



OSI Geospatial Inc.



OSI Geospatial Inc. - First Quarter 2008 Conference Call Transcription

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Speakers: **Jane Hayward**
Investor Relations

Kenneth Kirkpatrick
President and Chief Executive Officer

John T. Sentjens
Vice President, Finance



OPERATOR: At this time I'd like to turn the conference over to Jane Hayward, Investment Relations. Please go ahead.

JANE HAYWARD: Thank you Operator. Good afternoon, everyone, and thank you for joining us to discuss OSI Geospatial's 2008 First Quarter Results. Our results were issued approximately one-half hour ago. If you have not been able to obtain a copy of our news release, it is posted on our website at www.osigeospatial.com. 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, Chief Financial Officer.

We will begin this afternoon with Ken Kirkpatrick who will review the 2008 First Quarter Results. John Sentjens will follow with the financial and operating highlights and then we will open the call to analyst's 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 company's reliance on international government contracts, 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, changing foreign exchange rates and challenges related to the



company's ability to develop, introduce and implement new products and/or enhancements to existing products that respond to customer requirements in a rapidly changing and complex technological market. These and other risks are disclosed in the annual Management Discussion and Analysis filed with 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 they are not likely to be comparable to similar measures presented by other issuers.

Please note that all financial information is stated in US dollars and in accordance with Canadian GAAP. With that I will turn the call over to Ken Kirkpatrick.

KENNETH KIRKPATRICK: Thank you Jane. Good afternoon everyone, thank you for taking the time to join us for our First Quarter Conference Call. I will begin by giving you a high level overview of our financials.

In the first quarter of 2008 we reported revenue of \$5.8 million an increase of approximately 63% over the first quarter



revenue of \$3.6 million in 2007. We reported a net loss of \$627,000 before tax and \$533,000 after tax in Q1 2008 compared to a net loss of \$1.9 million before tax and \$2 million after tax in Q1 2007. As discussed during our year-end conference call, the significant improvement over the first quarter in 2007 was expected and we believe that this trend will continue.

I will now provide you with some details on the highlights for our first quarter of 2008. We've been successful in establishing a partnership with the Lockheed Martin Undersea Systems business unit to integrate our Advanced Submarine Digital Maritime Operations Plot System into their Submarine Integrated Combat System which they are marketing around the world. In our first quarter we announced that we have signed our first contract with this business unit to provide six systems that will ultimately be delivered to the Brazilian Navy. Strong industry partnerships such as this one with Lockheed Martin presents exciting opportunities to broaden our company's international market reach.

The company also completed work with BAE Systems to design the integration of our submarine navigation software into their command-and-control system that will be installed on the UK Navy's Astute Class submarines. We are now moving forward to negotiate the contract to complete the integration work to meet the project requirements. The Astute Class submarine is the largest and most powerful attack submarine ever built by the UK Navy and we are honored to be part of this very exciting program. We are confident that this program



and other projects with BAE Systems will lead to considerable future business for the company.

We continue to expand our relationship with the US Army and in our first quarter announced contracts to provide our land-based, command-and-control technology valued at more than \$2.1 million. The US Army has been a major contributor to the development of our Small Unit Situational Awareness or SUSA technology. We are confident that our commitment to meet and exceed the US Army's operational requirements will lead to a significant contract in the very near future.

In early 2007 the company signed its first contract with the US Marine Corps to provide our training technology in support of counter-IED training requirements. In the first quarter of 2008 we signed a \$2.2 million contract to provide our land-based command-and-control technology that will ultimately support US Marine Corps operational requirements. We are committed to expanding our relationship with this customer and we're optimistic that we will achieve further success.

I am very pleased with the progress that our Mapping Operation has made in the first quarter of 2008. They have successfully closed a four-year, \$3 million contract with the Province of Saskatchewan. This project is progressing very well and the customer has decided to increase the annual spending on this program so that all revenue is realized in three years instead of four. This contract was followed by more than \$1.4 million of additional contracts. The Mapping



Operation is well positioned to exceed our expectations in 2008.

