NORTHSTAR ELECTRONICS INC
Form 10KSB
March 30, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-KSB

[x] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2003

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from n/a to n/a

Commission file number: 333-90031

Exact name of small business issuer as specified in its Charter
Northstar Electronics, Inc.

| State or other jurisdiction of incorporation or organization | IRS Employer Identification No. |
|---|---|
| Delaware | #33-0803434 |

Address of principal executive offices
Suite # 1455- 409 Granville Street,
Vancouver, British Columbia,
Canada V6C 1T2

Registrant's telephone number
(604) 685-0364

Securities registered pursuant to section 12(b) of the Act
None

Securities registered pursuant to section 12(g) of the Act
100,000,000 shares of common stock with a par value of $0.0001 each

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
(1) [x] Yes [ ] No (2) [x] Yes [ ] No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (s229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. [x]

State the aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant. The aggregate market value shall be computed by reference to the price at which the common equity was sold, or the average bid and asked prices of such common equity, as of a specified date within 60 days prior to the date of filing. (See definition of affiliate in Rule 405, 17 CFR 230.405). Note - If a determination as to whether a particular person or entity is an affiliate cannot be made without involving unreasonable effort and expense, the aggregate market value of the common stock held by non-affiliates may be calculated on the basis of assumptions reasonable under the circumstances, provided that the assumptions are set forth in this Form.

Aggregate market value of voting common equity held by non-Affiliates as of December 31, 2003: $4,500,000 approximately

Aggregate market value of non-voting common equity held by non-affiliates as of December 31, 2003: $NIL

Indicate whether the registrant is an accelerated filer based on the market value of its public float held by non-affiliates at the end of the most recent second fiscal quarter:
[ ] Yes [x] No

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date:
Outstanding shares of common stock as of February 28, 2004: 15,841,256
Outstanding shares of preferred stock as of February 28, 2004: Nil

Documents incorporated by reference: None

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PART I

Item 1. Description of Business
The Company was incorporated May 11, 1998 as Scientific Technologies, Inc. under the laws of the State of Delaware. The name of the Company was changed to Northstar Electronics, Inc. (NEI) in September, 1999. Subsequently, there has been no material reclassification, merger, consolidation, purchase or sale of any significant amount of assets other than in the ordinary course of business. There have been no bankruptcy, receivership or similar proceedings.

The business of the Company is primarily that of its wholly owned subsidiaries, Northstar Technical Inc. (NTI) and Northstar Network Ltd. (NNL).

NTI develops, manufactures and sells undersea wireless sonar communications systems and produces, under contract, defense and aerospace electronic systems.

NNL was incorporated to pursue defense and aerospace contract manufacturing opportunities.

Sonar Products and Technologies
NTI developed a wireless communications technology with undersea applications. The technology is used in underwater sensing devices and can send information from one place in the ocean to another place. The electronic sensors take certain measurements that are then transmitted using underwater sound waves to a receiving unit, which processes the data and displays it on a computer monitor. The technology has many potential uses in a variety of industries including offshore oil and gas, defense, marine transportation, oceanography, environmental and fishing.

Homeland Security and Military Defense
The Company expects that design and manufacture of homeland security and anti-terrorism systems will grow to become a major component of Northstar's business over the next five years as the United States' Department of Homeland Security launches and ramps up its efforts to protect U.S. waterways and marine borders from ships, submarines and unwanted intruders.
Northstar Electronics has designed and is manufacturing sonar hardware for homeland security and military defense systems. These systems are designed to detect and track combat divers and are intended to protect naval ships, harbors and ports.

Research and Development - AQUACOMM
AQUACOMM is a $2.5Million fully funded in-house research and development program at Northstar that has been created specifically to develop new, leading edge multiple application sonar technologies and products for a variety of industries, including: defense, offshore oil and gas, commercial fishing, oceanography, marine environment and marine transportation. The Company has received funding for this project from the Canadian Federal Government's Atlantic Innovation Fund and the National Research Council, as well as from equity investment.
Scheduled to last for three years, Northstar believes that AQUACOMM will result in the development of up to 10 new technologies during this period. To date, Northstar has expended $1,783,039Cdn on this development program and has recovered $1,105,484Cdn.

Northstar intends to use its Venture Technology Business Model to maximize the success of AQUACOMM technologies. In this model, a technology developed through AQUACOMM will be partnered with an established company in a specific industry sector. One example could be the co-development of a military underwater communications system. Northstar would develop the "wet" end and a large defense contractor would be responsible for the "dry" end. Since the defense contractor is well established in the field, it would be the defense contractor that would undertake the product introduction, marketing and sales efforts. Another example of the type of technology that could be developed under AQUACOMM is the development of a Subsea wireless communications system for the offshore oil and gas industry. Northstar expects to have such a system ready this year and intends to market the system through a strategic alliance with an international oil field communications company.

Northstar believes it can build on its expertise in sonar technology and marine engineering to become a Commercial Sonar Center of Excellence upon the completion of its AQUACOMM program.

The NETMIND System
The first application of NTI's core technology is the NETMIND system. NTI developed, manufactures and markets this product for the world's commercial fishing industry.

The NETMIND Market
NETMIND was introduced to the fishing industry in late 1996. To date, approximately 180 systems have been sold in North America, Europe, New Zealand and Russia. The targeted customers have been strategic in that they are industry leaders and government agencies. They include the National Oceanic and Atmospheric Administration (NOAA) in the United States, the United States Department of the Interior and Fishery Products International in Canada. Customer feedback has shown that the NETMIND system enhances efficiency, reduces gear damage and improves catch quality.

Raw Material Sources and Availability
Raw materials for the manufacture of the NETMIND system are available from various sources.
The principal suppliers are as follows:
Compass Ltd. - stainless steel chamber and end caps for sensors, mounting flanges for hull mounted hydrophone and other miscellaneous stainless steel parts
MF Composites - polyurethane, resin and hardener
Astroflight - battery chargers
Mercury Wire Products - tow cable for hydrophone
Electrosonic - electronic components
Future Active Inc. - electronic components
Prism - circuit boards
Enerpower - battery packs

To date, NTI has received parts, supplies and materials from these suppliers in a timely fashion and has met its production schedules. In our efforts to reduce costs, we now produce transducers and other components in house.

Major Customer Dependency - NETMIND
NTI has sold approximately 180 NETMIND systems to over 100 different customers with no dependence on one or a few major customers.

Competition - NETMIND

The system has two main competitors, Furuno in Japan and Scanmar in Norway, both of which are private companies. Little information is available to the public on either of these companies; however, we believe that NETMIND has technical advantages over each. This belief is based on our testing program, which established our technical specifications, and on information gleaned from Furuno and from Scanmar. We have no direct access to any competitor's test data.

The NETMIND, Furuno and Scanmar systems consist of wireless acoustic sensors used underwater and all three systems operate by illustrating how the fishing net is behaving while being towed. However, unlike its competitors, NETMIND sensors are fully serviceable. The electronic circuitry is contained in stainless steel cylinders within each component and is easily removed for repair by opening the end cap.

We believe that NETMIND components have a longer battery life and a more effective communication over a longer distance than its competitors. We believe the rugged design of various NETMIND components has surpassed competitor's designs in that NETMIND's unique components require very little maintenance.

While NETMIND continues to expand its market presence, we believe the Company is smaller in size and resources when compared to its competitors. NTI's staff numbers twenty one while we believe Scanmar and Furuno each employ many times that number. As well, we believe the competitors' facilities are substantially larger than NTI's.

