

**SEAMILES LIMITED**  
**Management's Discussion and Analysis**  
**of Financial Condition and Results of Operations**  
**For the Three and Six Months Ended June 30, 2007**

Date: August 23, 2007

SeaMiles Limited (the "Company") is engaged in the business of cruise based loyalty rewards programs as well as the business of real estate development in the Muskoka region of Ontario. The Company's primary focus from a shareholder perspective is its cruise based loyalty program in the United States of America through its wholly owned subsidiary, SeaMiles, LLC ("SeaMiles"). In this regard, the management of the Company believes that more business opportunities to increase shareholder value lie in the Company's loyalty card division.

The following discussion and analysis is based on the Company's consolidated financial statements, including notes, for the six months ended June 30, 2007. These statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). The preparation of these financial statements requires management to make assumptions and estimates that affect the amounts reported of assets and liabilities as of the date of the financial statements and the amounts reported as revenue and expenses during the reporting period. Management estimates and judgment are based on historical experience and other factors deemed to be reasonable under the circumstances. Actual future results may differ materially from these estimates under different assumptions or conditions. Management believes the accounting policies outlined in the Summary of Significant Accounting Policies section of its consolidated financial statements reflect the more significant judgments and estimates used in the preparation of its consolidated financial statements.

This discussion includes assumptions made by management that involve certain risks and uncertainties. These assumptions should be given careful consideration and undue reliance should not be placed on these assumptions.

## **Overview**

During the first six months of 2007, the Company continued to place a great deal of emphasis on its affinity card program division by carrying on its strategic and operational initiatives that will position the Company for long term, sustainable growth.

The principal loyalty program asset is the Company's wholly owned subsidiary, SeaMiles, LLC ("SeaMiles"). SeaMiles maintains a long term strategic alliance with Carnival Cruise Lines ("Carnival"), which currently offers a co-branded Carnival/SeaMiles Master Card. The card offers a point accumulation program and redemption in use and continues to grow.

In November 2006, SeaMiles signed a long-term bank card marketing agreement with Chase Bank USA N.A. ("Chase"), the credit card division of JPMorgan Chase, which will allow for the expansion of the SeaMiles loyalty program. In early 2007, SeaMiles selected VISA as its payment credit card in connection with the Chase agreement under a Promotional Co-Branded Card Agreement it signed with Visa U.S.A. Inc.

SeaMiles' business partnerships with Chase and Visa enabled the Company to successfully launch the SeaMiles Visa Signature Rewards Card program in early 2007. Chase is the issuer of this credit card which enables U.S. consumers to earn for everyday spend, and much more, while redeeming on the cruise line of their choice through SeaMiles' unique redemption platform.

To further create value for its loyalty program members and to expand its commercial partnerships, SeaMiles launched the SeaMiles Designated Travel Agent program in June 2007. Members earn bonus points when they book their cruise vacation with a SeaMiles designated travel agency. Travel agency partners benefit from the potential increase in sales volume and customer retention rate.

The Company continues to grow its SeaPoints program offered exclusively to Canadians through its wholly-owned subsidiary SeaPoints Inc. This program has been successful in its limited marketing efforts to date and SeaPoints is well positioned to launch a credit card in Canada, which would significantly enhance its SeaPoints program.

Overall, the cruising industry has been a steadily growing segment of the travel business for the past 30 years. According to the Cruise Lines International Association (CLIA), more than 12.1 million passengers cruised in 2006 with approximately 10.18 million of the passengers originating from North America. For 2007, the CLIA has forecasted 12.62 million cruise passengers, an increase of over half a million passengers from the previous year, with 10.6 million of those passengers originating from North America. Many more potential cruisers have indicated in surveys that they intend to take a cruise vacation in the near future. The industry continues to add additional capacity to meet continuously increasing demand. The SeaMiles/SeaPoints programs will help past and future potential cruise passengers earn free cruises and discounts within the travel industry.