We announced the launch and the first order for our new Asset Control and Tracking, or ACT System. The ACT System is an innovative, effective and flexible command-and-control solution that can be deployed on land, air or sea-based assets. The system is designed to address the unique demands of operational scenarios such as Riverine Warfare, Maritime Interdiction Operations, Amphibious Operations and Port Security Operations. The company has been successful in selling our first system to a Canadian Navy Port Security Unit and the initial feedback has been excellent. We are confident that we will see significant follow-on business in Canada and we are receiving very positive feedback from all of our existing customers.

The company remains committed to our growth strategy and in 2008 we will continue to concentrate on the following key areas, expanding our product offerings; positioning for large programs; forging strong industry partnerships; strengthening customer relationships and entering the high-growth security market.

Before I turn the call over to John, I would like to confirm that the company has delivered its response to the January 9th, 2008 SEC comment letter and we remain confident that this response will be to the satisfaction of the SEC. With that I will turn the call over to John Sentjens, who will take you through



our financial and operating highlights for the first quarter of 2008.

JOHN SENTJENS:

Thanks Ken and good afternoon everyone. Please note that all financial information is stated in US dollars and in accordance with Canadian GAAP.

Moving on to the numbers for the first quarter of 2008, consolidated revenues were \$5.8 million, a significant increase compared to the \$3.6 million we generated in the first quarter of 2007. Our Marine Systems revenue was \$2.5 million, a \$1.8 million increase over Marine Systems revenue for the first quarter of 2007. Our Land-and-Air Systems revenue was \$2.8 million, a 19% increase over 2007. And our Mapping revenue was \$505,000, a small decrease of \$8,000 or 3% over 2007.

This quarter we reported a gross profit of \$2.2 million or 38% compared to \$669,000 or 19% in the first quarter of 2007. The higher gross profit and gross profit percentage was largely due to the increase of revenue, primarily from our Marine Systems business.

General and Administrative expenses were \$1.2 million, almost the same as the first quarter of 2007. We expect G&A expenses to continue to remain consistent. Engineering expenses decreased 46% to \$261,000 as we continued to charge engineering costs or related expenses to revenue-generating projects and capitalized development projects. Sales and marketing expenses increased 16% to \$907,000. This increase is due to our increased emphasis on sales and



marketing in support of our growth strategy. We continue to aggressively pursue business development opportunities with both new and existing customers in the US, the UK and Canada.

In this quarter we accrued royalties to Technology Partnerships Canada of \$152,000 in comparison to \$30,000 in the same period last year. Firm backlog, which consists of firm, fixed and signed orders, was \$42 million at quarter end compared to \$40 million for the same period of 2007. We will no longer report total backlog, or option backlog, as we have determined that we cannot reliably predict the likelihood of our customers exercising or funding option backlog. We believe firm backlog provides investors useful insight to our future prospects.

Overall, we reported a net loss before tax of \$627,000 and a net loss after tax of \$533,000 for the first quarter of 2008, compared to a net loss before tax of \$1.9 million and a net loss after tax of \$2 million in Q1 2007. This is a significant improvement over the first quarter of 2007 and we expect this trend to continue. The net loss was expected, as our first quarter is negatively impacted by the holiday season and that creates a slowdown in government contracting and project execution. Net loss attributable to common shareholders was \$692,000 or \$0.01 per share compared to a net loss of \$2.2 million or \$0.06 per share in Q1 2007.

Now turning to our balance sheet, at February 29, 2008 we had current assets totaling \$12.2 million and current liabilities



of \$5.2 million. Working capital was \$7 million at quarter end. We generated a positive cash flow from operations of \$639,000 in the quarter. We also invested \$221,000 in fixed assets and deferred development and paid \$377,000 in dividends during the quarter. At March 29, 2008 we had borrowed \$820,000 against our credit facilities compared to \$348,000 at the end of the first quarter of 2007, and \$822,000 at the end of the fourth quarter of 2007.

