



**2005 Fourth Quarter and Full Year Financial Results Conference Call  
February 21, 2006 at 5 pm ET**

**Introduction: Tracy Rawa, Manager Investor Relations**

Thank you operator. Good afternoon everyone, and thanks for joining us to discuss OSI's 2005 fourth-quarter and full year results. Our results were issued about 30 minutes ago. If you have not been able to get a copy of our news release, it is posted on our website at [triple w osil.com](http://triplew.osil.com) or you can call our IR firm Lippert Heilshorn at 415.433.3777 and they will send a copy right away. We are also broadcasting this event live on our website.

Joining me this afternoon on the call are Ken Kirkpatrick, president and CEO, and John Sentjens, vice president Finance.

We'll begin this afternoon with Ken Kirkpatrick, who will review the quarter and year. John Sentjens will follow with the financial and operating highlights. And then Ken will close with a few comments about the outlook for 2006.

During the call, we will be making forward-looking statements about OSI's businesses. These statements are subject to risks and uncertainties, which could cause actual results to differ materially. These risks are disclosed in the MD&A portion of the company's Annual Report and in the annual information form filed with the relevant securities regulators. These statements 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 total backlog, firm backlog, option 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 comparable to similar measures presented by other issuers. Also, unless otherwise noted, all financial amounts are in Canadian dollars and in accordance with U.S. GAAP.

And with that, I'll turn the call over to Ken Kirkpatrick.



**2005 Business Review: Ken Kirkpatrick, President and CEO**

Thanks Tracy. Good afternoon everyone and thank you for joining us today.

2005 was an important year for OSI. We saw strong demand from our existing customer base – and won contracts totaling about \$15.5 million. Our annual revenue was stable with momentum building in the fourth quarter. And we closed the year with the highest quarterly revenue in the company’s history. This confirms for me that OSI is ready and able to sustain strong and rapid growth.

However, the year had its challenges. After strong new customer wins in 2004, that included the British Royal Navy, the Royal Australian Navy and the Portuguese Navy, we did not close on any significant new customers in 2005. This factor directly affected our revenue growth and reflects the long customer sales cycle typical in our industry. As we continue to build our customer relationships, we are confident that our hard work in 2005 will lead to new customer wins in 2006.

Also among the challenges in the year – we experienced contract delays, lower gross profit, and non-recurring expenses. Three million dollars in contracts from existing customers that we had expected in 2005 were unfortunately delayed. We expect these contracts to come through in 2006. We also reported a decline in gross profit due to a reduction in software revenue of about \$1.7 million. We expect software sales, which are high margin, to be up substantially in 2006. And lastly – non-recurring G&A expenses and a one-time non-cash tax adjustment contributed significantly to the net loss on the quarter and the year. Excluding the effect of these charges, we would have reported positive net earnings in Q4 and a greatly reduced net loss for 2005. John will provide details of these charges later in the call.

2005 was a pivotal year for the company. We continued to focus on our growth strategy through technology leadership and market penetration. To achieve this, we focused on developing innovative products, forming valuable partnerships, and building strong customer relationships. Over the last five years we have built our leadership and reputation internationally, and our systems are now in use by eight navies. In fact at the Trafalgar 200 celebration last summer the British Royal Navy called our technology “a world class system” and “an important step forward in the history of navigation for the Royal Navy.”

In 2005 we stayed the course and addressed the company’s number one challenge – direct access to the U.S. market.

We raised net funds of \$14.2 million last April to pursue acquisition targets.

Weeks later we purchased Mapcon Mapping Consultants based in Utah for \$1.3 million in cash to address access barriers to the U.S. mapping market and improve our ability to compete as a prime contractor for U.S. contracts. By the end of our fiscal year, we had booked over \$3.5 million of new U.S. business from virtually no U.S. mapping business in the prior year. In addition we have won the prime contractor role in a number of mapping contracts including our



most recent award of \$3 million by Washoe County in Nevada. This is a clear indication to us that our U.S. market access strategy is working.

As with the U.S. mapping business – the U.S. defense market has largely been closed to us as a foreign company. Defense spending by the U.S. government has historically exceeded that of all other NATO countries and their allies combined. To penetrate the U.S. defense market and diversify our product offering, we initiated negotiations in June to buy a second U.S. company. In December we completed the purchase of CHI Systems headquartered in Philadelphia, a privately-held technology supplier to the U.S. Department of Defense.

This subsidiary will effectively be the U.S. base for our products and services with U.S. employees and the existing management team conducting classified and restricted work under a special security agreement. We have lined up two outside directors with impressive experience in the U.S. defense industry to support the administration of the special security agreement. We will announce those director appointments soon.

CHI has a history of revenue growth and profitability – and will be accretive to our operations. Their business is largely service based and we expect the addition of their revenue will help smooth quarter to quarter shifts in our consolidated revenue. This will not eliminate the lumpiness we have experienced in the past but we hope as their business grows it will dilute some of the quarterly volatility. Approximately two months of CHI's results will be included in our Q106 financials.