The Company continues to develop its Muskoka properties. Construction on Phase 1 of the Greene Slate Inn is 80% complete. Management has completed a redesign of Phase 2 of the project for the purpose of providing a more cost effective design in compliance with the existing zoning by-laws. The Ports project received approval from the Council of the Corporation of the Township of Muskoka Lakes on February 20, 2007 to develop a mixed use retail/residential/office development that would consist of 8,800 square feet of retail space, 1,600 square feet of office space and nine dwelling units, five of which will be located above boathouses and four of which will be located above the retail. In order to facilitate this development the Company purchased from the

Ministry of Natural Resources the bed of the adjacent river bed in the area that will include five dwelling units above their respective boathouses. Council's approval was appealed to the Ontario Municipal Board by the adjoining property owners however following a negotiated settlement the Company received notice on August 3, 2007 from the Ontario Municipal Board that the appeal has been abandoned and as a result the Council's approval of the Company's development plans are now final, and its development may proceed.

On the real estate side, the Company's goal is to maximize the profitability of all its real estate holdings and reinvest the profits into its loyalty program. The Company does not plan to acquire any additional real estate as it will focus all its efforts and resources on its core loyalty program.

As the Company operates in two different industry segments, the Company has provided segmented reporting for its loyalty program and real estate divisions.

## **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

### **Basis of Consolidation**

The consolidated financial statements include the accounts of all subsidiaries with inter-company transactions and balances eliminated on consolidation. All of the Company's subsidiaries are wholly-owned and are considered to be fully-integrated operations.

### **Revenue Recognition**

Revenue from the SeaMiles loyalty program is derived from the sale of a MasterCard to its members, from the sale of SeaMiles through MasterCard purchases, breakage and interest on its escrow account. Revenue from the sale of SeaMiles are recorded net of costs, in accordance with Abstract 123 of the Emerging Issues Committee ("EIC") of the Canadian Institute of Chartered Accountants ("CICA"), "Reporting Revenue Gross as a Principal Versus Net as an Agent," when the collection of the sales proceeds is reasonably assured and other material conditions of the exchange are met. Gross proceeds received on the resale of SeaMiles net of the commissions earned, are included in deposits in the consolidated balance sheet until remitted. Breakage represents the estimated SeaMiles that are not expected to be redeemed by members. Breakage is estimated by management based on the terms and conditions of membership and historical accumulation and redemption patterns as adjusted for changes to any terms and conditions that affect members' redemption practices. The current breakage factor is 17%. Changes in the breakage factor are accounted for as follows: in the period of change, the deferred revenue balance is adjusted as if the revised estimate had been used in prior periods with the offsetting amount recorded as an adjustment to revenue; and for subsequent periods, the revised estimate is used.

Breakage is recognized rateably over a period of 30 months, the estimated life of a SeaMile.

Revenue from rental income is recognized on a straight-line basis over the term of the rental agreement.

## **Foreign Currency Translation**

Monetary assets and liabilities are translated at currency exchange rates in effect at the balance sheet date. Revenue and expenses are translated at average rates prevailing during the year. Translation gains and losses for the year are reflected in the statement of operations.

## **Escrow Bank Account**

In conjunction with the sale of SeaMiles and SeaPoints, the Company has established a redemption reserve to fund redemptions. The amount to be held in the reserve, as well as the types of securities it may be invested in, are based on policies established by management, which will be reviewed periodically.

## **Deferred Costs**

Financing costs related to the issue of debt securities are deferred and amortized over the term of the debt.

## **Property Held for Development**

Property held for development includes properties held for future development. The Company capitalizes all costs relating to the acquisition, development and construction of these properties. The Company reduces the cost of the property held for development for any ancillary revenues earned.

## **Trademarks**

The Company capitalizes all trademark application costs. The trademarks have been determined to have an indefinite life. If the trademark applications are not renewed or abandoned, they will be charged to operations immediately.

## **Income Producing Properties**

Land is recorded at cost which includes development and carrying costs. Other income producing properties are stated at cost less accumulated amortization. Amortization based on the estimated useful life of the asset is calculated on a diminishing balance basis as follows:

- Building – 4%
- Furniture and fixtures – 20%
- Paving – 8%

## **Impairment of Long-Lived Assets**

The Company reviews long-lived assets such as property, equipment and intangible assets with finite useful lives for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If the total of the expected undiscounted future cash flows is less than the carrying amount of the asset, a loss is recognized for the excess of the carrying amount over the fair value of the asset.

