. The plaintiff also filed a complaint with the Canadian International Trade Tribunal (CITT) related to this contract award. In June 2005, the CITT issued its determination, confirming Calian as the successful bidder. On July 15, 2005, the plaintiff applied to the Federal Court of Appeal seeking to set aside the decision of the CITT by seeking a judicial review of that decision. The likely outcomes of the judicial review of the CITT decision and the civil lawsuit cannot be determined at this time.

### Disclaimer

This annual report contains certain forward-looking statements that involve a number of risks and uncertainties, including statements regarding the outlook for the Company's business and results of operations. By nature, these risks and uncertainties could cause actual results to differ materially from those indicated. Such factors include, without limitation, the various factors set forth in the Management Discussion and Analysis section of this report and as discussed in public disclosure documents filed with Canadian regulatory authorities. Please also refer to the section titled "risk factors" in the preceding discussion. The Company disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

### Additional Information

Additional information about the Company such as the Company's 2005 Annual Information Form and Management Circular can be found on SEDAR at [www.SEDAR.com](http://www.SEDAR.com)

Dated: November 30, 2005

## Management's Statement of Responsibility

The accompanying consolidated financial statements of Calian Technologies Ltd. and its subsidiaries and all information in the annual report are the responsibility of management and have been approved by the Board of Directors.

The financial statements include some amounts that are based on management's best estimates that have been made using careful judgment.

The financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada. Financial and operating data elsewhere in the annual report are consistent with the information contained in the financial statements.

In fulfilling its responsibilities, management of Calian and its subsidiaries has developed and continues to maintain systems of internal accounting controls including written policies and procedures and segregation of duties and responsibilities.

Although no cost-effective system of internal controls will prevent or detect all errors and irregularities, these systems are designed to provide reasonable assurance that assets are safeguarded from loss or unauthorized use, transactions are properly recorded and the financial records are reliable for preparing the financial statements.

The Board of Directors carries out its responsibility for the financial statements in this report through its Audit Committee. The Audit Committee meets periodically with management and with the external auditors to discuss the results of audit examinations with respect to the adequacy of internal controls and to review and discuss the financial statements and financial reporting matters.

The financial statements have been audited by Deloitte & Touche LLP, Chartered Accountants, who have full access to the Audit Committee with and without the presence of management.



Ray Basler  
*President and CEO*  
Kanata, Ontario  
October 27, 2005



Jacqueline Gauthier  
*Chief Financial Officer*

## Auditors' Report

To the Shareholders of Calian Technologies Ltd.

We have audited the consolidated balance sheets of Calian Technologies Ltd. as at September 30, 2005 and 2004 and the consolidated statements of earnings and retained earnings and of cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at September 30, 2005 and 2004 and the results of its operations and the changes in its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

*Deloitte & Touche LLP*

Chartered Accountants  
Ottawa, Ontario  
October 27, 2005

Calian Technologies Ltd.  
 Consolidated Statements of Earnings and Retained Earnings  
 Years Ended September 30, 2005 and 2004  
 (dollars in thousands, except per share data)

	2005	2004
Revenues	\$ 177,777	\$ 169,707
Cost of revenues	145,208	135,668
Gross profit	32,569	34,039
Selling and marketing	5,180	4,508
General and administration	10,568	9,664
Facilities	2,698	2,691
Amortization of capital assets	1,139	1,236
Amortization of intangibles	396	70
Prior year investment tax credits (Note 4)	(984)	-
Earnings before other income, interest and income tax expense	13,572	15,870
Gain on sale of investment (Note 3)	-	741
Interest income, net	545	467
Earnings from continuing operations before income tax expense	14,117	17,078
Income tax expense (Note 4):		
Current	5,159	3,424
Future	209	2,460
	5,368	5,884
Earnings from continuing operations	8,749	11,194
Loss on disposal of discontinued operation (net of income tax expense) (Note 17)	-	756
<b>NET EARNINGS</b>	<b>8,749</b>	<b>10,438</b>
Retained earnings, beginning of year	19,740	13,202
Excess of purchase price over stated capital on repurchase of shares (Note 8)	-	(2,052)
Dividend	(2,682)	(1,848)
Retained earnings, end of year	\$ 25,807	\$ 19,740
Earnings per share from continuing operations (Note 9)		
Basic	\$ 1.04	\$ 1.33
Diluted	\$ 1.03	\$ 1.31
Net earnings per share (Note 9)		
Basic	\$ 1.04	\$ 1.24
Diluted	\$ 1.03	\$ 1.22
Weighted average number of shares (Note 9)		
Basic	8,389,688	8,389,220
Diluted	8,489,121	8,578,138

*The accompanying notes are an integral part of the consolidated financial statements.*