As a combined company, we will be able to cross sell existing products and services to each other's customers. We also expect to share technical expertise in the development of new offerings. While we are both focused on the military command and control market, CHI is strong in the land and air domain and OSI's technology leadership is in the marine industry. This makes CHI a natural fit and a key element as we diversify into other defense markets.

We continue to invest heavily in R&D. Most of our R&D is devoted to sustaining the leadership of our product lines and ensuring that our customers have a path to continued improvements. Our systems are considered safety critical and require significant infrastructure investment by our customers to deploy. This creates considerable barriers to entry for our competitors. Our customers partner long-term with us knowing we deliver robust technology solutions meeting their specific requirements – in fact, our systems are repeatedly verified by our customers as best of breed. The British Royal Navy standardized on our system in 2004 which secured the international market for our technology giving smaller international navies the confidence to know significant resources backed and supported our systems. Based on the value of the initial contract we expect 15 to 20 percent annual business on average from existing customers as they deploy more vessels and add functionality. Increasingly, our customers also fund our research and development efforts to add to their capabilities. This leads to exciting new products that use our core technology as a base to deliver the value of enhanced situational awareness for use beyond the bridge and by other military services. As an example we announced the first full deployment of our Common Operational Picture product line by the



**Offshore Systems International Ltd.** (TSX: OSI; OTCBB: OFSYF)

Royal Danish Navy – marking the first entry of OSI technology into an active command and control system.

We continue to pursue strategic partnerships with the biggest and the best in our industry. Our current partners include Lockheed Martin, L-3 Communications, Northrop Grumman, Raytheon, Terma and others. In 2005, we extended our relationship with Terma for our Common Operational Picture product line and also signed a teaming agreement with Raytheon Marine in Germany to pursue integrated bridge system opportunities. Strong partnerships are a necessity in our industry and remain an essential building block of our strategy.

Now I will turn the call over to John Sentjens, who will take you through our financial and operating highlights for the year and fourth quarter.



**Financial Review: John Sentiens, Vice President Finance**

Thanks Ken and good afternoon everyone.

Consolidated company revenues of \$13.4 million were consistent with 2004. As Ken noted earlier, revenue growth for 2005 was negatively affected by contract delays. We expect these contracts to come through in 2006 and as such these have been included in our 2006 revenue guidance.

On the year, systems and systems components revenue increased by \$1.3 million or 30% and geomatics revenue was up 19% or approximately \$560 thousand. The increase in mapping revenue is primarily the result of our improved market position in the U.S. through the acquisition of Mapcon Mapping. Software revenue declined 30% or \$1.7 million. The lower software revenue contributed to our reduced gross profit. We reported a gross profit percentage of 48.4% - a decline of 9.5% from 2004.

General and administrative expenses increased 43% to \$4.8 million. This is primarily due to approximately \$800 thousand in non-recurring expenses relating to professional fees for capital advisory services, third-party stock-based compensation, and employee severance costs.

R&D costs decreased approximately 4% to \$2.0 million in 2005. The reduction is largely the result of an increase of approximately \$230 thousand for engineering labor costs charged to cost of sales from R&D. These engineering labor costs are to support specific customer orders. This decrease was offset by increases in the number of engineering staff. We believe that in order to maintain our technological leadership, we must continue to develop existing products and introduce innovative new products that challenge and redefine the industry standards.

Sales and marketing expenses were \$2.9 million for 2005 – a decrease of nearly 8%. The reduction in sales and marketing expenses is primarily due to:

- the internal re-alignment of sales staff to G&A activities to support corporate and operations initiatives,
- reduced travel costs due to more efficient travel planning, and
- decreased sales commissions as the result of lower bookings for the year.

This was in turn offset by increases in the number of sales and marketing employees.

At year-end, an assessment of our future taxable earnings determined that we were required to recognize a non-cash, one-time deferred tax expense in 2005 of approximately \$1.0 million. This tax adjustment – compounded by reduced gross profit and non-recurring G&A expenses – resulted in a net loss of \$3.4 million for 2005. This compares to net earnings of approximately \$250 thousand in 2004.

The net loss attributable to common shareholders was \$10.2 million or 37 cents per diluted share for 2005 and includes non-cash charges of \$4.8 million related to the one-time accretion of a beneficial conversion feature on the issuance of the class B preferred shares series 2 as a



part of our financing last April. This compares to a net loss of approximately \$58 thousand or 1 cent per diluted share for 2004.

Now I will summarize our fourth quarter results.

Consolidated revenue for Q4 was up 66% to \$6.1 million when compared Q4 04. Systems and systems components revenue increased by \$1.6 million or 82% and geomatics revenue was up 71% or nearly \$540 thousand. Software revenue grew by 33% or 300 thousand improving gross profit. Gross profit percentage was 51.4% for Q4 compared to 53.3% for Q4 last year. Increases in operating expenses were primarily a result of nearly \$800,000 in non-recurring expenditures in G&A. Higher R&D costs reflect an increase in staff levels and a lower amount of R&D charged to cost of sales when compared to Q4 04. Sales and marketing costs increased consistent with our business activities. The net loss of \$1.1 million in Q4 also includes a one-time, non-cash charge of \$1.0 million for the tax asset adjustment I noted in the fiscal year discussion.