Distribution of the NETMIND System

NETMIND is sold directly to customers by our own sales staff and through marine electronics dealers. We have dealer representation in Canada, the United States, Iceland, Ireland, New Zealand, Scotland, Spain, Denmark and South Africa. We support all sales efforts with product brochures, pamphlets, and customer testimonials and with booths at trade shows such as Fish Expo in Seattle. We also advertise in trade magazines, notably 'The Navigator' and 'Fishing News International'. Articles on the NETMIND have appeared recently in 'National Fisherman', Alaskan Fisherman's Journal' and 'SEA Technology'.

Technology Protection - NETMIND

Since commercializing NETMIND in 1996, NTI has made many enhancements to its system. These activities have resulted in an optimum design for which a patent application may be submitted. The technology is difficult to replicate because of its sophistication and, regardless of patent protection, it is expected it would take several years for a new player to catch up to the present system.

The Company has obtained Canadian trademark rights to the name NETMIND effective for fifteen years from August 24, 1999. No other intellectual property related applications have been filed or prepared. In the meantime, NTI continues to develop new and innovative NETMIND products.

Need for Government Approvals - NETMIND

There are no Government approvals required for the NETMIND system in the areas it is currently sold.

Effect of Existing or Probable Government regulations - NETMIND

There is no effect on the Company's sales arising from government regulations and the Company does not anticipate any change to this in the future.

Research and Development Expenditures - NETMIND
NTI has carried out research and development activities on NETMIND enhancements in 2003. None of these costs were borne directly by customers nor did these costs directly affect NTI's pricing structure.

Costs and Effects of Compliance with Environmental Laws - NETMIND
NTI has incurred no costs nor suffered any effects to maintain compliance with any environmental laws.

CONTRACT MANUFACTURING (CM)

NEI's second business activity, conducted through both its subsidiary companies (NTI and NNL) is contract manufacturing where the Company produces electronic systems under contract to the defense and aerospace industry (called 'build to print'). We build products according to designs provided by our customers. The Company's main customer is currently Lockheed Martin, for whom Northstar provides production engineering, sourcing and procurement of parts, assembly of parts into systems, testing and shipping. The Company has manufactured submarine control consoles under several contracts with Lockheed Martin Naval Electronics in Manassas, Virginia.

The Company markets its services in this area primarily through a network of contacts in the industry, attendance at trade shows and at conferences and special missions sponsored by the Department of Defense. In the past Northstar has attended defense and aerospace exhibitions in the United States and Canada and has participated in several missions to meet prime contractors involved in the Joint Strike Fighter Program in the United States.

The CM Market
NTI has focused attention on the North American military market. The United States and Canada have many programs where NTI's services could be used. This includes programs to manufacture control consoles for submarines, helicopters and fixed wing aircraft. For example, Canada has announced the award in 2004 of a contract for the US$2Billion Maritime Helicopter Project (MHP) that will require the type of console displays NTI can manufacture.

NTI signed a US$2Million contract with Lockheed Martin, Manassas, Virginia on October 19, 1999 to assemble, test and deliver control consoles for the Canadian Navy's Victoria Class submarines. Since NTI successfully completed the project to the satisfaction of both Lockheed Martin and the Navy, Lockheed Martin has awarded follow-on contracts to NTI. In 2003, Lockheed Martin and NTI signed a Manufacturing License Agreement approved by the US State Department. The Agreement allows for NTI to manufacture command and control consoles for Lockheed Martin on projects they have anywhere in the world. As well, NTI is permitted to offer Lockheed Martin's console technology directly to the Canadian Armed Forces.

Competition - CM
For control consoles produced for Lockheed Martin, NTI's competition would be primarily similar sized companies as NTI in the United States, Canada or abroad. We are not aware, at this time, of any companies in particular that are direct competitors. However, we expect that, dependent upon the economic and political factors influencing Lockheed Martin, there will indeed be strong competition for future contracts. NTI's main competitive advantages are price

(our labor and overhead rates are low compared to many other jurisdictions) and quality (we have proven performance) based on the success to date of the submarine control console contract.

Marketing - CM
With respect to other Lockheed Martin divisions and with other prime contractors, we expect to use our success on the submarine console contract to showcase our expertise. The benefits of our marketing efforts are contacts made through networking in the industry and attendance at trade shows, conferences and special missions sponsored by the department of defense. In 2003, we continued to attend defense and aerospace exhibitions in Canada and the United States and we participated in several missions to meet prime contractors involved in the Joint Strike Fighter Program in the United States.

Technology Protection - CM
NTI currently owns no proprietary technology requiring protection with respect to its CM activities.

Raw Material Sources and Availability - CM
Materials and parts are available on an as needed basis from a variety of sources in the United States and Canada.

Dependence on One or a Few Major Customers - CM
NTI currently depends to a great extent on Lockheed Martin for its contracts. Lockheed Martin is comprised of many semi-autonomous divisions, which have many customers. We are dealing with four divisions regarding contract opportunities which is similar to dealing with four independent companies. We are attempting to reduce our dependency on these Lockheed Martin divisions by contacting other large prime contractors about CM opportunities with them. We expect this activity will result in NTI developing new business in addition to business with Lockheed Martin in the future.

Need for Government Approvals - CM
There are no government approvals applicable to our CM activities, except any required as part of a contract. In that event, the requirement would be passed down from the prime contractor as a part of the statement of work

Effect of Existing or Probable Government Regulations - CM
Commerce between the United States and Canada in the defense and aerospace industry is governed by some general rules and regulations. These typically require a prime contractor, such as Lockheed Martin, to obtain certain United States government clearances before providing NTI with potentially sensitive information. Similarly, a Canadian prime contractor would need Canadian government clearances to give classified information to a United States subcontractor. To date, these clearances have not caused any problems for our CM activities and we do not anticipate any in the foreseeable future.

Research and Development Expenditures - CM
NTI has incurred no expenditures in fiscal 2003 on CM research and development activities.

Costs and Effects of Compliance with Environmental Laws - CM
The Company has incurred no costs or adverse effects in its compliance with any environmental laws.

SYSTEM INTEGRATION

NNL carries out multifaceted contracts that require several subcontractors to perform specialized tasks. This ability to integrate the work of several components to create one complete system is one of Northstar's main areas of business - system integration.

As a result of its expertise, NNL has developed its approach to securing and executing large defense contracts by bringing together a number of affiliate companies thereby being able to present a unique capability to prime defense contractors. A major potential project in this area is the $3Billion Maritime Helicopter Project, the contract for which is expected to be awarded in 2004. Because NNL offers 'one stop shopping' to twenty five companies with a wide range of relevant expertise, it is anticipated that some contract work for the Maritime Helicopter Project will flow to NNL, regardless of which consortia wins the bid.

NNL has signed a memorandum of interest (MOI) with three separate Lockheed Martin companies in the United States and with four major subcontractors of Lockheed Martin, for potential work on the Joint Strike Fighter (JSF) program.

This program is a $200Billion plus multinational program led by the United States Government to design and produce the next generation fighter aircraft, in order to replace existing fleets of F-16, F-18, A-10 and Harrier aircraft worldwide. Sales are predicted to exceed 3,000 aircraft in the US and UK alone, with an additional export market of 3,000 aircraft expected.

The JSF contract is the largest defense contract ever awarded and it will continue for 35 years or longer. Northstar has developed relationships with Lockheed Martin, Harris Corporation, TRW, BAE Systems and Northrop Grumman, which the Company expects will lead to contract work on the JSF program.

In 2003, NNL as prime contractor, with TYCO International, submitted a bid to provide the dual mode fiber optic assemblies for the JSF. Prototype test assemblies were provided to the customer and extensive testing was carried out on them as well as on assemblies of competing companies. The project is expected to continue for the lifetime of the JSF program with the first contract award expected in 2004.

EMPLOYEES

As of December 31, 2003 the Company had a total of 31 full time employees.