**Calian Technologies Ltd.**  
**Consolidated Balance Sheets**  
 As at September 30, 2005 and 2004  
 (dollars in thousands)

	2005	2004
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 17,889	\$ 30,997
Accounts receivable	35,843	18,726
Note receivable (Note 3)	172	158
Work in process	3,609	3,747
Prepaid expenses and other	825	875
Future income taxes (Note 4)	2,166	2,428
	<u>60,504</u>	<u>56,931</u>
NOTE RECEIVABLE (Note 3)	186	358
CAPITAL ASSETS (Note 5)	3,551	3,873
INTANGIBLES (Note 6)	1,016	1,412
GOODWILL (Note 7)	9,518	5,923
	<u>\$ 74,775</u>	<u>\$ 68,497</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable and accrued liabilities	\$ 24,343	\$ 18,136
Unearned contract revenue	7,312	14,094
	<u>31,655</u>	<u>32,230</u>
FUTURE INCOME TAXES (Note 4)	43	96
	<u>31,698</u>	<u>32,326</u>
CONTINGENCIES (Note 10)		
<b>SHAREHOLDERS' EQUITY</b>		
Share capital (Note 8)	17,270	16,431
Retained earnings	25,807	19,740
	<u>43,077</u>	<u>36,171</u>
	<u>\$ 74,775</u>	<u>\$ 68,497</u>

*The accompanying notes are an integral part of the consolidated financial statements.*

Approved by the Board:



**Larry O'Brien**  
 Chairman



**Richard Vickers**  
 Director

Calian Technologies Ltd.  
**Consolidated Statements of Cash Flows**  
 Years Ended September 30, 2005 and 2004  
 (dollars in thousands)

	2005	2004
<b>CASH FLOWS FROM (USED IN) OPERATING ACTIVITIES</b>		
Earnings from continuing operations	\$ 8,749	\$ 11,194
Items not affecting cash		
Interest on note receivable	(42)	-
Employee stock purchase plan compensation expense	32	41
Amortization	1,535	1,306
Gain on sale of investment (Note 3)	-	(516)
Future income taxes (Note 4)	209	2,460
	10,483	14,485
Change in non-cash working capital		
Accounts receivable	(17,117)	4,077
Work in process	138	1,070
Prepaid expenses and other	50	(385)
Investment tax credits	-	866
Accounts payable and accrued liabilities	2,612	(941)
Unearned contract revenue	(6,782)	(3,951)
	(10,616)	15,221
<b>CASH FLOWS USED IN FINANCING ACTIVITIES</b>		
Repayment of debt	-	(897)
Issuance of common shares	807	1,044
Repurchase of common shares, including cost associated with repurchase (Note 8)	-	(2,478)
Dividend	(2,682)	(1,848)
	(1,875)	(4,179)
<b>CASH FLOWS USED IN INVESTING ACTIVITIES</b>		
Note receivable	200	-
Acquisition of capital assets	(817)	(928)
Business acquisition (Note 16)	-	(4,302)
	(617)	(5,230)
<b>NET CASH INFLOW (OUTFLOW)</b>	<b>(13,108)</b>	<b>5,812</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>	<b>30,997</b>	<b>25,185</b>
<b>CASH AND CASH EQUIVALENTS, END OF YEAR</b>	<b>\$ 17,889</b>	<b>\$ 30,997</b>
<b>SUPPLEMENTARY INFORMATION:</b>		
<b>Income taxes paid</b>	<b>\$ 4,090</b>	<b>\$ 2,536</b>
<b>Interest paid</b>	<b>\$ 9</b>	<b>\$ 9</b>

*The accompanying notes are an integral part of the consolidated financial statements.*



# Calian Technologies Ltd.

## Notes to the Consolidated Financial Statements

Years Ended September 30, 2005 and 2004  
(dollars in thousands, except per share data)

### 1. Nature of Operations

Calian Technologies Ltd. ("the Company"), incorporated under the Canada Business Corporations Act, and its wholly-owned subsidiaries provide technology services to industry and government.

### 2. Accounting Policies

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and include the following significant accounting policies:

#### Basis of consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries Calian Ltd., Calian Inc., Calian Technology (U.S.) Ltd. and Titan Consulting Group Ltd.

#### Use of estimates

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires the Company's management to make estimates that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods presented. Significant areas requiring the use of estimates relate to the determination of percentage of completion and estimated project costs and revenues for contract revenue recognition, contingencies, estimated amount for income tax balances, allowance for doubtful accounts, business acquisitions and the related goodwill and intangibles and the impairment of goodwill, based on currently available information. Actual results could differ from those estimates.