We have \$3.2 million available in our revolving credit facilities. We have enough cash in credit facilities to manage the business and we expect cash flow from operations will continue to improve in the upcoming quarters. Now I would like to turn the call back to Ken.

KEN KIRKPATRICK:

2008 is an extremely important year for the company and we are committed to achieving the following objectives, secure significant contracts in the United States, United Kingdom and Canadian defense and security markets; secure US, Maritime and Port Security integrated vulnerability assessment contracts; close our first project to provide our Naval Situational Awareness Technology to the maritime security market; establish a new strategic partnership with a large defense contractor to integrate our technology into their systems to provide the company entry to large programs and extend our reach into the international market; and continue to leverage the company's core technology to develop and enter into adjacent and new markets.



We are well positioned to meet all of our established objectives in 2008. With that I would be happy to take your questions.

OPERATOR: Our first question today comes from Robert Catellier of Clarus Securities.

ROBERT CATELLIER: Yes, I didn't quite catch the comment on backlog, I think the indication was you wouldn't be giving the option backlog, but did I miss the firm backlog number?

KENNETH KIRKPATRICK: Yes, the firm backlog number was 42 million.

ROBERT CATELLIER: Ok. And when you targeting your 2008 objectives, signing on another major defense contractor, what target markets did you have in mind there, given that you're already involved in the Astute Class submarine as well as the large ships?

KENNETH KIRKPATRICK: We're actively pursuing several large opportunities in the security space and also in an area that we call Soldier Modernization Programs. So the latter is, in the United States, United Kingdom and Canada they are ramping significant programs related to modernization of their soldier systems; our Small Unit Situational Awareness Technology that we have developed over the last ten years with the support of the US Army, we believe positions us very well for those programs.

ROBERT CATELLIER: That's a pretty big program, that Soldier Modernization; to your knowledge are there components that are necessary to lead to sales opportunities for the company funded?



KENNETH KIRKPATRICK: Yes. I'll give you one example that's close to home is, there's a program that's called the Integrated Soldier System Program that's ramping up for the Canadian Army. And this is a sizeable program and it is ramping up in the near term, it's budgeted and it is progressing very aggressively.

ROBERT CATELLIER: Ok. And then just with the respect to Layered Security Solutions, have you made progress towards any new mandates? Can you give us an update there?

KENNETH KIRKPATRICK: Yes, our Layered Security Solutions business unit is progressing well. What we have found is the Department of Homeland Security budget has been a little slow to flow into the procurement arms of DHS. But we have a significant amount of activity related to submitting proposals and we are still very optimistic that we'll see that unit contribute substantially in 2008.

ROBERT CATELLIER: Are you willing to provide the Q1 contribution to the revenues?

KENNETH KIRKPATRICK: We're not providing that level of guidance this year, Rob.

ROBERT CATELLIER: Ok. And are there any developments that are noteworthy on the Littoral Combat Ship as well as the destroyer program in the US?

KENNETH KIRKPATRICK: Yes, both those programs, as is pretty public in the news, are going through some challenging times and rebasing of requirements. Our involvement in the DDG 1000 program,



which is the new destroyer program, we have delivered our solution to L-3 and L-3 is building on that. And we expect to see additional revenues from that program as some of the issues are resolved, and hopefully in the near term. The Littoral -- the LCS program, similarly, unfortunately, is also having some challenges and our component of that program is the least of their concerns, but we're optimistic that we'll start to see some movement there you know closer to the end of 2008.

ROBERT CATELLIER: Sorry, just a clarification. You've delivered but you have not recognized revenue because the program hasn't moved forward? Is that the interpretation?

KENNETH KIRKPATRICK: No. Sorry, just to clarify, on the destroyer program we have delivered and recognized revenue against that program, but that program is at the very initial stages and we would expect that we would see additional revenue from that program as they start to move into the development and production phase of the project.

ROBERT CATELLIER: Ok. And can you just comment if you've made any substantive changes to your revenue recognition policies after the filing of that comment letter?