PUBLIC INFORMATION

The Company electronically files with the Securities and Exchange Commission (SEC) all its reports, including, but not limited to, its annual and quarterly reports. The SEC maintains an internet site (http://www.sec.gov) that contains reports and other information regarding issuers that do file electronically. The Company maintains a web site address at www.northstarelectronics.com

Item 2. Description of Properties

The Company leases its corporate offices located at 1455 - 409 Granville Street, Vancouver, British Columbia, Canada V6C 1T2

Northstar Technical Inc. leases its offices and operations facilities at 1 Duffy Place, Unit #6, St. John's, Newfoundland, Canada A1B 4M6

Northstar Network Ltd. leases its offices and operations facilities at 67 Majors Path, Unit #102, St. John's, Newfoundland, Canada A1A 4Z9

Item 3. Legal Proceedings
No change since previous filing

Item 4. Submission of Matters to a Vote of Security Holders
No change since previous filing.

The Company has filed with the SEC an SB-1 registration statement April 20, 2000, an S-8 registration November 2000 and quarterly reports (form 10QSB) for June and September 2000 and for March, June and September 2001, 2002 and 2003 and annual reports (form 10KSB) for December 31, 2000, 2001 and 2002.

PART II

Item 5. Market for Registrant's Common Equity and Related Stockholder Matters
No change since previous filing

Item 6. Management's Discussion and Analysis or Plan of Operation
The following discussion, comparison and analysis should be read in conjunction with the Company's accompanying audited consolidated financial statements for the years ended December 31, 2003 and 2002 and the notes related thereto. The discussion of results, causes and trends should not be construed to infer conclusions that such results, causes or trends necessarily will continue in the future.

Results of Operations
The following table sets forth for the years indicated items included in the Company's consolidated statement of operations:

| | 2003 | 2002 | 2001 | 2000 | 1999 | 1998 |
|---|---|---|---|---|---|---|
| Total revenue | $1,641,960 | $976,234 | $1,176,527 | $2,301,378 | $462,659 | $193,913 |
| Cost of goods sold | 230,213 | 253,377 | 472,227 | 1,370,427 | 136,955 | 71,189 |
| Discounts | 198,950 | 148,425 | 171,830 | 187,392 | 69,399 | 29,087 |
| | 429,163 | 401,802 | 644,057 | 1,557,819 | 206,354 | 100,276 |
| Gross margin | 1,212,797 | 574,432 | 532,470 | 743,559 | 256,305 | 93,637 |
| Expenses | 1,905,942 | 1,366,567 | 974,394 | 595,823 | 623,826 | 80,676 |
| Net income (loss) | $(693,145) | $(792,135) | $(441,924) | $147,736 | $(367,521) | $(187,039) |
| Net income (loss) per share | $(0.05) | $(0.08) | $(0.06) | $0.02 | $(0.05) | $(0.03) |

As a result of its design engineering programs and expenditures, Northstar Electronics, Inc. is building an infrastructure to position itself for significant growth. In each of its core areas of business, the Company has proven itself with an ability to deliver high quality projects on time and within budget.

DISCUSSION

The Company's revenues were $1,641,960 for 2003 ($976,234 in 2002) and we incurred a net loss of $(693,145) for 2003 [$(792,135) in 2002]. Management is confident that the steps taken this past year can provide the basis for substantially increased revenues and profitability over the ensuing years.

Sonar Products and Technologies

Most of the loss is attributable to the Company's development projects to design and develop sonar products, sonar systems and leading edge sonar technologies. The development program has taken on two complementary directions, one aimed at defense and Homeland Security, the other aimed at civilian markets in offshore petroleum, environment and commercial fishing industries.

In 2002 and 2003, we carried out work on an underwater sonar system designed to protect ports, offshore oil platforms and ships from underwater threats, including combat divers. We designed and built the sonar and mechanical hardware components of a prototype underwater intruder detection system for a major defense contractor, which markets the system. In 2003 we received a follow-on order for additional intruder detection systems and we expect substantial production orders after testing is completed by the military. We believe that Homeland Security will form the largest part of our business over the next five years.

Our second development program is called AQUACOMM for which we are receiving considerable financial support from the federal government of Canada. The program plan calls for the development of up to ten new products over the next two to three years. At present we are putting in place the technological infrastructure including new specialized equipment, laboratory facilities and engineering personnel. With this infrastructure established, we are able to draw on the particular capabilities needed for the development of each product.

One example of the type of system we intend to develop is for the offshore petroleum industry. Floating production systems, in the shape of ships, are held in place by a large subsea buoy that is moored to anchoring points on the ocean floor. It is important prior to the mating of the ship with the buoy to monitor the motions of the buoy in six degrees of freedom. Through our AQUACOMM program, we can develop a system that measures these motions (heading, pitch and roll) along with depth, water temperature, salinity and water current speed. All of the data would be then transmitted via our sonar communication link to a receiver on a support ship.
An important part of our AQUACOMM program is enhancements to our NETMIND trawl monitoring system for the commercial fishing industry. These enhancements would give NETMIND an advantage over our competitors and, therefore, we expect to see resulting increased sales and profits. Several AQUACOMM sonar products are expected to be introduced to the marketplace in 2004.

Netmind

Sales of NETMIND systems increased in 2003 over 2002 primarily because of new markets opened up in Europe. In particular, the new dealership in Spain is exceeding sales expectations for that area. Previously mentioned technical enhancements are being introduced and will continue to be introduced throughout 2004. These enhancements combined with an aggressive national and international marketing campaign should lead to a further growth in NETMIND sales revenues for 2004.

Contract Manufacturing
Northstar remained active pursuing contract manufacturing opportunities during 2003. We expect to play a strong regional role in fulfilling the extensive industrial benefit requirements of the $3billion Maritime Helicopter Project that will be part of the contract. We also expect to carry out more submarine console contracts for Lockheed Martin Naval Electronics and Surveillance Systems in Manassas, Virginia, having signed a Manufacturing License Agreement with them in 2003. We are also actively pursuing business development for contract work on the Joint Strike Fighter (JSF) program for which Lockheed Martin in Dallas-Fort Worth is the prime contractor. The areas we have focused on to date have been fiber optics, training and courseware. In particular, we have bid to provide the dual mode fiber optic assemblies for the JSF.

Systems Integration
During 2002 we carried out the development of the sonar hardware and mechanical housing for the intruder detection system, as mentioned above. We conducted the project as a system integration in that Northstar Network was the project manager and contracted other companies to perform sub-tasks. Northstar then brought all the sub-tasks together to make and test the final system.

We foresee carrying out future system integration projects on contract work we expect on the Maritime Helicopter Project, the JSF and other defense related projects. During 2003, we continued systems integration work on the intruder detection system.

Total revenues were $1,641,960 for 2003 compared with $976,234 in 2002 and $1,176,527 in 2001. Contract revenues declined over the years 2001 and 2002. The Company continues to pursue further contract business and is anticipating several substantial contracts in 2004.

Gross margins were 74% for 2003 compared with 59% in 2002 and 44% in 2001. The percentage increase was created by lower component costs and higher gross margins associated with NETMIND sales, a decrease in the lower margined contract sales volume and the inclusion of Aquacomm grants totaling $633,731 in revenue (2002 - $218,597). A significant cause of the fluctuation in the gross margin percentages is due to changes in the revenue mix where the Company is now generating revenue with significantly less direct costs attached.