#### Revenue recognition

Revenue on fixed-price contracts is recognized at the net realizable value of services provided using the percentage of completion method based on management estimates. Billings and cash receipts in advance of amounts earned are reflected as unearned contract revenue. Provision is made for the entire amount of the expected losses, if any, in the period in which they are first determinable. In addition, a provision for warranty claims is established when revenue is recognized, based on warranty terms and prior claim experience. As some contracts extend over one or more years, any revision in cost and profit estimates made during the course of the work are reflected in the accounting period in which the facts indicating a need for the revision become known.

Revenue derived from per-diem contracts is recognized in the period the services are provided.

#### Work in process

Work in process represents work performed but not invoiced and is recorded at net realizable value.

#### Capital assets

Capital assets are recorded at cost, net of related government assistance and investment tax credits. Amortization is calculated using the declining balance method at rates ranging from 20% to 30%. The Company's policy is to review all long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. When events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable, the Company will estimate the undiscounted future cash flows expected to result from the use of the assets and their eventual disposition and record an impairment loss if required.

# Calian Technologies Ltd.

## Notes to the Consolidated Financial Statements

Years Ended September 30, 2005 and 2004  
(dollars in thousands, except per share data)

### 2. Accounting Policies *(Continued)*

#### Intangibles

Intangibles are comprised of acquired customer relationships, non-competition agreements, order backlog and consultant database. Intangibles are amortized on a straight-line basis over their estimated useful life not exceeding five years. The intangibles are tested for recoverability whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

#### Goodwill

Goodwill represents the excess of the purchase price over the fair value of net assets of acquired businesses. Goodwill is not amortized and is tested for impairment annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired. When the carrying amount of a reporting unit's goodwill exceeds its fair value, an impairment loss is recognized in an amount equal to the excess. An impairment charge is recorded for goodwill that is considered impaired.

The Company performs its annual review of goodwill September 30th each year. Based on the impairment tests performed at September 30, 2005 and 2004, the Company concluded that no goodwill impairment charge was required.

#### Income taxes

The Company accounts for income taxes using the liability method. Under this method, current income taxes are recognized for the estimated income taxes payable for the current year. Future income tax assets and liabilities are recognized for temporary differences between the tax and accounting bases of assets and liabilities and for the benefit of tax losses available to be carried forward to future years if these are more likely than not to be realized.

#### Research and development costs and related investment tax credits

Research costs are expensed in the period incurred. Development costs are expensed in the period incurred unless the Company believes a development project meets generally accepted criteria for deferral and amortization. No such costs have been deferred at September 30, 2005 and 2004.

Research and development costs are reduced by related government assistance. Investment tax credits are accounted for using the cost reduction method, whereby the benefit is recognized as a reduction in the cost of the related asset or expenditure when there is reasonable assurance the tax credits will be received and if it is more likely than not that they will be utilized to reduce taxes payable.

#### Stock-based compensation

The Company has a stock option plan for executives and other key employees and an employee stock purchase plan. The Company recognizes stock-based compensation expense in accordance with CICA Handbook section 3870 "Stock-Based Compensation and Other Stock-Based Payments". The Company measures and recognizes compensation expense based on the fair-value of the stock or stock options issued. Consideration paid by employees on the purchase of shares under the employee stock purchase plan and exercise of stock options is recorded as share capital when the shares are issued.

#### Foreign currency translation

The accounts of a wholly-owned subsidiary, which is considered to be an integrated subsidiary, and accounts in foreign currencies have been translated into Canadian dollars using the temporal method of foreign currency translation. Under this method, monetary assets and liabilities are translated at the rate of exchange in effect at year-end. Non-monetary items are translated at rates in effect on the dates of the transactions. Revenues and expenses are translated at rates in effect during the year except for amortization, which is translated at the same rate as the assets to which it relates. Gains and losses from translation are included in earnings in the period in which they occur.

# Calian Technologies Ltd.

## Notes to the Consolidated Financial Statements

Years Ended September 30, 2005 and 2004  
(dollars in thousands, except per share data)

### 2. Accounting Policies *(Continued)*

#### Financial instruments and risk management

The carrying amount of the Company's current monetary assets and liabilities approximates fair value. The carrying value of the note receivable represents the discounted value of the note using current market interest rates and as such approximates fair value.

The Company utilizes derivative financial instruments in the management of its foreign currency exposures. The Company's policy is not to utilize derivative financial instruments for trading or speculative purposes. The Company applies hedge accounting when appropriate documentation and effectiveness criteria are met.

The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives to specific firm contractually related commitments on projects.

The Company also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

The Company hedges foreign currency exposures by entering into offsetting forward exchange contracts. Foreign exchange translation gains and losses on foreign currency denominated derivative financial instruments used to hedge foreign currency denominated contracts are deferred and recognized as an adjustment of either the hedged revenues or the hedged project costs.