KENNETH KIRKPATRICK: No. We have not.

ROBERT CATELLIER: Okay. Thank you.

KENNETH KIRKPATRICK: Thank you too.



OPERATOR: Our next question comes from Dev Bhangui of Haywood Securities.

DEV BHANGUI: Hi John and Ken. How are you?

KENNETH KIRKPATRICK: Hi Dev, well, yourself?

DEV BHANGUI: Good. Ken, just I guess two or three questions I'll just fire them in rapid order. I guess you have been talking for the last few quarters about the growth and the fact that OSI obviously considered LSS to be a high-growth area. You are going to lump all those revenues and all that growth in the Marine Systems business right?

KENNETH KIRKPATRICK: Sorry, in our growth area?

DEV BHANGUI: Yes. I'm saying in LSS revenues you will be recognized in Marine Systems, right?

KENNETH KIRKPATRICK: The actual LSS revenues will actually be grouped under our US Operations, which currently is being flagged as part of the Land and Air Systems business.

DEV BHANGUI: Ok. Now, we were contemplating at that time, well I guess some of the projections since that we had were that LSS probably is going to be a 10 million annualized kind of a business. Is that on track?



KENNETH KIRKPATRICK: We believe that the business has the potential to grow to that level. One of the challenges that we are facing this year, as explained earlier, is that the rolling out of some of the Department of Homeland Security budgets have been quite slow. The good news, we are seeing some signs of things starting to move forward. So we're still very optimistic about the potential of that business unit.

DEV BHANGUI: Ok. And could you also give us some additional details in terms of, I know that earlier you have been awarded contracts and you have not been able to burn them into revenues, especially with respect to the marine side of things and because of the vessels not reporting back to be fitted with your solutions and so on. Can you just give all of us some kind of color in terms of what sort of additional theory of control, or better control you have in 2008, because you've alluded to the fact that the growth in 2008 compared to 2007 is going to be pretty significant.

KENNETH KIRKPATRICK: Yes, I would say as it relates to our, I guess our insight and control of our existing backlog, I think what we have achieved in 2007, and leading into '08 is a better insight and control. I think what happened to some degree last year, as we had been moving from, what I would call, more of a retrofit market where we were installing systems in existing platforms and integrating it; we are getting more and more involved now in major long-term new build programs; and our ability to influence and forecast that revenue and that backlog was challenged. So I think this year those programs, specifically, have now ramped up, we are moving forward with the



execution and we have a better insight to the timing of those types of programs.

DEV BHANGUI: Ok. So just to kind of ball park it, what is the magnitude of the overall backlog, that you would have control over, with respect to that area of the business this year?

KENNETH KIRKPATRICK: Approximately – at the end of Q1 we're approximately at \$10 to \$11 million.

DEV BHANGUI: Ok. For the year you mean?

KENNETH KIRKPATRICK: For the remainder of the year.

DEV BHANGUI: For the remainder of the year. Okay, and in terms of your press release, obviously you guys reported 63% CAGR quarter-over-quarter from the last year and you are expecting this trend to continue. So by trail, meaning obviously, we're not expecting 60% growth are we?

KENNETH KIRKPATRICK: We're not giving revenue guidance this year, but I guess what the message is, is that we expect to show continued progress for '08 over '07.

DEV BHANGUI: Ok. And one last question, Ken, if you don't mind. I know that revenue makeup is a combination of some kind of a repeat business, I would say approximately \$7 to \$8 million per year, and I would say that also, as you have said, in the short term, large order, large projects may kind of crystallize. Can you give us anything that you are expecting in the short term,



meaning for the rest of the fiscal year, that you think might materialize; and give us the kind of size of those particular contracts please?

KENNETH KIRKPATRICK: As communicated, ending last year, we had a couple sizeable contracts that we were awarded that we are working hard to close. And I think you'll see very shortly, as I indicated in my script, on the US Army side, a very attractive contract that will come to close very quickly.

DEV BHANGUI: Okay, and what about Canada?