As mentioned previously, in 2002, the Company was successful in funding its $2.5Million AQUACOMM product development program. In 2003 the Company spent $848,277 on design engineering and prototype development related to the development of underwater sonar technology ($609,299 in 2002). The Company received contract revenues of $325,000 (2002 -$179,269) and government incentives of $626,496 (2002 -$218,597) during the current year to offset certain of these costs. The direct result of extensive spending on design engineering and prototype development during the current year has been a loss of $(693,145) for 2003 compared to losses of $(792,135) in 2002 and $(441,924) in 2001.

The Company expects that design and manufacture of homeland security and anti-terrorism systems will be a major component of its business over the next five years. The Company is expecting to receive production contracts from a major US defense contractor for the sonar hardware portions of detection systems.

Liquidity and Capital Resources

The Company used cash in operations of $(368,708) in 2003 compared to cash used by operations of $(589,419) during 2002 and cash used by operations of $(138,931) during 2001. Cash used in operations was offset by the Company's raising of capital by the issuance of its common shares. In 2003, the Company was successful in raising net equity financing of $1,096,040 ($706,793 in 2002) through a Regulation S common share issuance and private placements.

The Company's working capital and capital requirements will depend on many factors, including the ability of the Company to increase sales from marketing of the NETMIND system in order to generate sufficient funds to cover the current level of operating expenses. The Company further intends to create working capital from the business to be generated pursuant to the Manufacturing License Agreement with Lockheed Martin. During the most recent fiscal year the Company increased its long-term debt by $106,331. The availability of sufficient future funds will depend to an extent on the obtaining of manufacturing contracts on a timely basis. Accordingly, the Company may be required to issue securities to finance any working capital requirements. There can be no assurance whether or not such future financings will be available on satisfactory terms.

Certain statements in this report and elsewhere (such as in other filings by the Company with the Securities and Exchange Commission ("SEC"), press releases, presentations by the Company of its management and oral statements) may constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Words such as "expects," "anticipates," "intends," "plans," "believes," "seeks," "estimates," and "should," and variations of these words and similar expressions, are intended to identify these forward-looking statements. Actual results may materially differ from any forward-looking statements. Factors that might cause or contribute to such differences include, among others, competitive pressures and constantly changing technology and market acceptance of the Company's products and services.
The Company undertakes no obligation to publicly release the result of any revisions to these forward-looking statements, which may be made to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

Item 7. Financial Statements

NORTHSTAR ELECTRONICS, INC.

Index to Consolidated Financial Statements December 31, 2003 and 2002 (U.S. Dollars)

Report of Independent Chartered Accountants
Consolidated Balance Sheets
Consolidated Statements of Operations
Consolidated Statements of Changes in Stockholders' Equity (Deficit)
Consolidated Statements of Cash Flows
Notes to Consolidated Financial Statements

TO THE BOARD OF DIRECTORS AND STOCKHOLDERS
OF NORTHSTAR ELECTRONICS, INC.

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

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits 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. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, these consolidated financial statements present fairly, in all material respects, the consolidated financial position of Northstar Electronics, Inc., as at December 31, 2003 and 2002 and the results of its operations and its cash flows for each of the three years ended December 31, 2003 in accordance with accounting principles generally accepted in the United States of America.

\S\

Chartered Accountants

Vancouver, Canada
March 26, 2004

NORTHSTAR ELECTRONICS, INC.
Consolidated Balance Sheets
December 31
(U.S. Dollars)

| | 2003 | 2002 |
|---|---|---|

| | | |
|---|---|---|
| **Assets** | | |
| Current | | |
| Cash | $613,040 | $117,690 |
| Accounts receivable (note 5) | 227,444 | 345,454 |
| Inventory | 161,602 | 147,846 |
| Prepaid expenses | 11,148 | 4,682 |
| Total Current Assets | 1,013,234 | 615,672 |
| Intangible asset (note 6) | 37,285 | 33,613 |
| Property and equipment (note 6) | 118,956 | 104,458 |
| Total Assets | $1,169,475 | $753,743 |
| **Liabilities** | | |
| Current | | |
| Accounts payable and accrued liabilities | $236,255 | $418,555 |
| Loans payable (note 7) | 58,905 | 72,863 |
| Deferred revenue (note 5) | 143,309 | 0 |
| Current portion of long-term debt (note 8) | 83,527 | 62,079 |
| Total Current Liabilities | 521,996 | 553,497 |
| Long term debt (note 8) | 376,282 | 315,932 |
| Discount on long term debt (note 8) | 137,910 | 113,377 |
| Due to Cabot Management Limited (note 9) | 85,268 | 70,105 |
| Due to Director (note 9) | 44,255 | 140,297 |
| Total Liabilities | 1,165,711 | 1,193,208 |
| Contingencies and Commitment (notes 10 and 11) | | |
| Stockholders' Equity (Deficit) | | |
| Common Stock | | |
| Authorized | | |
| 100,000,000 Common shares with a par value of $0.0001 each | | |
| 20,000,000 Preferred shares with a par value of $0.0001 each | | |
| Issued and outstanding | | |
| 15,838,074 (11,907,976 - 2002) Common shares | 1,584 | 1,191 |
| Additional Paid-in Capital | 3,423,191 | 2,179,624 |
| Other Comprehensive Income (loss) | (82,373) | 25,213 |
| Accumulated Deficit | (3,338,638) | (2,645,493) |
| Total Stockholders' Equity (Deficit) | 3,764 | (439,465) |
| Total Liabilities and Stockholders' Equity (Deficit) | $1,169,475 | $753,743 |

NORTHSTAR ELECTRONICS, INC.
Consolidated Statements of Operations
Years Ended December 31
(U.S. Dollars)

| | 2003 | 2002 | 2001 |
|---|---|---|---|
| Revenues | $ 1,641,960 | $ 976,234 | $ 1,176,527 |
| Discounts | 198,950 | 148,425 | 171,830 |
| Revenues net of Discounts | 1,443,010 | 827,809 | 1,004,697 |
| Cost of Goods Sold | 230,213 | 253,377 | 472,227 |
| Gross Margin | 1,212,797 | 574,432 | 532,470 |
| Expenses | | | |
| Research and development | 848,277 | 439,003 | 71,852 |
| Tax credits on research and development | (138,810) | (55,401) | (26,142) |
| Salaries, wages and benefits | 358,970 | 248,553 | 330,316 |
| Consulting | 219,161 | 129,875 | 42,900 |
| Travel and marketing | 163,143 | 145,610 | 167,321 |
| Rent | 108,623 | 95,226 | 78,423 |
| Business development | 82,221 | 85,491 | 76,147 |
| Office | 45,387 | 51,446 | 38,092 |
| Interest and bank charges | 9,917 | 43,779 | 4,228 |
| Professional fees | 91,440 | 63,975 | 87,523 |
| Telephone, light and heat | 48,820 | 32,671 | 26,067 |
| Interest on long-term debt | 18,574 | 32,043 | 32,065 |
| Miscellaneous | 12,404 | 22,460 | 13,818 |
| Amortization | 37,815 | 31,836 | 31,784 |
| | 1,905,942 | 1,366,567 | 974,394 |
| Net Loss | (693,145) | (792,135) | (441,924) |
| Other Comprehensive Income (Loss) | (107,586) | (12,095) | 3,314 |
| Total Comprehensive Loss | $(800,731) | $(804,230) | $(438,610) |
| Net Loss Per Share | $(0.05) | $(0.08) | $(0.06) |
| Weighted Average Number of Shares Outstanding | 14,446,986 | 9,954,597 | 7,820,940 |