Realized and unrealized gains or losses associated with derivative instruments, which have been terminated or cease to be effective prior to maturity, are deferred under other current and non-current assets or liabilities on the balance sheet and recognized in income in the period in which the underlying hedged transaction is recognized. In the event a designated hedged item is extinguished, settled or is no longer probable of occurring prior to the termination of the related derivative instrument, any realized or unrealized gain or loss on such derivative instrument is recognized as an adjustment to revenue or cost of the related project.

#### Earnings per share

Diluted earnings per share is calculated based on the weighted average number of common shares outstanding during the period plus the effects of potentially dilutive common shares outstanding during the period. This method requires that the dilutive effect of outstanding options be calculated using the treasury stock method, as if all dilutive options had been exercised at the later of the beginning of the reporting period or date of issuance, and that the funds obtained thereby were used to purchase common shares of the Company at the average trading price of the common shares during the period. Contingently issuable shares are included in the diluted earnings per share calculation once the actual level of earnings indicate that the conditions will be met to issue shares (Note 16). The number of shares included is determined based on the earnings to date and the current market price of the shares at the end of the reporting period, if the effect is dilutive.

#### Cash and cash equivalents

Cash and cash equivalents include investments with a major Canadian chartered bank and money market instruments that have terms of three months or less at the time of acquisition. The carrying amounts of cash and cash equivalents are stated at cost, which is equal to their fair value.

Calian Technologies Ltd.  
 Notes to the Consolidated Financial Statements  
 Years Ended September 30, 2005 and 2004  
 (dollars in thousands, except per share data)

### 3. Note Receivable

In fiscal 2004, the Company sold its investment in Square Peg Communications Inc. (Square Peg) for \$850. The gain on sale of investment was determined as follows:

	2004
Cash received	\$ 250
Net present value of note receivable	516
Legal and accounting cost	(25)
	<u>\$ 741</u>

As at September 30, 2005 the nominal value of the note receivable is \$400. The note is non-interest bearing and is secured by a general security agreement over the assets of Square Peg second to any bank indebtedness. The balance of the note is repayable in two equal instalments of \$200 on September 30, 2006 and 2007. Each instalment payment can be delayed by one year at which time interest will accrue at a rate of prime + 3%. The book value of the note of \$358 represents the fair value at September 30, 2005 after considering an implied interest rate of prime + 3%.

### 4. Income Taxes

The balances of future income tax assets and liabilities (current and long-term) at September 30, 2005 and 2004 represent the future benefits of temporary differences between the tax and accounting bases of assets and liabilities, consisting mainly of future tax deductions.

The future tax assets of the Company are comprised of the following elements:

	2005	2004
Donation carry-forward and income tax losses	\$ -	\$ 55
Book base of liabilities in excess of tax base	2,166	2,373
	<u>2,166</u>	<u>2,428</u>
Current	2,166	2,428
Non-current	\$ -	\$ -

The non-current future tax liability of the Company is comprised of the book base of assets in excess of tax base for \$43 (2004: \$96). None of the goodwill is expected to be deductible for tax purposes (Note 16).

The following table reconciles the difference between the income taxes that would result solely by applying statutory tax rates to pre-tax income and the income taxes actually provided in the accounts:

	2005	2004
Earnings from continuing operations before income tax expense	\$ 14,117	\$ 17,078
Tax provision at the combined basic Canadian federal and provincial income tax rate of 37.0% (2004: 37.6%)	5,223	6,421
Increase (decrease) resulting from:		
Permanent differences	69	(91)
Impact of rate reductions on valuation of future income tax assets	-	(252)
Other	76	(194)
	<u>\$ 5,368</u>	<u>\$ 5,884</u>

# Calian Technologies Ltd.

## Notes to the Consolidated Financial Statements

Years Ended September 30, 2005 and 2004

(dollars in thousands, except per share data)

### 4. Income Taxes (Continued)

During fiscal 2005, the Company re-filed its scientific research and experimental development (R&D) claim with respect to its 2003 fiscal year-end to increase its claim. The Company received its reassessment and \$3,021 in additional R&D costs was allowed creating an additional \$1,143 of investment tax credits available to recover from taxes already paid. Costs associated with the re-filing have been applied against the investment tax credits resulting in a net recovery of \$984. The investment tax credits have been recorded against income taxes otherwise payable. The Company also intends to re-file its R&D claim with respect to 2004. However, the level of qualified R&D activity was significantly lower than 2003 and therefore, the Company is expecting only minimal recoveries for 2004. The investment tax credits for the 2004 R&D claim will be recorded once the Company has been reassessed by the Canada Revenue Agency.

