



OSI Geospatial Inc.

Fourth Quarter 2009 and Year-End Conference Call Transcript

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Speakers: **Sandy Oneschuk**
Investor Relations

John Sentjens
VP, Finance

Ken Kirkpatrick
President, CEO



SANDY ONESCHUK: Good afternoon, everyone, and thank you for joining us to discuss OSI Geospatial's 2009 Fourth Quarter and Year-End results. We will also be discussing our 2010 strategic direction. Our results were issued at 4:05 PM. on March 1st, 2010. These documents are now available on our web site at www.OSIGeospatial.com. We are also broadcasting this event live on our web site. There is a link posted to that page.

Joining me this afternoon on the call, are Ken Kirkpatrick, President and CEO, and John Sentjens, Vice President Finance. We will begin this afternoon with John Sentjens who will review the 2009 fourth quarter and year-end financial and operating results. Ken Kirkpatrick will follow with the 2009 highlights and the 2010 strategic plan. We will then open the call to analysts' questions.

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 government authorities; the effects of general economic and political conditions; and changing foreign exchange rates. These and other risks are disclosed in the management discussion and analysis portion of the Company's Annual Reports 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 selected 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. With that, I will turn the call over to John Sentjens.

JOHN SENTJENS: Thanks, Sandy and good afternoon, everyone. I will begin by providing you with a high level overview of our financials. In the fourth quarter, we reported revenue of \$4.7 million, a decrease of approximately 42% over the fourth quarter revenue of \$8.1 million in 2008. Our 2009 consolidated quarter revenue of \$8.1 million in 2008. Our 2009 consolidated revenue was \$23 million, compared with \$26.9 million in 2008, a decrease of 14%.

Our revenue growth in 2009 was negatively impacted by delays in the execution of signed contracts, and delays in the signing of new contracts and contract options. For the fourth quarter of 2009, the Company reported a net loss before and after tax of \$5.7 million, compared to a profit before tax of \$363,000 and after-tax of \$1 million for the same quarter in 2008. For the full-year of 2009, the net loss before tax of \$7.9 million and after-tax of \$7.7 million compares with a net loss before tax of \$2.4 million and after tax of \$1.4 million in 2008.

The net loss in 2009 was driven by the delays in contracts executed in the fiscal year, the delays in contract awards, one-time restructuring costs of \$652,000, and a goodwill impairment charge of \$4.5 million.

Moving on to particulars: our Maritime systems revenue decreased \$4.2 million to \$8.2 million, primarily due to the delays in the execution of signed contracts, and delays in the signing of new contracts and contract options.

We reported \$11.1 million of Land and Air systems revenue, an increase of 9% from the \$10.2 million generated in 2008. This increase was largely attributable to



the delivery schedules of existing contracts and the timely passage of the US defense budget for 2009. Our Mapping Operations revenue decreased 13%, to \$3.8 million, from \$4.3 million in 2008. The revenue decrease was primarily the result of poor flight conditions, which resulted in lower production levels during the third and the fourth quarters of 2009.

For 2009, we reported a gross profit percentage of 32%, compared to 36% for 2008. This lower percentage is primarily due to the lower revenue levels of our high-margin Maritime business. General and administrative expenses decreased 6% to \$5.3 million. The comparative decrease is primarily due to lower professional fees that resulted from the Company's termination of its SEC registration in the fourth quarter of 2008, and lower salaries as a result of reductions in staff levels.

Engineering expenses decreased 26%, to \$872,000 as more staff and related costs were charged to cost of sales to support revenue-generating projects. Also, certain development costs met the deferral criteria under Canadian GAAP, so these expenditures were capitalized. The Company deferred \$237,000 of development cost incurred in the fiscal year of 2009. Sales and marketing expenses decreased 23%, to \$3.2 million, due to lower commissions, vacancies in sales positions, and reduction in discretionary spending; but as a percentage of revenue, we are lower by only 1%.

During the fiscal year 2009, the Company incurred one-time restructuring costs of \$652,000, and a noncash goodwill impairment charge of \$4.5 million. The restructuring costs are the result of a workforce reduction of approximately 20 employees. The goodwill impairment charge reflects the impact of the sustained decrease in the Company's market capitalization, reduced operating forecasts, and the divestiture of a non-core intellectual property asset.