NORTHSTAR ELECTRONICS, INC.
Consolidated Statements of Changes in Stockholders' Equity (Deficit)
Years Ended December 31
(U.S. Dollars)

| | Number of Shares | Par Value | Additional Paid-in Capital | Other Compre hensive Income | Accumu lated Deficit | Total Stock holder Equity (Deficit) |
|---|---|---|---|---|---|---|
| Balance, December 31, 2001 | 7,942,009 | $794 | $1,146,447 | $ 37,308 | $(1,853,358) | $(668,809) |

| | | | | | | |
|---|---|---|---|---|---|---|
| Issuance of common stock | | | | | | |
| For cash | | | | | | |
| On private Place- ment | 3,173,309 | 318 | 1,114,448 | 0 | 0 | 1,114,766 |
| On exercise of Options | 78,123 | 8 | 0 | 0 | 0 | 8 |
| For serv- Ices | 714,535 | 71 | 275,075 | 0 | 0 | 275,146 |
| Share issue Costs | 0 | 0 | (407,981) | 0 | 0 | (407,981) |
| Valuation of stock Options | 0 | 0 | 51,635 | 0 | 0 | 51,635 |
| Other comprehensive income (loss) | 0 | 0 | 0 | (12,095) | 0 | (12,095) |
| Net loss | 0 | 0 | 0 | 0 | (792,135) | (792,135) |
| Balance December 31, 2002 | 11,907,976 | $1,191 | $2,179,624 | $25,213 | $(2,645,493) | $(439,465) |
| Issuance of common stock | | | | | | |
| For cash | | | | | | |
| On private Place- Ments | 1,782,405 | 178 | 798,967 | 0 | 0 | 799,145 |
| On unit offe- Rings | 1,720,235 | 172 | 587,328 | 0 | 0 | 587,500 |
| On exercise of Options | 25,000 | 3 | 12,497 | 0 | 0 | 12,500 |
| For serv- Ices | 152,361 | 15 | 72,261 | 0 | 0 | 72,276 |
| For fees | 250,097 | 25 | 103,881 | 0 | 0 | 103,906 |
| Share issue costs | | | | | | |
| - for cash | 0 | 0 | (303,105) | 0 | 0 | (303,105) |
| - for shares | 0 | 0 | (103,906) | 0 | 0 | (103,906) |
| Valuation of stock Options | 0 | 0 | 75,644 | 0 | 0 | 75,644 |
| Other compre- hensive (loss) | 0 | 0 | 0 | (107,586) | 0 | (107,586) |
| Net loss | 0 | 0 | 0 | 0 | (693,145) | (693,145) |
| Balance, December 31, 2003 | 15,838,074 | $1,584 | $3,423,191 | $(82,373) | $(3,338,638) | $ 3,764 |

NORTHSTAR ELECTRONICS, INC.
Consolidated Statements of Cash Flows
Years Ended December 31
(U.S. Dollars)

| | 2003 | 2002 | 2001 |
|---|---|---|---|
| Operating Activities | | | |
| Net loss | $(693,145) | $(792,135) | $(441,924) |
| Adjustments to reconcile net loss to net cash Used in operating activities | | | |
| Amortization | 37,815 | 31,836 | 31,784 |
| Stock based and uncompensated services | 75,644 | 51,635 | 42,900 |
| Services paid with | | | |

| | | | |
|---|---|---|---|
| common stock | 72,276 | 275,146 | 87,610 |
| Changes in operating assets and liabilities | | | |
| Accounts receivable | 162,195 | (206,001) | 302,970 |
| Prepaid expenses | (5,543) | 716 | (3,339) |
| Inventory | 15,039 | (40,589) | 28,279 |
| Accounts payable and accrued liabilities | (165,703) | 89,973 | (187,211) |
| Deferred revenue | 132,714 | 0 | 0 |
| Cash Used in Operating Activities | (368,708) | (589,419) | (138,931) |
| Investing Activities | | | |
| Acquisition of equipment | (45,810) | (78,004) | (24,080) |
| Proceeds on disposal of Equipment | 9,415 | 0 | 0 |
| Cash Used in Investing Activities | (36,395) | (78,004) | (24,080) |
| Financing Activities | | | |
| Issuance of common stock for cash | 1,096,040 | 706,793 | 0 |
| Loans payable (repayment) | (73,823) | 79,941 | (9,067) |
| Proceeds from long-term Financing | 69,972 | 30,066 | 189,415 |
| Repayment of long-term debt | (69,923) | (186,668) | (83,466) |
| Advances from (repayment to) Director | (132,030) | 115,896 | (23,088) |
| Cash Provided by Financing Activities | 890,236 | 746,028 | 73,794 |
| Effect of Foreign Currency Translation on Cash | 10,217 | (614) | 3,314 |
| Inflow (Outflow) of Cash | 495,350 | 77,991 | (85,903) |
| Cash, Beginning of Year | 117,690 | 39,699 | 125,602 |
| Cash, End of Year | $613,040 | $117,690 | $39,699 |
| Supplemental Information | | | |
| Interest paid | $18,574 | $32,043 | $32,065 |

NORTHSTAR ELECTRONICS, INC.
Notes to Consolidated Financial Statements
Years Ended December 31, 2003 and 2002
(U.S. Dollars)

1. ORGANIZATION, BASIS OF PRESENTATION AND NATURE OF OPERATION
These financial statements include the accounts of Northstar Electronics, Inc. ("the Company") and its wholly owned subsidiaries Northstar Technical Inc. ("NTI") and Northstar Network Ltd. ("NNL"). All inter-company balances and transactions are eliminated.  The parent company was incorporated May 11, 1998 in the State of Delaware and had no operations other than organizational activities prior to the January 2000 merger described below.  The Company's business activities are conducted principally in Canada and the financial statements are prepared in accordance with accounting

principles generally accepted in the United States of America with all figures translated into United States dollars for reporting purposes.

On January 26, 2000, the Company completed the acquisition of 100% of the shares of Northstar Technical Inc. The Company effected the merger through the issuance of 4,901,481 shares of treasury stock with the former shareholders of the subsidiary receiving a majority of the total shares then issued and outstanding. The transaction has been accounted for as a reverse take over resulting in the consolidated financial statements including the results of operations of the acquired subsidiary prior to the merger.

As a result of the reverse takeover described above the liabilities of the accounting acquiree in excess of its identifiable assets were treated as a recapitalization and charged to additional paid-in capital.

The Company, through its subsidiaries, develops, produces and sells an undersea wireless communications system ("Netmind") and manufactures, under contract, defence and aerospace electronic systems. The Company also carries out research and development activities for customers on specific fixed price contract bases.

2. SIGNIFICANT ACCOUNTING POLICIES

(a) Revenue recognition
Revenue from the sales of the NETMIND system are recognized on an accrual basis based on agreed terms with the customers. Sales are recorded when the systems are delivered and the customer is invoiced at the agreed terms. Contract manufacturing sales are recorded as each contracted unit is delivered to the contracting customer.

Revenue from fixed price research and development contracts is recognized using the percentage of completion method whereby revenue is recognized at the same percentage that contract costs to date is of total costs at contract completion.

(b) Inventory
Inventories are valued at the lower of average cost and net realizable value.

(c) Research and development
Research and development costs are expensed to operations as incurred.

(d) Investment tax credits
Investment tax credit refunds arising from the incurrence of qualifying research and development expenditures are not recognized until the applicable project is approved as a qualifying research and development project by Canada Revenue Agency. The refunds are recorded as a reduction in the applicable research and development expense.