### 5. Capital Assets

			2005	2004
	Cost	Accumulated Amortization	Net Book Value	Net Book Value
Equipment, furniture and fixtures	\$ 10,411	\$ 6,860	\$ 3,551	\$ 3,873

### 6. Intangibles

			2005	2004
	Cost	Accumulated Amortization	Net Book Value	Net Book Value
Acquired customer relationships	\$ 788	\$ 212	\$ 576	\$ 772
Non-competition agreements	480	104	376	472
Order backlog	126	126	-	82
Consultant database	88	24	64	86
	\$ 1,482	\$ 466	\$ 1,016	\$ 1,412

### 7. Goodwill

The change in the book value of goodwill is as follows:

	2005	2004
Balance, beginning of year	\$ 5,923	\$ 3,246
Acquired during year (Note 16)	3,595	2,677
Balance, end of year	\$ 9,518	\$ 5,923

Calian Technologies Ltd.  
 Notes to the Consolidated Financial Statements  
 Years Ended September 30, 2005 and 2004  
 (dollars in thousands, except per share data)

## 8. Share Capital

Authorized: Unlimited number of common shares  
 Unlimited number of preferred shares issuable in series

Issued: Common shares as follows:

	2005		2004	
	Shares	Amount	Shares	Amount
Balance, beginning of year	8,287,725	\$ 16,431	8,212,066	\$ 15,772
Shares issued under stock option plan	193,880	585	247,415	878
Shares issued under employee share purchase plan	21,708	254	43,144	207
Shares repurchased	-	-	(214,900)	(426)
Balance, end of year	8,503,313	\$ 17,270	8,287,725	\$ 16,431

During fiscal 2004, the Company acquired 214,900 of its outstanding common shares at an average price of \$11.50 per share for a total of \$2,478 including related expenses, through normal course issuer bids initiated in May 2003 and May 2004 each for a period of one year. The excess of the purchase price over the average stated capital of the shares has been charged to retained earnings.

### Share options

In 1993, the Company established a stock option plan, whereby grants were made at the sole discretion of the Company's Board of Directors (The Old Plan). The Old Plan expired in 2003. During 2005, the Company established a new plan (The New Plan) whereby a total of 250,000 common shares have been authorized for issuance under the New Plan. Under both plans, eligible directors and employees are granted the right to purchase shares of common stock at a price established by the Board of Directors on the date the options were granted but in no circumstances below fair market value of the shares at the date of the grant. During the year no options were granted.

The purchase options granted under the Old Plan vested over three years with a maximum term to expiry of five years, and are contingent on the option holders maintaining their employment.

	2005		2004	
	Options	Weighted Avg. Exercise Price	Options	Weighted Avg. Exercise Price
Outstanding, beginning of year	218,125	\$2.99	467,540	\$3.28
Exercised	(193,880)	\$3.02	(244,915)	\$3.54
Forfeited or expired	-	\$ -	(4,500)	\$3.83
Outstanding, end of year	24,245	\$2.73	218,125	\$2.99



# Calian Technologies Ltd.

## Notes to the Consolidated Financial Statements

Years Ended September 30, 2005 and 2004

(dollars in thousands, except per share data)

### 8. Share Capital (Continued)

As at September 30, 2005:

Range of Exercise Prices	Options Outstanding and Exercisable		
	Number of Options	Weighted Avg. Remaining Contractual Life (Yrs)	Weighted Avg. Exercise Price
\$2.25 - \$2.65	18,025	1.2	2.45
\$2.80 - \$6.90	6,220	0.5	3.54
	24,245	1.0	2.73

#### Employee stock purchase plan

The Company has an Employee Stock Purchase Plan (ESPP) under which most full-time employees may register once a year to participate in one of two offering periods. Eligible employees may purchase common shares by payroll deduction throughout the year at a price of 80% of the fair market value at the beginning of the initial offering period or may purchase common shares at a price of 90% of the fair market value at the beginning of the interim offering period. Such shares are issued from treasury once a year at the end of the offering periods.

A total of 500,000 common shares have been authorized for issuance under the plan. During fiscal 2005, the Company issued 21,708 (2004: 43,144) shares under the ESPP and employees subscribed to approximately 16,121 common shares, which will be issued during fiscal 2006 at an average price of \$10.67. Since inception and including the issuance of shares in 2005, 185,463 shares have been issued under the plan.

During the twelve-month period ending September 30, 2005, the Company recorded a compensation expense of \$32 (2004: \$41) relating to its ESPP.