## **Stock-Based Compensation**

The Company grants stock options to officers, directors, employees and consultants pursuant to a stock option plan. The Company accounts for the stock-based compensation using the fair value as at the grant date. Under this method, compensation expense related to option grants is recorded in the consolidated statement of operations over the vesting period of the options. The compensation expense amount is based on the fair value of the option as estimated using the Black-Scholes option pricing model. The assumptions used in calculating the value of the stock options include management's best estimate, as of the date of grant, of the expected share price volatility over the term of the stock option and expected option life. As such, the amounts reported as compensation expense are subject to measurement uncertainty as the expense amount may vary significantly based on the assumptions used.

## **Income Taxes**

The Company follows the liability method of tax allocation in accounting for income taxes. Under this method, future income tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities,

and measured using the substantively enacted tax rates and laws expected to be in effect when the differences are realized.

## **Income (loss) per Share**

Income (loss) per share is calculated based on the weighted average number of shares outstanding during the year. The treasury stock method is used for the calculation of the dilutive effect of stock options.

## **Financial Instruments**

Unless otherwise noted, it is management's opinion that the Company is not exposed to significant interest, currency or credit risks arising from its financial instruments and their carrying values approximate fair values.

## **Use of Estimates**

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates that affect the reported amounts of assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from management's best estimates as additional information becomes available in the future.

## **RESULTS OF OPERATIONS**

For the three months ended June 30, 2007, the Company reported a net loss of \$2,405,866 or \$0.21 per share compared to a net loss of \$412,903 or \$0.05 per share for the same period in the previous year. The net loss was comprised of \$329,612 in net income from the loyalty card division, offset by a net loss of \$2,442,399 from real estate and \$293,079 in corporate expenses. Corporate expenses include fees paid for management and professional services to support the ongoing strategic and operational activities of the Company and its subsidiaries.

For the six months ended June 30, 2007, the Company reported a net loss of \$2,399,335 or \$0.21 per share compared to a net loss of \$783,390 or \$0.11 per share for the same period the previous year.

## **Revenue**

For the second quarter ended June 30, 2007, the Company reported total net revenue of \$2,806,443 compared to \$2,382,669 for the second quarter in 2006. Revenue for the

quarter was completely derived from the loyalty program division in the amount of \$2,806,443 compared to revenue reported for this segment of \$2,223,011 for the same period last year. The \$583,432 or 26% increase in loyalty program revenue is mainly attributed to the continued growth in the number of active SeaMiles loyalty program members, partially offset by a weakening U.S. dollar. As the Company disposed of all of its income producing properties during the fourth quarter of 2006, there was no rental revenue for the period compared to \$149,658 the previous year.

For the six months ended June 30, 2007, the Company had total revenue of \$5,612,327 versus \$2,583,473 in 2006. The loyalty program segment comprised \$5,612,327 of total revenue compared to \$2,278,065 the previous year. As SeaMiles was not acquired until March 29, 2006, the previous year's revenue for the six months ended June 20, 2006 only included SeaMiles loyalty program revenue from March 30, 2006 to June 30, 2006. Rental revenue was nil compared to \$305,408 in 2006.

## **Expenses**

Total expenses for the three months ended June 30, 2007 were \$5,212,310, inclusive of the \$2,440,407 write down of property held for development, compared to \$2,795,572 for 2006. The expenses for 2007 are comprised of \$2,476,831 related to the loyalty program versus \$1,864,394 in the previous year, \$2,442,399 related to real estate versus \$291,640 in 2006 and \$293,079 in corporate expenses versus \$639,538 in 2006. For the six months ended June 30, 2007, total expenses amounted to \$8,011,662 versus \$3,366,863 in 2006.

Expenses related to the loyalty program excluding amortization, interest and bank charges amounted to \$2,455,308 for the second quarter, versus \$1,846,628 last year. The current quarter's increase in expenses of \$608,680 is mainly attributed to increased operational activities required to support the SeaMiles loyalty program. For the first six months of 2007, loyalty program expenses excluding amortization, interest and bank charged came to \$4,967,158.