(e) Property and equipment
Property and equipment are recorded at cost less any government assistance received and are being amortized over their estimated useful lives or term of lease, whichever is shorter, using the following rates:

| | | |
|---|---|---|
| Computer equipment | - | 30% Declining balance |
| Computer software | - | 30% Declining balance |

| | | |
|---|---|---|
| Furniture and equipment | - | 20% Declining balance |
| Manufacturing equipment | - | 20% Declining balance |
| Leasehold improvements | - | 20% Straight-line |

(f) Long-lived assets
SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" establishes a single accounting model for long-lived assets to be disposed of by sale including discontinued operations. SFAS 144 requires that these long-lived assets be measured at the lower of carrying amount or fair value less cost to sell, whether reported in continuing operations or discontinued operations.
As such, these long-lived assets of the Company are reviewed when changes in circumstances require as to whether their carrying value has become impaired, pursuant to SFAS 144. Management considers assets to be impaired if the carrying value exceeds the future projected cash flows from related operations (undiscounted and without interest charges). If impairment is deemed to exist, the assets will be written down to fair value less cost to sell.

(g) Government assistance
The Company's subsidiaries have been awarded assistance under certain Government of Canada assistance programs. Amounts received or receivable under these programs are recorded as revenue at the time the amounts are approved for payment by the government agency.

(h) Foreign currency translation
The Company's operations and activities are conducted principally in Canada; hence the Canadian dollar is the functional currency. Amounts incurred in U.S. dollars are translated as follows:
i. Monetary assets and liabilities at the rate of exchange in effect as at the balance sheet date;
ii. Non-monetary assets and liabilities at the exchange rates prevailing at the time of the acquisition of the assets or assumption of the liabilities; and
iii. Revenues and expenditures at rates approximating the average rate of exchange for the year.

For reporting purposes, assets and liabilities of non - U.S. subsidiaries that operate in a local currency environment are translated to U.S. dollars at year end exchange rates. Translation adjustments are recorded as other Comprehensive income or (loss) not affecting deficit within stockholders' equity.

(i) Other comprehensive income (loss)
The Company has other comprehensive income (loss) arising from foreign currency translation of the subsidiary companies financial statements to US funds. Accordingly, other comprehensive income (loss) is shown as a separate component of stockholders' equity (deficit).

(j) Use of estimates
The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant areas requiring the use of management estimates relate to the determination of the impairment

of assets, useful lives for depreciation and amortization. Financial results as determined by actual events could differ from those estimates.

(k) Net loss per share
Net loss per share calculations are based on the weighted average number of common shares outstanding during the year. Diluted net income per share is computed using the weighted average number of common and dilutive common equivalent shares outstanding during the year. The following is a reconciliation of the numerators and denominators of the basic and diluted net loss per share computations for the periods presented:

| | Net Loss | Weighted Average Number of Shares | Net Loss Per Share |
|---|---|---|---|
| Year ended December 31, 2001 | | | |
| Basic net loss | $(441,924) | 7,820,940 | $ (0.06) |
| Year ended December 31, 2002 | | | |
| Basic net loss | $(792,135) | 9,954,597 | $ (0.08) |
| Year ended December 31, 2003 | | | |
| Basic net loss | $(693,145) | 14,446,986 | $(0.05) |

Diluted loss per share is not shown as it is anti-dilutive

(l) Stock-Based Compensation
The Company applies the intrinsic value method of accounting as prescribed by APB Opinion No. 25 "Accounting for Stock Issued to Employees" and related interpretations, in accounting for options granted to employees. As such, compensation expense is recorded on the date of the grant when the market price of the underlying stock exceeds the exercise price. SFAS 123 "Accounting for Stock-based Compensation" establishes accounting and disclosure requirements using the fair value-based method of accounting for stock-based compensation plans. As allowed by SFAS 123, the company elected to continue to apply the intrinsic value-based method of accounting described above and has adopted the disclosure requirements of SFAS 123.

Compensation expense of $nil (2002-$24,000; 2001 - $37,240) was recognized as salaries expense. Had compensation expense been determined as provided in SFAS 123 using the Black-Scholes option-pricing model, the pro-forma effect on the Company's net loss and per share amounts would have been as follows:

| | 2003 | 2002 | 2001 |
|---|---|---|---|
| Net loss, as reported | $(693,145) | $(792,135) | $(441,924) |
| Deduct: stock-based employee compensation expense under intrinsic value method | 0 | 24,000 | 37,240 |
| Add: total stock-based compensation expense determined under fair value based method | (54,560) | (414,054) | (67,480) |
| Net loss, pro-forma | $(747,705) | $(1,182,189) | $(472,164) |
| Net loss per share, as reported | $(0.05) | $(0.08) | $(0.06) |
| Deduct: stock-based employee compensation | | | |

| | | | |
|---|---|---|---|
| expense under intrinsic value method | 0 | 0 | 0 |
| Add: total stock-based compensation expense determined under fair value based method | (0.01) | (0.04) | (0.01) |
| Net loss per share, pro-forma | $(0.06) | $ (0.12) | $ (0.07) |

The fair value of each option grant is calculated using the following weighted average assumptions:

| | | | |
|---|---|---|---|
| Expected life (years) | 5 | 7 | 5 |
| Risk free interest rate | 2.75% | 4.38% | 4.00% |
| Expected volatility | 93.93% | 80.86% | 45.04% |
| Expected dividend yield | 0.00% | 0.00% | 0.00% |

During the year the Company granted stock options to consultants and accounted for the options using the Black-Scholes option pricing model resulting in consulting expense of $58,610 recorded by the Company. In addition, $17,034 (2002 - $23,136) relating to stock options granted in a prior year, and vested in 2003, for legal services has been expensed as professional fees.

(l) Recent accounting pronouncements

i. In January 2003 the FASB issued interpretation No. 46, Consolidation of Variable Interest Entities, an interpretation of Accounting Research Bulletin No. 51, Consolidated Financial Statements. Interpretation 46 establishes accounting guidance for consolidation of variable interest entities that function to support the activities of the primary beneficiary. Interpretation 46 applies to any business enterprise both private and public that has a controlling interest, contractual relationship or other business relationship with a variable interest entity. The Company has no investment in or contractual relationship or other business relationship with a variable interest entity and therefore the adoption did not have any impact on the Company's consolidated financial position, results of operations or cash flows.

ii. On April 30, 2003 the FASB issued Statement No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities. Statement 149 is intended to result in more consistent reporting of contracts as either freestanding derivative instruments subject to Statement 133 in its entirety, or as hybrid instruments with debt host contracts and embedded derivative features. In addition, Statement 149 clarifies the definition of a derivative by providing guidance on the meaning of initial net investments related to derivatives. Statement 149 is effective for contracts entered into or modified after June 30, 2003. The adoption of Statement 149 did not have any effect on its consolidated financial position, results of operations or cash flows.

iii. On May 15, 2003 the FASB issued Statement No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity. Statement 150 establishes standards for classifying and measuring as liabilities certain financial instruments that embody obligations of the issuer and have characteristics of both liabilities and equity. Statement 150 represents a significant change in practice in the accounting for a number of financial instruments, including mandatory redeemable equity instruments and certain equity derivatives that frequently are used in connection with share repurchase programs. Statement

150 is effective for all financial instruments created or modified after May 31, 2003 and to other instruments as of September 1, 2003. The adoption of Statement 150 on July 1, 2003 did not have any impact on its consolidated financial position, results of operations or cash flows.

iv. In December 2002, FASB issued SFAS 148, "Accounting for Stock-based Compensation - Transition and Disclosure, an amendment to SFAS 123". SFAS 148 provides two additional transition methods for entities that adopt the preferable method of accounting for stock-based compensation. Further, the statement requires disclosure of comparable information for all companies regardless of whether, when, or how an entity adopts the preferable, fair value method of accounting. These disclosures are now required for interim periods in addition to the traditional annual disclosure. The amendment to SFAS 123, which provides for additional methods, are effective for the periods beginning after December 15, 2002, although earlier application is permitted. The amendments to the disclosure requirements are required for financial reports containing condensed financial statements for interim periods beginning after December 15, 2002.