### 9. Earnings Per Share

The diluted weighted average number of shares has been calculated as follows:

	2005	2004
Weighted average number of common shares—basic	8,389,688	8,389,220
Additions to reflect the dilutive effect of employee stock options	73,408	188,918
Shares to be issued for the Titan acquisition (Note 16)	26,025	-
Weighted average number of common shares—diluted	8,489,121	8,578,138

### 10. Contingencies

On January 24, 2005, the Company was served with a civil lawsuit by way of a Statement of Claim filed in the Ontario Superior Court of Justice claiming \$100 million in damages from the Company and an employee of the Company for breach of confidence, breach of fiduciary duty and unlawful interference with economic interests. The claim relates to the recently awarded limitation of expenditure contract by the Department of National Defence for the provision and management of Health Service Providers. The contract value for the initial 5-year period is in excess of \$400 million with the potential for 5 additional option years worth an additional \$480 million in total. The Company intends to vigorously defend the claim, including the basis of the claim and the amounts being sought.

# Calian Technologies Ltd.

## Notes to the Consolidated Financial Statements

Years Ended September 30, 2005 and 2004

(dollars in thousands, except per share data)

### 10. Contingencies (*Continued*)

The plaintiff also filed a complaint with the Canadian International Trade Tribunal (CITT) related to this contract award. In June 2005, the CITT issued its determination, confirming Calian as the successful bidder. On July 15, 2005, the plaintiff applied to the Federal Court of Appeal seeking to set aside the decision of the CITT by seeking a judicial review of that decision. The likely outcomes of the judicial review of the CITT decision and the civil lawsuit cannot be determined at this time.

In prior years the Company received assistance from the Government of Canada relating to research and development activities. This assistance may be repayable based on the level of future sales of the projects funded until the date it is forgiven as per the terms of the contract. At September 30, 2005 \$232 (2004: \$2,648) of the assistance received was not forgiven. A liability will be recognized in the period in which conditions arise that cause repayment. At September 30, 2005 no provision for payment is required.

### 11. Commitments

The Company has lease agreements with terms extending to the year 2010. The aggregate minimum rental payments under these arrangements are as follows:

2006	\$3,279
2007	\$3,144
2008	\$3,065
2009	\$2,504
2010	\$1,933

At September 30, 2005, the Company's bank has issued a letter of credit for \$650 (2004: NIL).

### 12. Guarantees

In the normal course of business, the Company enters into agreements that may provide for indemnification and guarantees to customers in transactions such as staffing, outsourcing and engineering. These indemnification undertakings and guarantees may require the Company to compensate customers for costs and losses incurred as a result of various events, including breaches of representations and warranties, intellectual property right infringement, claims that may arise while providing services, or as a result of litigation that may be suffered by customers. The Company mitigates its responsibility by removing from its contracts clauses relating to liability for indirect or special damages such as loss of revenue or profit in all of its engineering agreements. The Company also mitigates the risk of loss by including similar indemnification clauses in the agreements entered into with its subcontractors. The term and nature of these indemnifications vary based upon the agreement, which often provides no limit. Consequently, the Company is unable to make a reasonable estimate of the maximum potential amounts that the Company could be required to pay to its customers. Historically, the Company has not been obligated to make significant payments under these indemnification clauses.

### 13. Segmented Information

Operating segments are identified as components of an enterprise about which separate discrete financial information is available for evaluation by the chief operating decision maker, regarding how to allocate resources and assess performance. The Company's chief operating decision maker is the Chief Executive Officer.

The Company operates in two reportable segments described below, defined by their primary type of service offering, namely Systems Engineering and Business and Technology Services.

- Systems Engineering involves planning, designing and implementing solutions that meet a customer's specific business and technical needs, primarily in the satellite communications sector.
- Business and Technology Services involves short and long-term placements of personnel to augment customers' work forces as well as the long-term management of projects, facilities and customer business processes.

The Company evaluates performance and allocates resources based on earnings before interest and income taxes. The accounting policies of the segments are the same as those described in Note 2.

# Calian Technologies Ltd.

## Notes to the Consolidated Financial Statements

Years Ended September 30, 2005 and 2004

(dollars in thousands, except per share data)

**13. Segmented Information (Continued)**

For the Fiscal Year ending September 30, 2005

	Systems Engineering	Business and Technology Services	Corporate	Total
Revenues	\$ 50,303	\$ 127,474	\$ -	\$ 177,777
Operating expenses	42,369	119,344	1,941	163,654
Amortization	620	915	-	1,535
Prior year investment tax credits	(984)	-	-	(984)
Earnings before interest income and income tax expense	\$ 8,298	\$ 7,215	\$ (1,941)	\$ 13,572
Interest income, net				545
Income tax expense				5,368
Net earnings				\$ 8,749
Total assets other than cash and goodwill	\$ 14,578	\$ 32,257	\$ 533	\$ 47,368
Goodwill		9,518		9,518
Cash				17,889
Total assets				\$ 74,775
Capital asset expenditures	\$ 414	\$ 403	\$ -	\$ 817

