



OSI Geospatial Inc.

Third Quarter 2009 Conference Call Transcript

Date: Thursday, October 15, 2009

Time: 2:00 PM PT / 5:00PM ET

Speakers: **Jane Hayward**
Investor Relations

John Sentjens
VP, Finance

Ken Kirkpatrick
President, CEO



OPERATOR: Hello, this is conference operator. Welcome to the OSI Geospatial's 2009 Third Quarter Conference Call. As a reminder, all participants are in a listen-only mode and the conference is being recorded. Should anyone need assistance during the conference call they may signal for an operator by pressing * and then 0 on their touch-tone telephone. At this time I would like to turn the conference over to Jane Hayward, Investor Relations. Please go ahead.

JANE HAYWARD: Thank you Brock. Thank you and good afternoon everyone and thank you for joining us to discuss OSI Geospatial's 2009 third quarter results. Our results were issued at 4:05 PM today, October 15, 2009. These documents are now available on our website at www.osigeospatial.com. We are also broadcasting this event live on our website. There is a link posted to our Investor's page.

Joining me this afternoon on the call are Ken Kirkpatrick, President and Chief Executive Officer, and John Sentjens, VP, Finance. We will begin this afternoon with John Sentjens, who will review the 2009 third quarter financial and operating results. Ken Kirkpatrick will follow with the third quarter highlights.

During the call we will be making forward-looking statements about OSI Geospatial's business. These statements are subject to risks and uncertainties which could cause actual results to differ materially, these include but are not limited to risks related to the number of large customer transactions and their related lengthy sales cycles, uncertainties associated with competitive bidding processes and contract negotiations, actions by international government authorities, the effects of general economic and political conditions and changing foreign exchange rates. These and other risks are disclosed in the Management's Discussion and Analysis filed with the relevant securities regulators.



Statements made on this call reflect management's analysis as of today, and management does not assume any responsibility or obligation to update any forward-looking statements made during this presentation.

During the call we will make reference to selective non-GAAP financial measures, including firm backlog and working capital. We feel these measures provide meaningful information to investors. These non-GAAP measures do not have a standardized meaning and are not likely to be comparable to similar measures presented by other issuers. Please note that all financial information is stated in Canadian dollars and in accordance with Canadian GAAP.

I would now like to turn the call over to John.

JOHN SENTJENS: Thanks Jane and good afternoon everyone. I will begin by providing you a high-level overview of our financials.

In the third quarter we reported revenue of \$6.2 million, similar to the third quarter revenue of \$6.3 million in 2008. For the third quarter of 2009 the Company reported a net loss before tax of \$293,000 and after tax of \$263,000, compared to a net loss before tax of \$692,000 and after tax of \$683,000 for the same quarter in 2008.

Our Marine Systems revenue decreased 37% or \$1.2 million to \$2 million due to the delay in closing awarded contracts. We reported \$2.9 million of Land and Air Systems revenue, an increase of 31% from the \$2.2 million generated in Q3, 2008. This increase was attributable to the delivery schedules of existing contracts.

Our Mapping Operations revenue increased 39% to \$1.3 million from \$942,000 in Q3 2008. The increase was also due to the delivery schedules of existing



contracts as conditions allowed work, delayed from previous quarters, to be performed.

We reported a gross profit percentage of 38%, compared to 35% for the same quarter in 2008. The slight increase is due to higher margins than average on several projects in the US operations. Overall, operating expenses decreased 10% to \$2.6 million or 43% of revenue, general and administrative expenses remained consistent at \$1.4 million or 22% of revenue. Engineering expenses decreased 42% to \$175,000 from \$300,000 or 3% of revenue as engineering staff and related costs were charged to cost of sales to support specific customer orders and capitalized deferred development activities, sales and market expenses decreased 5% to \$867,000.

The net loss attributable to common share holders was \$410,000 or \$0.01 per share compared to \$839,000 or \$0.02 per share in the same quarter of 2008. At August 31, 2009 firm backlog which consists of firm, fixed and signed orders at quarter end was \$45 million compared to \$53 million at August 31, 2008. Of the \$45 million, \$5 million is expected to be executed in the fourth quarter of fiscal 2009 and the remainder will be executed in fiscal 2010 and beyond.

As of August 31, 2009 we had awarded contracts of approximately \$20 million of which we expect to realize \$1.7 million in the fourth quarter of 2009 and the remainder will be executed in 2010 and beyond.