3. FINANCIAL INSTRUMENTS

i. Fair values
The carrying value of cash, accounts receivable, accounts payable and accrued liabilities and loans payable approximate their fair value because of the short maturity of these financial instruments. The fair value of long term debt net of discount for interest free loans, the significant portion of long term debt being interest free or with fixed interest rates, and amounts due to related parties all approximate their fair values.

ii. Interest rate risk
The Company is not exposed to significant interest rate risk due to the short term maturity of its monetary current assets and current liabilities.

iii. Credit risk
The Company is exposed to credit risk with respect to its accounts receivable. The Company follows a program of credit evaluations of customers and limits the amount of credit extended when deemed necessary. The Company maintains provisions for potential credit losses and any such losses to date have been within management's expectations.

iv. Foreign exchange risk
The Company translates the results of foreign operations into US currency using rates approximating the weighted average exchange rate for the year. The exchange rate may vary from time to time.

4. ECONOMIC DEPENDENCE

During 2003 one customer accounted for 35% of the Company's sales (28% 2002 and 2001). The Company has no further contracts in place with this customer at this time although additional orders are anticipated from this customer.

5. ACCOUNTS RECEIVABLE

| | 2003 | 2002 |
|---|---|---|

| | | |
|---|---|---|
| Trade receivables | $125,886 | $93,066 |
| Government assistance – research and Development | 0 | 197,239 |
| Investment tax credits Receivable | 101,558 | 55,149 |
| | $227,444 | $345,454 |

During 2002 the Company received approval for government assistance to a maximum amount of $2,200,000Cdn based on 60.2% of eligible project costs estimated at $3,658,765Cdn.

The project, 'Aquacomm', is a research and development project to develop new products. Qualifying costs must be incurred prior to March 31, 2005. During 2003 the Company received advances in excess of costs incurred and shown as deferred revenue at December 31, 2003. During 2002 the Company incurred qualifying costs on which the applicable government assistance of $197,239 was not received until 2003 and was shown as a receivable at the 2002 year end. Assistance received is contingently repayable as disclosed in Note 10 (ii).

NORTHSTAR ELECTRONICS, INC.
Notes to Consolidated Financial Statements
Years Ended December 31, 2003 and 2002
(U.S. Dollars)

6. PROPERTY AND EQUIPMENT

| | Cost | 2003 Accumulated Depreciation And Amortization | Net |
|---|---|---|---|
| Computer equipment | $34,944 | $14,782 | $20,162 |
| Computer software | 59,098 | 38,831 | 20,267 |
| Furniture and equipment | 49,439 | 18,740 | 30,699 |
| Manufacturing equipment | 73,940 | 31,280 | 42,660 |
| Leasehold improvements | 7,729 | 2,561 | 5,168 |
| | $225,150 | $106,194 | $118,956 |

During the 2003 year the Company reduced the cost of property and equipment additions by $42,040 in government assistance received.

| | Cost | 2002 Accumulated Depreciation And Amortization | Net |
|---|---|---|---|
| Computer equipment | $28,266 | $10,529 | $17,737 |
| Computer software | 53,616 | 32,053 | 21,563 |
| Furniture and equipment | 33,792 | 16,324 | 17,468 |
| Manufacturing equipment | 49,983 | 8,181 | 41,802 |
| Leasehold improvements | 7,180 | 1,292 | 5,888 |
| | $ 172,837 | $ 68,379 | $ 104,458 |

Intangible Asset

The Company acquired the design rights and tooling for a significant component of its Netmind system at a cost of $37,285. The asset has an indefinite life and will be tested for impairment annually.

7. LOANS PAYABLE

| | 2003 | 2002 |
|---|---|---|
| 10% term loan with monthly interest payments only, due July 3, 2006. | $50,000 | $0 |
| 10% demand loan payable on June 26, 2004 | 8,905 | 6,656 |
| 10% loan payable to Enterprise Newfoundland and Labrador in monthly interest payments, due on demand | 0 | 2,817 |
| 10% demand loan payable on November 5, 2002. The loan was repaid in January, 2003 | 0 | 63,390 |
| | $58,905 | $72,863 |

NORTHSTAR ELECTRONICS, INC.
Notes to Consolidated Financial Statements
Years Ended December 31, 2003 and 2002
(U.S. Dollars)

8. LONG-TERM DEBT

| | 2003 | 2002 |
|---|---|---|
| Atlantic Canada Opportunities Agency ("ACOA") | | |
| Interest free loan with monthly principal repayments of $3,256 Cdn ($94,395 Cdn: 2002 - $133,467 Cdn) | $72,778 | $84,605 |
| 12% loan with monthly principal repayments of $1,786 Cdn plus interest ($53,574Cdn: 2002 - $75,006 Cdn) | 41,306 | 47,546 |
| Interest free loan repayable in 72 monthly consecutive instalments of $3,119 Cdn ($130,975 Cdn: 2002 - $168,403 Cdn) | 100,982 | 106,751 |
| Interest free unsecured loan repayable in monthly payments of Cdn $5,938 commencing April, 2005 ($448,875 Cdn: 2002 - $350,875 Cdn) | 346,083 | 222,420 |
| Interest free loan payable $867Cdn monthly commencing January 2004 ($47,432 Cdn) | 36,570 | 30,066 |
| | 597,719 | 491,388 |
| Less: Current portion | 83,527 | 62,079 |
| | 514,192 | 429,309 |
| Discount on interest free loans payable | (137,910) | (113,377) |
| | $376,282 | $315,932 |

| | | |
|---|---|---|
| Principal repayment terms are approximately: | 2004 | $83,527 |
| | 2005 | $124,730 |
| | 2006 | $112,604 |
| | 2007 | $77,370 |
| | 2008 | $59,422 |
| | Thereafter | $140,066 |

| |
|---|
| $597,719 |

9. RELATED PARTY TRANSACTIONS

(i) The amount due to Cabot Management Limited, an associated private company related by a common shareholder and director, bears no interest, has no set terms of repayment and is subordinated to amounts due to ACOA.

(ii) The amount due to a director bears no interest and has no set terms of repayment and is subordinated to amounts due to ACOA.

10. CONTINGENT LIABILITIES

(i) The Company is a defendant in a lawsuit commenced against them in 1999 by their former master distributor. The former distributor has alleged that the Company has interfered with the ability of the former distributor to sell products. The Company has filed a counter claim for monies owing by the former distributor to the Company.

(ii) The Company is contingently liable to repay $852,328 ($1,105,484Cdn) in assistance received under the Atlantic Innovation Fund. The assistance is repayable annually commencing August 1, 2005 at the rate of 5% of gross revenues from sales of products resulting from the Aquacomm research and development project. Gross revenues are to be calculated for the fiscal year immediately preceding the due date of the respective payment. Repayment is to continue until the assistance is repaid in full.

11. COMMITMENT

The Company is committed to minimum rental payments of $77,000 per year for the next two years for office space and operations facilities.