Overall we reported a loss of \$7.7 million, compared to a net loss of \$1.4 million in 2008. The net loss attributable to common shareholders was \$8.3 million, or \$0.18 per share, compared to \$2 million or \$0.04 per share in 2008. At November 30, 2009, firm backlog - which consists of firm, fixed and signed orders at year-end - was \$43 million, compared to \$57 million at November 30, 2008. Of the \$43 million in firm backlog, we expect \$9 million to be executed in 2010.

Now, turning to our balance sheet: at November 30, 2009, current assets were \$8.8 million and current liabilities were \$5.3 million. Working capital is \$3.5 million at year-end. Our current assets and working capital have decreased this year, largely due to the conversion of receivables to cash during the year. Subsequent to the year-end on February 1, 2010, we announced that our US systems operations signed a contract valued at \$6.5 million US, with Harris Corporation.

Under the terms of this contract, the company sold all of its rights to its Soldier Systems intellectual property and transferred its San Diego-based employees, office and associated equipment, furniture and fixtures to Harris. The expected net cash proceeds after corporate income taxes are approximately \$5 million. The funds from the sale of these non-core assets will strengthen our balance sheet, and provide the resources to further develop our core technologies and expand our marketing capabilities to support the continuing development of our Maritime niche markets.

Now I would like to turn the call over to Ken.

KEN KIRKPATRICK: Thank you, John. I will begin by discussing our 2009 operating performance. Our consolidated revenue in 2009 was \$23 million, compared to \$27 million in 2008, a decrease of 14%. Our revenue decline in 2009 was primarily driven by our Maritime business. This was a direct result of key projects being delayed, and our new, niche market development initiatives taking longer to yield results than



expected. In a few minutes, I will discuss the progress that we have made towards closing these projects, and how our market expansion efforts are developing.

The consolidated gross profit for 2009 was \$7.5 million compared to \$9.8 million in 2008. Our gross profit percentage of revenue in 2009 was 32%, compared to 36% in 2008, a decline of 4%. This was primarily the result of the decline in revenue from our high gross profit Maritime business.

Our overhead expenses in 2009 were \$10.2 million, compared to \$12.2 million in 2008, a reduction of \$2 million or 16%. The reduction in overhead expenses in 2009 is the result of the Company's effort to streamline our business and narrow our focus on the market opportunities that will yield the highest return for the Company and our shareholders.

Our loss before restructuring costs, taxes and goodwill impairment was \$2.8 million, compared to \$2.4 million in 2008. The restructuring costs of \$652,000 incurred in 2009, will result in a cost savings of approximately \$1.6 million in 2010. The goodwill impairment charge of \$4.5 million in 2009 was driven by the sustained decrease in market capitalization, conservative operating forecast, and the divestiture of a non-core asset. I'm very disappointed with our financial performance in 2009, but I believe we have taken the necessary steps to ensure this is not repeated in 2010.

I am confident that our Maritime niche market expansion strategy will be successful, and will drive our growth in 2010 and in the future. This statement is supported by the fact that we have qualified and positioned the Company for several active pursuits in each of our new markets. I will discuss this in more detail in a few minutes.



Subsequent to the end of 2009, we announced the divestiture of our soldier systems intellectual property to Harris Corporation for \$6.5 million. These funds will significantly strengthen our balance sheet and provide us with the resources to take advantage of the growth opportunities that our niche Maritime markets present for our world-leading technologies.

In 2009, we remained focused on the execution of our business strategy to expand our Maritime niche markets, forge strong industry partnerships, strengthen our end customer relationships, and position the Company for large programs. I will now discuss the challenges we experienced, and the progress that we have made on a number of fronts in 2009.

As discussed in the Q3 conference call, the project delays in the UK were the primary reason for the poor performance of our Maritime business in 2009. We have a clear understanding of the reasons why these delays have occurred, and have been proactively working with our partners and the end customer, the Royal Navy, to move these projects to closure in 2010. We continue to focus on the development of the warship navigation market, leveraging our world leading ECPINS service and non-service navigation. After an extensive competitive process, we were successful in closing our seventh fleet-wide customer, The Netherlands Navy. That further strengthens our leadership position, and provides direct evidence of the competitive advantage that we enjoy in this market.

We recognize the importance of partnerships that can support access to key markets and programs. In support of this, we are committed to building on our existing partnerships and developing new partnerships. This includes the work we are doing with Lockheed Martin and BAE Systems in the UK. Our warship navigation market leadership position has provided us with the foundation to develop and build new niche Maritime markets that we strongly believe will offer significant growth opportunities for our Company.