As at the year-end, total backlog was \$20.4 million compared to \$21.1 million in 2004. Firm backlog – which consists of firm, fixed, signed orders issued and executable at year-end – was \$11.7 million compared to \$8.4 million for 2004. Option backlog – which is unexercised contract provisions - was \$8.7 million compared to \$12.7 million for 2004.

Our balance sheet is healthy and strong. At November 30, 2005, current assets were \$22.5 million and current liabilities were \$4.7 million. Working capital – defined as current assets less current liabilities – improved \$9.5 million to \$17.8 million at year-end. This is primarily due to the cash received from the private placement. Cash outflows from operations were \$2.1 million this year, an improvement of \$1.3 million from 2004. Our unrestricted cash on hand stood at \$9.6 million at year-end. Shortly after year-end, we used approximately \$9.3 million in cash to fund the CHI acquisition. At the time of the acquisition, CHI had a cash balance of over \$1.3 million so the net outflow of cash was approximately \$8 million – these changes in our balance sheet will be reflected next quarter. We will be filing on SEDAR and EDGAR our business acquisition report for the CHI acquisition on February 27. This report will provide you with additional information on CHI's financial performance for 2005 and pro forma statements for the combined company.

We believe we have enough cash to manage the business. We expect cash flow from operations will continue to improve throughout the year.

I would now like to turn the call back over to Ken to review our goals for 2006.



**Review of 2006: Ken Kirkpatrick, President and CEO**

Thanks John. We exit 2005 having made steady progress on our strategy. Looking ahead to the next year and beyond, it is evident we have a solid foundation to accelerate our growth.

Market conditions continue to be strong for the defense industry. Today only about 10 percent of the world's naval vessels have deployed electronic navigation systems. Of those deployed vessels, we lead the market with about 60 percent share. With the addition of CHI access to our addressable market grows substantially. We deliver products and services to a large and fast-growing part of the defense and homeland security market that is estimated by Frost and Sullivan to generate annual spending in the U.S. alone of US\$500 million. Our systems and software address critical defense issues within this niche.

We enter 2006 with leading technology and a market access strategy that we have tested and has demonstrated success.

We will focus on driving revenue growth with attention to the bottom line. We are forecasting annual revenue for 2006 of between \$28 million and \$32 million. We are confident in our ability to meet our annual guidance. As expected, delays in the approval of the U.S. federal budget and the holiday season have slowed awards in the first quarter, but we have a good number of active bids in all of our market areas, and we expect that we will win our fair share of programs.

Our key initiatives for the year are directed at strengthening our leadership in the international defense market and penetrating the U.S. defense and homeland security market.

In 2006 we intend to demonstrate our ability to penetrate the U.S. market by winning a significant U.S. Navy contract. We will also focus on market development with existing customers and expect to win a significant prime contract from the British Royal Navy. Our third goal is to secure one new customer in each of the three defense domains: air, land, and sea. Partnerships are also essential to our success and we anticipate partnering with another top-tier strategic defense contractor to accelerate U.S. and international market penetration. Our final goal for 2006 is to achieve product diversification into new market sectors – this will be accomplished by working with existing and new customers to enhance and deploy solutions, like our Common Operational Picture product line and simulation-based training products.

Beyond 2006, our long-term goal remains to grow the company's consolidated revenues to greater than \$75 million over the next three years. We will continue to pursue acquisitions in support of our growth strategy. Our acquisition focus will be on companies that can provide market access and product diversification. I would like to reinforce that our intent is to execute this strategy in a manner that benefits both the company and provides value to shareholders.

And lastly, starting in 2006 we plan to change our financial reporting segments. We will do this to reflect changes in the analysis of our business following the addition of CHI and Mapcon. We will report revenue as marine systems, land and air systems, and mapping. Our reportable segments will be our subsidiaries, namely Offshore Systems, CHI Systems, and Mapcon Mapping.



On that note, I will wind up my remarks by repeating that we are on strategy and feel strongly that we have made the right decisions for OSI to position us for our next stage of growth and development. Andrew Carniel, our VP Corporate Development, and I will be getting out on road each quarter in Canada and the U.S. to meet with our shareholders and investors. I look forward to meeting you in person.

Thank you for your attention and now we would be pleased to take your questions.

**Closing Remarks: Ken Kirkpatrick, President and CEO**

Thank you for joining us this afternoon.

In summary our objectives for 2006 are:

- Revenue of \$28 and \$32 million
- A significant U.S. Navy win
- A significant prime contract with the British Royal Navy
- One new customer in each defense domain
- Another top-tier defense contractor partnership
- And further diversification of our products into new markets

We are on strategy and feel strongly that we have made the right decisions for OSI to position us for our next stage of growth and development. I look forward to speaking to you again in April when we report our first quarter results.