Now, turning to our balance sheet, at August 31, 2009 we had current assets were \$9.8 million and current liabilities \$5.7 million. Working capital was \$4.1 million at quarter end, a reduction from the \$4.7 million at the end of the second quarter.

As stated in our second quarter conference call, the company's US operating line of credit was frozen at USD604,000. In August we reached an agreement with



our bank to extend our line of credit to October 31, 2009. Earlier this month the company successfully established credit facilities with another US financial institution. The new facility has a variable limit that is based on the outstanding accounts receivable of the US operations, which we expect will provide credit facilities of approximately \$1.2 million if required. In Canada we did not meet the interest coverage ratio for the three and nine months ended August 31, 2009. In addition, for the three months ended May 31, 2009 and August 31, 2009 we did not meet the tangible net worth covenant.

Early in the fourth quarter our bank requested we operate within the line of credit of \$1.35 million due to our failure to remedy the covenant breaches. As at August 31, 2009 the company had drawn on its operating line of credit in the amount of \$1 million. The company forecasts that it will be able to operate its Canadian operations within the reduced line of credit. I will now turn the call over to Ken.

KEN KIRKPATRICK: Thank you John. Before I start I would like to apologize in advance, I have a very bad cold but will do my best to be as clear as possible.

In the third quarter we were successful in closing contracts valued at approximately \$3 million and made progress towards closing awarded contracts valued at approximately \$20 million. Subsequent to the end of the third quarter we have been successful in closing an additional \$3 million of awarded contracts.

During the first nine months of 2009 we've experienced significant delays in closing awarded contracts and a number of our key pursuits have been delayed due to budget and program issues. The most significant impact on the company has been the result of project delays in the United Kingdom, I will discuss this in more detail in a few minutes. These challenges have negatively impacted our financial results in the first nine months.



To respond to the situation we have taken the necessary steps to reduce expenses across the company including headcount reductions, suspension of our RRSP and 401(k) matching programs, mandatory vacation usage and several other non-labor cost reduction initiatives. We remain committed to returning the business to a profitable position and we are working hard to get there but unfortunately we will not be able to achieve this in 2009.

I would now like to tell you about our key accomplishments since the second quarter conference call and the progress that we are making towards achieving our objectives.

I am pleased to report that we closed a \$1.3 million contract to provide warship navigation systems to the Royal Netherlands Navy. The Dutch Navy is our seventh fleet wide WEDCIS customer and we fully expect our business relationship to expand. In fact, we have recently announced a \$400,000 contract with the Dutch Navy to deliver and install a training simulator that will be used to train students in the use of the company's world-leading ECPINS-W system. This is our first training simulator project and we are optimistic that we can leverage the success to develop opportunities with our other customers.

We will deliver the majority of these contracts before the end of our fiscal year and I am confident that we will close additional business with this customer in 2010. The Netherlands Navy win is very important as it builds on our WEDCIS niche market leadership position that directly supports the development and entry into adjacent niche markets that are so critical to our growth strategy.

The UK continues to be a very important market for our company. We have successfully implemented a fleet-wide deployment of our WEDCIS and W-AIS technology for the UK Navy. We have been actively developing new business in the UK and we are making progress, but unfortunately budget and program delays directly impacted our business in 2009.



The CBF Aircraft Carrier Program has been delayed two years due to budget issues. The Astute Class Submarine Program has been delayed due to procurement delays and the T-45 Destroyer Upgrade Program has been slow to ramp up due to program issues.

I am pleased to report that we are making solid progress as we have now signed the engineering design contracts for the integration of our WEDCIS and W-AIS technologies for the T-45 Program and the procurement process for Astute Submarine program is nearing completion. We expect that these programs and others will provide significant revenue in 2010.

The company continues to focus key resources on the development of large projects in Canada. There are a number of projects that are ramping up leading into 2010 that the company has been positioning for over the last two years. These projects are multi-year, multi-million-dollar contracts and we expect the procurements to ramp up in early 2010. We have established strong partnerships to support these procurements and believe that we are well positioned for these projects. We will provide more information as we make further progress.

In the third quarter we continued to develop our W-AIS and ACT niche markets. This focus is built on the success of the projects delivered to the Royal UK and Canadian navies, respectively. These systems provide a tactical advantage and directly enhance the operational performance, security and safety of their critical assets, people and equipment.