We are confident that our work in 2009 will lead to success in this market in 2010. Over the last three years, the Company has invested significant resources in the development of new Maritime niche markets. In support of these markets, we have developed disruptive technologies that will afford us a competitive advantage and position the Company to secure a leadership position.

I will now discuss these markets and the progress that we are making. In 2009, we completed the development of a disruptive technology that provides advanced, tactical asset control and tracking capabilities for naval, small boat operations. Naval ships generally operate with one to three small boats depending on their size and mission. Our Small Boat Tactical System is designed to have a base station installed on the naval ship, and a system installed on each of the small boats that support naval operations. The Small Boat Systems could be integrated to one of our 400 warship navigations currently installed across 12 navies or as a stand-alone base station for a navy that has selected another company's navigation system, or does not have a requirement for a navigation system at all.

All of our existing customers have indicated significant interest in this capability, and most have completed sea trials to evaluate the effectiveness of this system. Several of our customers, including the UK, Australia and Canada, have all indicated that they are ramping up fleet-wide procurements for this technology over the next 12 months. We are actively developing opportunities with the U.S. Navy, and will be installing demonstration systems for evaluation on vessels that are being deployed to the Middle East in 2010.

In early 2009, we delivered and installed a shore-based tactical asset control and tracking system for the Canadian Navy Port Security unit that is responsible for the 2010 Vancouver Olympics, Maritime security. This system included a base station that was installed and a shore-based command center and 15 systems that were installed on small boats used to support Maritime security operations.



This project has provided us with the opportunity to better understand shore-based operations, and how our technology can significantly improve the effectiveness of Maritime security operations. The feedback that we have received from this customer, on the effectiveness of our system, has been excellent. In support of this market opportunity, we have developed many active pursuits around the world, and have established partnerships with companies that can provide us access to foreign markets and large programs. We are optimistic that this technology presents a significant growth opportunity for our Company, and we are confident that we will achieve success in 2010.

There are many countries around the world that have been investing significant resources in the development of national security and critical infrastructure protection. There are many Middle Eastern and Asian Pacific companies located in regions experiencing extreme security risks, and many NATO countries are conducting operations in these regions. They are responding to these threats by building small and fast patrol vessels that are armed and designed for littoral operations.

In response to the significant market opportunity, we have developed an integrated navigation and tactical system or INTS that integrates our ECPINS, W-AIS, and TACT technologies to provide unparalleled capability to this market. Our system can be easily integrated into a patrol vessel's navigation sensors, weapons system and combat management system. We are extremely excited about the potential of the patrol vessel market, as it has 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 seven to ten years. We believe that we have developed the best solution in the world, and it is ready to be delivered. To succeed in this market, it is critical that we develop strong partnerships with systems integrators, and shipyards, and we are making solid progress on this front. We are actively developing business in select NATO, Middle East, and Asian countries with the support of our partners, 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 late 2010, and 2011. Our advanced technology, research and development business continues to make solid progress in developing advanced technologies that could enhance military and security operations. In December 2009, we announced more than \$7.5 million of US military contracts that will provide funding to enhance and develop new technologies. In February 2010, we sold our Soldier Systems intellectual property developed by our R&D team to Harris Corporation for \$6.5 million.

Over the last two years, our R&D team has made significant progress in closing a number of contracts and 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 in the battle field, :extremity hemorrhage, airway compromise, and penetrating chest wounds. It is estimated that 15% of battlefield deaths are preventable with proper procedure and training. This is a high priority area for US government funding due to the 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 that this work will lead to significant contracts and partnerships in 2010.

We realize that the necessary steps must be taken to position the Company for profitability, and we have committed to achieving this goal in 2010 and in the



future. This objective will be realized by securing key projects in our warship navigation market, and closing projects in our new niche markets.

In 2009, we recruited key management staff that have the industry experience required to effectively develop and close projects in our growth markets. The recent sale of our Soldier Systems intellectual property has strengthened our balance sheet, and will provide the capital required to ensure that we can effectively implement our Maritime niche market growth strategy. In 2010, we will continue to focus on the execution of our business strategy to expand our Maritime niche markets for strong industry partnerships, and strengthen our end customer relationships, and position the Company for large programs. We are confident that the Company is well positioned to deliver results in 2010.