For the Fiscal Year ending September 30, 2004

	Systems Engineering	Business and Technology Services	Corporate	Total
Revenues	\$ 83,942	\$ 85,765	\$ -	\$ 169,707
Operating expenses	68,539	82,328	1,664	152,531
Amortization	659	647	-	1,306
Earnings before other income, interest income and income tax expense	\$ 14,744	\$ 2,790	\$ (1,664)	\$ 15,870
Gain on sale of investment				741
Interest income, net				467
Income tax expense				5,884
Earnings from continuing operations				\$ 11,194
Discontinued operation				756
Net earnings				\$ 10,438
Total assets other than cash and goodwill	\$ 11,014	\$ 19,872	\$ 691	\$ 31,577
Goodwill	-	5,923	-	5,923
Cash				30,997
Total assets				\$ 68,497
Capital asset expenditures	\$ 592	\$ 336	\$ -	\$ 928

# Calian Technologies Ltd.

## Notes to the Consolidated Financial Statements

Years Ended September 30, 2005 and 2004

(dollars in thousands, except per share data)

### 13. Segmented Information (Continued)

Revenues from external customers are attributed as follows:

	2005	2004
Canada	75%	53%
United States	10%	31%
Europe	15%	16%

Revenues are attributed to foreign countries based on the location of the customer. No significant assets are held outside of Canada.

Revenues from various departments and agencies of the Canadian federal government represented 43% (2004: 28%) of the Company's total revenues. Both operating segments conduct business with this major customer.

In 2005, revenue from a certain customer in the call-centre business accounted for 16% of the Company's total revenues (2004: 17%), all from the Business and Technology Services segment.

In 2005, revenue from a certain customer in the surveillance and security market accounted for 1% of the Company's total revenues (2004: 22%), all from the Systems Engineering segment.

### 14. Financial Instruments and Risk Management

The Company is exposed to foreign currency fluctuations on its cash balance, accounts receivable, accounts payable and future cash flows related to contracts denominated in a foreign currency. Future cash flows will be realized over the life of the contracts.

The Company uses financial instruments, principally in the form of forward exchange contracts, in its management of foreign currency exposures. These contracts primarily require the Company to purchase or sell certain foreign currencies with or for Canadian dollars at contractual rates. At September 30, 2005, the Company had the following forward foreign exchange contracts:

Type	Notional	Currency	Maturity	Equivalent Cdn. Dollars
SELL	11,542	USD	October 2005	\$13,554
BUY	2,783	USD	October 2005	3,254
SELL	3,349	EURO	October 2005	4,870
BUY	2,286	EURO	October 2005	3,325
BUY	410	GBP	October 2005	851

The fair value of the financial instruments at September 30, 2005 is \$171 (2004: \$431). The foreign exchange loss recorded in 2005 is \$25 (2004: \$18).

The Company is exposed to credit-related losses in the event of non-performance by counter-parties to derivative financial instruments but does not expect any counter-parties to fail to meet their obligations. The Company only deals with major financial institutions.

### 15. Pension Plan

The Company sponsors a defined contribution pension plan for its employees. Required contributions have been fully funded to September 30, 2005. For the year ended September 30, 2005, an amount of \$549 (2004: \$519) was expensed related to this pension.

# Calian Technologies Ltd.

## Notes to the Consolidated Financial Statements

Years Ended September 30, 2005 and 2004

(dollars in thousands, except per share data)

### 16. Business Acquisition

On September 7, 2004, the Company acquired 100% of the outstanding shares of Titan Consulting Group Ltd. (Titan). Titan specializes in delivering skilled SAP, PeopleSoft, Oracle and Siebel professionals to industry and government on a per diem model to private and public sector clients. The purchase price was based on the book value of assets and liabilities as of the date of acquisition plus a multiple of 4.5 times Titan's earnings before interest, taxes and amortization (EBITDA) of up to \$1,566 and 1 times EBITDA in excess of \$1,566 achieved during the period September 1, 2004 to August 31, 2005. The purchase price will be satisfied with 90% cash and the balance through the issuance of common shares.

The acquisition has been accounted for using the purchase method of accounting and accordingly, the purchase price was allocated to the assets and liabilities based on their estimated fair values as of the acquisition date. The results of operations relating to the acquisition have been included in the consolidated financial statements from the effective date of acquisition.

The following table summarizes the purchase price allocation that was determined by the Company based on internal appraisals of the fair value of the tangible and intangible assets acquired.