Our sales and technical teams have been making considerable progress over the last six months in developing and qualifying opportunities in the United States through our maritime security operation as well as Australia, Canada, the United Kingdom, and specific Middle Eastern and Asian countries. We are optimistic that these technologies present a significant growth opportunity for our company and we are confident that we will achieve success leading into 2010.



Over the last several years, countries around the world have been investing significant resources in national security and critical infrastructure protection. There are many Middle Eastern and Asian Pacific countries that are regions where there are extreme security risks and many NATO countries are conducting operations in these regions. They are responsible -- they are responding to these threats by building small and fast patrol vessels that are armed and designed for littoral operations.

To respond to this significant market opportunity, we have developed an integrated navigation and tactical system, or INTS, as a direct result of the integration of ECPINS, W-AIS and ACT that provides unparalleled capability. Our system can be easily integrated into a patrol vessels', navigation sensors, weapon system and combat management system.

We are extremely excited about the potential of the patrol vessel market as it can have a shorter sales cycle and it will position our company to increase our average revenue per vessel fivefold. In addition, this market offers a much higher number of platforms when compared to major combatants, our traditional target market.

We believe that this market presents the largest growth opportunity for our Company with a total addressable market of \$700 million to \$1 billion over the next eight to 10 years. We believe that we have the best solution in the world and it's ready to be delivered.

We are actively developing business in select NATO, Middle Eastern and South-eastern Asian countries and strongly believe that we are well placed for success in these markets. We have identified and qualified a number of opportunities that we are actively pursuing that we believe will close in 2010.



In the third quarter, we continued to work closely with our partner, the Raytheon Company, to execute the competitive phase of the US Army ground soldier systems program. Our team was successful in delivering 10 prototype systems under Increment 1 in September 2009 and we were awarded Increment 2 for 50 additional systems.

The execution of this project is going extremely well and we strongly believe that our team is well positioned to win the overall US Army, Ground Soldier Systems Program that is expected to be awarded in 2011. Our business relationship with Raytheon is progressing very well and we are beginning to discuss other opportunities. I look forward to sharing more information as things progress over the next few months.

Our advanced technology, research and development division continues to make solid progress in developing land-based, command and control and advanced training technologies in support of military applications. We've recently announced \$2 million of US Army contracts and we continued to expand the US Army classified program that we discussed last quarter.

We remain confident that this program will lead to a multi-year, multi-million-dollar contract by the end of the fourth quarter or early in the first quarter of 2010. Our R&D team has made significant progress in closing a number of contracts in support of developing hands-on advanced emergency medicine training devices that provide a low-cost, flexible training solution for combat medics and soldiers, addressing the three most common causes of preventable deaths on the battlefield; extremity hemorrhage, airway compromise, and penetrating chest wounds.

It is estimated that 15% of battlefield deaths are preventable with proper procedures and training. This is a high priority area for the US government funding due to significant military operations being conducted in Iraq and



Afghanistan. We have made considerable progress in developing advanced technologies to directly address these concerns and expect this work to lead to significant contracts leading into 2010.

Our Mapping business had a strong third quarter. This was primarily driven by Canadian government projects. We continued to experience the results of the economic downturn in the United States as the number of available projects has declined. The reduction in the number of projects has put added pressure on the already price competitive industry. We expect our Mapping business to experience continued top line pressure and expect revenue in 2009 to be similar to 2008.

These market conditions are making the divestiture strategy more challenging but we are ramping up a more aggressive effort to complete a transaction as quickly as possible. We believe that the US stimulus package that has been established in 2009 will benefit the mapping industry and we will see an increase in projects leading into 2010.

We realize that aggressive steps must be taken to ensure the Company is profitable. As discussed earlier, we are taking the necessary actions to return the business to a profitable position in 2010. It is also critical that the Company strengthen its balance sheet by securing the necessary capital to ensure we can effectively implement our growth strategy.

As previously communicated, we have developed a plan to divest non-core assets that do not directly support our strategic direction. We are making good progress and we are optimistic that we will achieve success leading into 2010.

Over the last three years, we have made the necessary investments to position the Company in a number of growth markets and we strongly believe that our



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shareholders will see benefit in 2010. Thank you for joining us today. We look forward to speaking with you again on our year-end conference call.

OPERATOR:

Ladies and gentlemen, this concludes today's conference call. You may now disconnect your telephones. Thank you for joining and have a pleasant day.