I would now be happy to take your questions.

OPERATOR: We will now begin the question-and-answer session. Your first question is from Blake Corbet of Haywood Securities. Please go ahead, sir.

BLAKE CORBET: Ken, how are you doing?

KEN KIRKPATRICK: I'm well, Blake, how are you?

BLAKE CORBET: I'm great, thanks, appreciate the color. I wonder if you could elaborate a bit on what was driving the goodwill charge. That looked like a big item in the end of the quarter and noncash, I think. If you could provide some color on that I would appreciate it.

KEN KIRKPATRICK: Sure. It is definitely a noncash impact, and will have no direct implication in our business operations, but the decision to take an impairment charge was driven by our sustained market capitalization, decrease in our capitalization. The ultimate sale of our Soldier Systems intellectual property and how that was



treated as part of the goodwill valuation, and our intent to be conservative in our forecasting as it relates to goodwill, and that was applied to our US operations.

BLAKE CORBET: Okay. All of that resulted in a charge?

KEN KIRKPATRICK: All that resulted in the charge, and again, no cash implication and no impact on our going-forward operations.

BLAKE CORBET: Thank you.

KEN KIRKPATRICK: Okay. You're welcome.

OPERATOR: The next question is from Vincent LoPriore of Gravitass Capital. Please go ahead. Mr. LoPriore, go ahead, please.

VINCENT LOPRIORE: Hello?

KEN KIRKPATRICK: Hello.

VINCENT LOPRIORE: Yes, Ken. Can your Soldier Systems IP sale to Harris Corporation for \$6.5 million be repeated in 2010? And if so, have you identified what that specific technology might be?

KEN KIRKPATRICK: Yes, over the last several years, our R&D team has developed a number of technology platforms that present the opportunity for the Company to either commercialize it our self, to establish partnerships that could lead to licensing, or ultimately could lead to divestitures of the IP itself. We have not progressed any specific technology platform to the point where I can talk clearly with certainty, but I can say that we do have technology platform that definitely create the potential. The one that I did discuss on our conference call, related to the Combat



Medic Training Solution. That is a technology base that has a lot of attention, and we are obtaining significant funding to move that technology along.

VINCENT LOPRIORE: All right. Great. Thank you.

KEN KIRKPATRICK: You're welcome.

OPERATOR: The next question is from Jason Dipaola of Axiom Capital. Please go ahead, sir.

JASON DIPAOLA: Hey, Kenneth, how's it going?

KEN KIRKPATRICK: Well, thanks.

JASON DIPAOLA: I was just curious about the INTS market opportunity, and you gave some overview on the potential size of the overall market. I mean, how aggressive can that market grow for OSI in particular? And are there are any particular programs that are already out there that you guys are going after?

KEN KIRKPATRICK: Yes, we see this market opportunity as a -- a significant growth potential. And there are a number of programs ramping up around the world. Literally hundreds of these vessels are going to be built over the next five to ten years, and we have developed, what we believe, is a unique technical solution for that market that allows to us take the advanced capabilities that we have developed for major warships, such as destroyers, and larger naval ships, and move that down into these small platforms, and giving them a significant increase in capability.

And we're able to do that in a way that allows us to be competitive with the historical technologies that have been delivered into that market which are typically commercial-grade systems. But also in support of your question is, there are a number of active programs that are budgeted, that are ramping up that have a requirement for an integrated navigation system. We believe we can step



into those programs with the right partnerships, and offer a superior solution for their operational requirements and at a very competitive price. For us, that creates an opportunity where we typically see a stand-alone system on a major warship, ranging from \$100,000 to \$200,000, to a complete system for one of these vessels ranging from \$500,000 to \$750,000. So significant increase per platform, and then the number of platforms that are available are also significantly higher than our traditional market, which is the major combatant market.

JASON DIPAOLA: Great. I appreciate it.

KEN KIRKPATRICK: You're welcome.

OPERATOR: There are no more questions at this time from analysts.

KEN KIRKPATRICK: Okay. Thank you for attending our call, and we look forward to our discussions in Q1, and to provide you a positive update on our progress. Thank you.

OPERATOR: Ladies and gentlemen, the conference has now concluded. You may now disconnect your telephone. Thank you for joining us. Have a pleasant day. Good-bye.