Management fees were nil for the second quarter and first six months of 2007 compared to \$92,417 and \$137,417, respectively, for the same periods last year. The decrease in fees is due to the addition of permanent resources to support head office activity which is now reflected in selling, general and administrative expenses.

Selling, general and administrative expenses for the three months ended June 30, 2007 increased to \$189,531 versus \$104,828 last year. For the six months ended June 30, 2007, selling, general and administrative expenses were \$353,297 compared to \$186,080 in 2006. The increase in expenses is due to the increase in resources required to support head office activity.

Interest on long-term debt for the three months ended June 30, 2007 was \$85,908 compared to \$220,046 for the same period in 2006. For the first six months of 2007,

interest on long-term debt was \$169,907 versus \$389,098 in 2006. The decrease by \$134,138 and \$219,191, respectively, is primarily due to the disposal of the Company's income producing real estate properties in 2006 which greatly reduced the amount of interest costs incurred for the real estate segment.

Bank charges and interest expense for the second quarter was \$23,975 for 2007 versus \$56,254 in 2006. The decrease of \$32,279 is mainly attributed to the improvement in the Company's working capital position. For the six months ended June 30, 2007, bank charges and interest expenses was \$48,011 compared to \$117,686 for the same period in 2006.

Amortization expense on the Company's equipment for the second quarter of 2007 was \$9,579 versus \$6,934 in 2006. For the first six months of 2007, amortization expense was \$17,780 compared to \$9,899 in 2006. The increase in amortization expense is a result of increased equipment purchases made to support the growing needs of the Company.

The amortization of deferred costs for the three months ended June 30, 2007 was \$7,602 compared to \$52,142 in 2006 and \$15,102 for the six months ended June 30, 2007 compared to \$73,284 for the same period in 2006. This primarily relates to financing costs incurred for the issuing of debt securities which are capitalized and amortized over the term of the debt.

There are no expenses related to income producing properties for the three and six months ended June 30, 2007 compared to \$10,626 and \$22,728, respectively, for the same periods in 2006 as the Company disposed of all of its income producing properties in the fourth quarter of 2006.

For the three and six months ended June 30, 2007, amortization expense on income producing real estate was nil compared to \$59,452 and \$143,129, respectively, for the same periods in 2006.

Stock based compensation for the three and six months ended June 30, 2007 are nil versus \$346,245 and \$346,245 for the three and six months ended June 30, 2006, respectively.

During the quarter ended June 30, 2007, management reviewed the book value of its property held for development. As a result of this review, management determined that a non-temporary decline in the value of the property has occurred and has recorded a write down in the amount of \$2,440,407 against the book value of the property. The book value of the Company's property held for development at June 30, 2007 is \$3,220,000.

## LIQUIDITY AND CAPITAL RESOURCES

As at June 30, 2007, the Company had total assets of \$30,112,476 compared to total assets of \$28,715,942 as at December 31, 2006. The increase in assets by \$1,396,534 is mainly related to the loyalty card division where there was an increase in funds held in the escrow account, accounts receivable and cash held in bank accounts. The company had \$1,147,967 in cash compared to \$276,582 on December 31, 2006. As at June 30, 2007, the Company held funds in an escrow bank account totaling \$15,142,815. The funds in the account will be used to primarily fund future point redemptions made by members of the SeaMiles loyalty program for cruise rewards.

As at June 30, 2007, the Company had total liabilities of \$25,623,191 versus total liabilities of \$21,882,322 on December 31, 2006. Total liabilities include \$3,000,000 in convertible debt (\$3,000,000 at December 31, 2006) and current and long term debt of \$3,535,959 (\$3,582,882 at December 31, 2006).

The Company's net working capital as at June 30, 2007 was a deficit of \$1,503,862 compared to a deficit of \$693,869 as at December 31, 2006. The increased deficit is primarily due to the mortgage of \$1,000,000 due January 2008 moving from long term debt to current liabilities in 2007.

The Company's long-term debt, including the current portion, as of June 30, 2007 was \$3,535,959 compared to \$3,582,882 at December 31, 2006. The decrease of \$46,923 is primarily due to the Company making payments on its long-term debt.