	Acquisition date	Contingent consideration	TOTAL
Non-cash working capital	\$ 1,426	\$ -	\$ 1,426
Capital assets	70	-	70
Intangibles (Note 6)	1,482	-	1,482
Long-term debt	(805)	-	(805)
Future income tax liability	(548)	-	(548)
Goodwill (Note 7)	2,677	3,595	6,272
<b>Purchase Price</b>	<b>\$ 4,302</b>	<b>\$ 3,595</b>	<b>\$ 7,897</b>
Consideration: Net cash, including costs of the acquisition	\$ 4,302	\$ 2,884	\$ 7,186
Calian shares		711	711
<b>Total consideration</b>	<b>\$ 4,302</b>	<b>\$ 3,595</b>	<b>\$ 7,897</b>

On September 7, 2004, the Company paid \$691 for the book value of the assets and liabilities as of the date of acquisition, \$3,524 as an advance payment on the earn-out amount and \$87 in costs of the acquisition.

The balance of the cash of \$2,875 will be paid on or before November 30, 2005 and the common shares will be issued on February 28, 2006 at the then-prevailing market prices. The Company has accrued the liability associated with the cash payment and the issuance of the shares in accrued liabilities. The shares to be issued on February 28, 2006 were not recorded as share capital due to the fact that the number of shares is unknown at September 30, 2005 as it is based on the average market price of the shares for the ten days prior to February 28, 2006. Based on the share price as at September 30, 2005, 52,050 shares would be issuable. These shares are included in the dilutive earnings per share calculation.

# Calian Technologies Ltd.

## Notes to the Consolidated Financial Statements

Years Ended September 30, 2005 and 2004  
(dollars in thousands, except per share data)

### 17. Discontinued Operation

As part of its e-business strategy, during the year 2000, the Company entered into a 10-year lease for an office building in the Ottawa area expiring in April 2010. Upon exit of the e-business sector in 2001, the Company did not have any requirements for the space and accordingly sublet the excess space to a third party for a period of 5 years ending May 2006.

During 2004, the Company revised its estimate of the provision for future costs relating to the discontinued e-business operation and recorded an additional charge of \$1,200 (\$756 after tax). This charge represents a non-cash transaction. During 2005, the Company entered into a new agreement with the existing sub-tenant to lease a significant portion of the space for a 5-year period extending to April 2010 at the current market price. As a result, the Company will be required to assume a portion of the costs associated with this facility. Unless the sub-lessee defaults on future payments, it is expected that the current provision of \$2,100 will be sufficient to cover the Company's share of the costs. The lease payments including operating costs relating to the excess space amount to approximately \$960 per year. During the year, the Company received lease revenues of \$838 (2004: \$955).

### 18. Comparative Figures

Certain of the comparative figures have been reclassified to conform to the financial statement presentation adopted this fiscal year.



## Corporate Information

### Corporate & Business and Technology Services

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Web: www.calian.com

### Ottawa Downtown Office

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Ottawa, Ontario, Canada K1P 5H2  
Phone: 613.238.2600  
Fax: 613.238.3831

### Toronto Office

1 City Centre Drive  
7th Floor  
Mississauga, Ontario, Canada L5B 1M2  
Phone: 905.848.2818  
Fax: 905.848.4944

### Systems Engineering (SED)

P.O. Box 1464  
18 Innovation Blvd.  
Saskatoon, Saskatchewan, Canada  
S7K 3P7  
Phone: 306.931.3425  
Fax: 306.933.1486  
Web: www.sedsystems.ca

### United States Office

7960 Donegan Drive  
Suite 223  
Manassas, Virginia, USA 20109  
Phone: 703.392.4950  
Fax: 703.392.0980

### Board of Directors

Larry O'Brien  
Chairman, Calian Technologies Ltd.

Kenneth J. Loeb  
President, Capital Box of Ottawa Limited  
Lead Director

Major General (retired) C. William Hewson  
Consultant  
Chair of the Governance Committee

David Tkachuk  
Senator  
Chair of the Compensation Committee

Richard Vickers, FCA  
Consultant  
Chair of the Audit Committee

Ray Basler  
President and CEO, Calian Technologies Ltd.

### Common Share Information

The Company's common shares are listed for trading on the Toronto Stock Exchange under the symbol CTY.

### Dividend Policy

The Company intends to continue to declare a quarterly dividend in line with its overall financial performance and cash flow generation. Decisions on dividend payments are made on a quarterly basis by the Board of Directors. There can be no assurance as to the amount of such dividends in the future.

### Annual Meeting of Shareholders

The Annual General Meeting of the Shareholders of Calian will be held on February 8, 2006 at 3:00 p.m. at the Brookstreet Hotel, Kanata, Ontario, Canada. All shareholders are invited to attend. The telephone number of the Brookstreet Hotel is 613.271.1800.





ANNUAL REPORT