12. STOCK OPTIONS

The following table summarizes the Company's stock option activity for the years ended December 31, 2003 and 2002:

| | Number of Shares | Exercise Price Per Share | Weighted Average Exercise Price |
|---|---|---|---|
| Balance, December 31, 2001 | 1,547,123 | $0.0001 to $0.60 | $ 0.48 |
| Granted during year | 1,755,000 | $ 0.50 to $ 1.00 | $ 0.56 |
| Cancelled or Expired | (100,000) | $ 0.50 | $ 0.50 |
| Exercised | (78,123) | $ 0.0001 | $ 0.0001 |
| Balance, December 31, 2002 | 3,124,000 | $ 0.50 to $ 1.00 | $ 0.57 |
| Granted during year | 522,500 | $0.50 to $1.50 | $0.81 |
| Cancelled or | | | |

| | | | |
|---|---|---|---|
| Expired | (485,000) | $0.50 to $1.00 | $0.62 |
| Exercised | (25,000) | $0.50 | $0.50 |
| Balance, December 31, 2003 | 3,136,500 | $0.50 to $1.50 | $0.57 |

As at December 31, 2003 and 2002 the outstanding stock options granted to directors, employees and others are as follows:

| Expiry Date | Exercise Price | Number of Shares 2003 | 2002 |
|---|---|---|---|
| February 12, 2004 | $ 0.50 | 425,000 | 525,000 |
| February 12, 2009 | $ 0.50 | 265,000 | 265,000 |
| October 12, 2009 | $ 0.50 | 25,000 | 25,000 |
| December 15, 2010 | $ 0.50 | 244,000 | 244,000 |
| October 26, 2003 | $ 0.50 | 0 | 160,000 |
| March 31, 2006 | $ 0.0001 | 0 | 0 |
| April 24, 2011 | $ 0.50 | 25,000 | 25,000 |
| May 25, 2006 | $ 0.0001 | 0 | 0 |
| September 17, 2006 | $ 0.50 | 50,000 | 50,000 |
| January 26, 2006 | $ 0.50 | 75,000 | 75,000 |
| June 25, 2007 | $ 0.50 | 125,000 | 125,000 |
| June 25, 2007 | $ 0.75 | 175,000 | 175,000 |
| July 5, 2007 | $ 0.50 | 815,000 | 815,000 |
| December 19, 2012 | $ 0.50 | 405,000 | 405,000 |
| October 1, 2003 | $ 0.50 | 0 | 75,000 |
| October 1, 2003 | $ 0.75 | 0 | 75,000 |
| October 1, 2003 | $ 1.00 | 0 | 75,000 |
| December 4, 2011 | $ 0.50 | 10,000 | 10,000 |
| May 31, 2008 | $0.50 | 50,000 | 0 |
| May 31, 2008 | $0.75 | 75,000 | 0 |
| May 31, 2008 | $1.00 | 75,000 | 0 |
| May 31, 2008 | $1.25 | 75,000 | 0 |
| May 31, 2008 | $1.50 | 50,000 | 0 |
| July 8, 2008 | $0.50 | 22,500 | 0 |
| April 30, 2008 | $0.50 | 150,000 | 0 |
| Total outstanding and exercisable | | 3,136,500 | 3,124,000 |

Subsequent to December 31, 2003 options expiring February 12, 2004 were extended to February 12, 2009 by the Company.

Warrants

The Company has issued 1,428,570 warrants exercisable at $0.50 per share. The warrants provide for a cashless exercise and expire in July, 2010.

During the year ended December 31, 2003 the Company issued 291,665 warrants exercisable at $0.35 to $0.50. These warrants expired unexercised during the year.

NORTHSTAR ELECTRONICS, INC.
Notes to Consolidated Financial Statements
Years Ended December 31, 2003 and 2002

(U.S. Dollars)

13. INCOME TAXES

The subsidiaries have operating losses which may be carried forward to apply against future year's Canadian taxable income. The tax effect has not been recorded in these consolidated financial statements. These losses expire as follows:

| | |
|---|---|
| 2004 | $367,978 |
| 2005 | 194 |
| 2006 | 211,391 |
| Thereafter | 832,478 |
| $1,412,041 | |

The components of future income tax assets are as follows:

| | 2003 | 2002 |
|---|---|---|
| Future income tax assets | | |
| Non-capital loss carry forwards | $1,412,041 | $1,001,000 |
| Approximate tax rate | 40% | 40% |
| | 564,817 | 400,400 |
| Less: Valuation allowance | (564,817) | (400,400) |
| | $0 | $0 |

Item 8. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure

Item 8A. Controls and Procedures
Within 90 days prior to the date of this report, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Executive and Financial Officer, of the effectiveness of the design and operation of the Company's disclosure and control procedures. Based upon that evaluation, the Chief Executive and Financial Officer concluded that the Company's disclosure and control procedures are effective. There were no significant changes in the Company's internal controls or in other factors that could significantly affect these subsequent to the date of their evaluation.

There are no reportable disagreements on accounting or financial disclosure issues

PART III

Item 9. Directors, Executive Officers, Promoters and Control Persons; Compliance with Section 16(a) of the Exchange Act

| Name of Director | Age | Office |
|---|---|---|
| Wilson Russell, PhD | 58 | President and Principal Financial Officer |
| Mr. Robert Blair | 72 | Director |

David Buttle, PhD 55 Director

Item 10. Executive compensation
During the year the Company paid $53,550 (2002 - $35,227) to Wilson Russell for his services.

Item 11. Security Ownership of Certain Beneficial Owners and Management

| Class | Name and Address | Number of Shares | Percentage of Shares* |
|---|---|---|---|
| Common | Frank Power<br>998 Riverside Drive<br>Port Coquitlam, B.C.<br>Canada V3B 7Y4 | 1,018,200 | 6.43% |
| Common | Wilson Russell<br>4742 Collingwood Street<br>Vancouver, B.C.<br>Canada V6S 2B4 | 2,540,743 | 16.04% |
| Common | David Buttle<br>The Well House, Burkham<br>Wokington, Berkshire<br>United Kingdom RG114P5 | 44,399 | 0.28% |
| Common | All officers and directors<br>as a group | 2,585,142 | 16.32% |

*Based on 15,838,074 shares of common stock issued and outstanding December 31, 2003

Item 12. Certain Relationships and Related Transactions
No change since previous filing

PART IV

Item 13. Exhibits and Reports on Form 8-K
No change in exhibits since previous filing
No Form 8K was filed during the fourth quarter of 2003

Item 14. Principal Accountants Fees and Services
During the year the company's auditors and principal accountants received approximately $34,695 in remuneration for audit and related (quarterly reviews) services. No other services were provided to the Company by its auditors and principal accountants.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

(Registrant) Northstar Electronics, Inc.

By (Signature and Title) /S/ WILSON RUSSELL
Date March 16, 2004 Wilson Russell, PhD, President, Principal Financial Officer

By (Signature and Title) /S/ ROBERT BLAIR
Date March 16, 2004 Robert Blair, Director

By (Signature and Title) /S/ DAVID BUTTLE
Date March 16, 2004 David Buttle, PhD, Director

CERTIFICATION OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER
PURSUANT TO 18 W.S.C. SECTION 1350 as adopted and PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002, the undersigned Chief Executive Officer and chief Financial Officer, or persons fulfilling similar functions, each certify:
(i) That the financial information included in this Annual Report fairly presents in all material respects the financial condition and results of operations of the Company as of December 31, 2003 and for the periods presented in the report; and
(ii) That the Annual Report fully complies with the requirements of Sections 13(a) or 15(d) of the Securities exchange Act of 1934

By: /s/ Wilson Russell
Title: Chief Executive Officer and Chief Financial Officer
Date: March 16, 2004

302 CERTIFICATION

I, Wilson Russell, Chief Financial Officer, certify that:

1. I have reviewed this annual report on Form 10-KSB of Northstar Electronics, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;

4. I am responsible for establishing and maintaining disclosure controls and procedures, as defined in Exchange Act Rules 13a - 14 and 15d - 14, for the registrant and have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and
c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date.

5. I have disclosed, based on my most recent evaluation, to the registrant's auditors and the audit committee of the registrant's board of directors or persons performing the equivalent functions:
a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
b) any fraud, whether or not material, that involves management or

other employees who have a significant role in the registrant's internal controls.

6. I have indicated in this annual report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: March 16, 2004 /s/ Wilson Russell

Wilson Russell, CEO and Chief Financial Officer and Director