As at June 30, 2007, the Company had \$3 million in convertible debt which is unchanged from December 31, 2006. The \$3 million in convertible debentures was issued in April 2006 and has a two year term, bearing interest at a coupon rate of 10%, payable monthly. The debentures are convertible into common shares at the rate of \$3.00 per share at the sole option of the lenders for the entire term expiring no later than April 30, 2008. If all of the current debentures are converted, it will result in the issuance of 1,000,000 common shares. The debentures are secured by a general security agreement and mature on April 30, 2008.

As at June 30, 2007, the Company's share capital was \$16,677,907 compared to \$16,585,047 at December 31, 2006. The increase of \$92,860 is attributed to the Company receiving \$55,000 cash from the exercise of 50,000 stock options and the re-allocation of \$37,860 from contributed surplus to share capital regarding the applicable stock based compensation.

At June 30, 2007, the Company had the following issued and outstanding common shares and common share purchase warrants:

	Number of		\$	
	Voting Common Shares	Common Share Purchase Warrants	Voting Common Shares	Equity Component of Convertible Debt
Balance	11,321,399	200,000	\$16,677,907	\$ -

The terms of the outstanding common share purchase warrants are as follows:

Warrants	Exercise Price	Expiry Date
200,000	\$3.50	September 30, 2007

The Company had the following stock options to its officers, directors and certain consultants outstanding as at June 30, 2007:

Date of Grant	Stock Options (#)	Exercise Price	Expiry Date
May 12, 2006	410,000	\$3.50	May 12, 2008
August 24, 2006	150,000	\$3.25	August 24, 2008
	<u>560,000</u>		

The fair value of stock options granted were based on the Black-Scholes model for pricing options.

Cash provided from operations was \$518,305 for the three months ended June 30, 2007 compared to cash used in operations of \$1,128,591 for the same period in 2006. For the six months ended June 30, 2007, cash provided from operations was \$710,200 compared to cash used in operations of \$735,412. The increase in cash is primarily attributed to an increase in the Company's accounts payable balance and improved operating results in 2007 versus 2006.

## FINANCIAL INSTRUMENTS

The Company's financial instruments involve mortgages payable which are secured against property of the Company and convertible debentures. The risks associated with the mortgages payable is that interest rates could rise, making it more expensive to borrow money against the various properties, and cyclical changes in the real estate

market. The convertible debentures are also subject to the risk of interest rates rising. The Company is not exposed to any significant interest risks and their carrying values approximate their fair values.

## **RELATED PARTY TRANSACTIONS**

Related party transactions are in the normal course of operations and are measured at the exchange value (the amount of consideration established and agreed to by the related parties), which approximates the arm's length equivalent for the services.

## **SUBSEQUENT EVENTS**

In July 2007, the Company received \$126,500 from the exercise of 115,000 stock options.

On July 8, 2007, 135,000 stock options of the Company expired.

## **RISKS AND UNCERTAINTIES**

The Company is exposed to a variety of risk factors relative to the nature of its business. It is difficult to accurately predict future operating results as actual results may differ significantly from any forward-looking statements. Factors that may cause such differences include but are not limited to the following:

- Obtaining adequate and timely financing on terms that are acceptable
- Whether properties are successfully developed and the timing of such developments
- Obtaining municipal approval for its development projects
- Costs and timing of products and services required associated with development activities
- Market acceptance of properties offered
- The cyclical nature of real estate market values
- Interest rate trends
- Circumstances that are beyond the control of the travel industry such as acts of terrorism or severe climate changes
- Competition in the cruise card loyalty business
- Ability to generate positive cash flow from operations
- Ability to retain and attract key management and other experienced personnel

## **DISCLOSURE CONTROLS AND PROCEDURES**

As at the quarter ended June 30, 2007, an evaluation was carried out under the supervision of and with the participation of the Company's management, including the President and Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures. Based on that evaluation, the President and the Chief Financial Officer concluded that the design and operations of these disclosure controls and procedures were effective as at June 30, 2007 to provide reasonable assurance that material information relating to the Company would be made known to them by others within the Company.