KENNETH KIRKPATRICK: And in addition to that we're pursuing several programs in each market, including Canada. And as you have seen in the past, it's very hard to predict the exact timing of those programs. We are optimistic that we will see some of those come to close in 2008 as per the objective that we've set for the year.

DEV BHANGUI: Ok. And one last housekeeping question and then I'll stand back, would be just in terms of the OpEx; I know, I mean we have heard John's comments but in terms of sales and marketing as well as in terms of Technology Partnership royalty, do we have a significant variation going forward? Or are we going to more or less on the same kind of level that we see here?

KENNETH KIRKPATRICK: Yes, I would say first on the sales and marketing side we would see our sales and marketing not growing over last year, it'll be pretty consistent year-over-year. As you know, we made



a significant investment to enhance our capabilities in that area and we think we're well placed now to leverage that and significantly grow the business.

As it relates to our Technology Partnership Canada, it's very much driven by our revenue. So unfortunately, the higher the revenue the higher the royalty we actually pay.

DEV BHANGUI: Ok. Ok thanks Ken and John and all the best.

KENNETH KIRKPATRICK: Ok, thank you.

OPERATOR: Our next question comes from Blair Abernathy of Thomas Weisel.

BLAIR ABERNATHY: Hi Ken, can you hear me?

KENNETH KIRKPATRICK: Yes I can Blair, hi.

BLAIR ABERNATHY: A couple of things, first off just can you give us a snapshot of the Layered Security Solutions business as it stands today; and you know some sense of how many opportunities these guys are working on right now?

KENNETH KIRKPATRICK: Sure. I think the first place to start is the contract we announced mid last year with the Department of Homeland Security. That was a contract that is scheduled to be completed in the second quarter and that's a contract that is positioning us for several new contracts with that customer. And those are progressing well but, as indicated, we're finding



that the budget process within DHS is slow to kick-start this year. So that side of the business is moving forward and looking very positive.

The other aspect was the maritime security vulnerability assessment project we announced for the Sabine Neches region and that area is extremely active and we're seeing more opportunities than we can actually chase, to be quite honest with you. Okay. Now, with that point, with that said, obviously with that amount of activity and that amount of money being spent, you know there's a lot of people going after that business. So we're not going to win them all but I think we're going to win our share of them.

BLAIR ABERNATHY: Given the nature of you know these contracts, I mean there isn't a lot of upfront here for you guys; they're more consultative contracts at this stage, correct?

KENNETH KIRKPATRICK: Yes. Yes, really what it is, our strategy is to leverage this expertise to better understand the operational requirements related to counter surveillance, port security, harbour security and leverage those relationships to lead us into providing technology solutions. So we're not looking at building a \$100 million consulting company, but we are looking at leveraging this expertise to open the market from providing technology solutions into those spaces, which is a very scalable model.

BLAIR ABERNATHY: Right, understood. And I guess the challenge for you this year, given you've got a November year-end, is, if you do win another one or two of these consulting contracts, you've got to



be able to get the work done this year. And I guess do you feel at the end of Q2, when you finish the first contract, I guess I'm trying to understand how you're going to get much more in this year.

KENNETH KIRKPATRICK: Yes, I think the behind-the-scenes work that we're doing is we're working to be very proactive in making whatever modifications and changes that are required to our Naval Situational Awareness Technologies; to be able to introduce that into that market very, very quickly. And we've not just started working on this on the basis of these contracts. We've been working in developing these opportunities for quite some time. And we just view our Layered Security Solutions as a compliment to help move that process forward.

So if you look at the Sabine Neches region contract, that we're executing now, which by the way is going very, very well, that is a very large port region and not just government organizations as a potential target for our technology. We're even moving down into some more of the private entities such as liquid natural gas plants and what have you. So we remain optimistic that we will see some success in making that transition for our naval technology into that market.

BLAIR ABERNATHY: Ok. And just to clarify what you've said earlier, if you do win some technology sales into the US Homeland Security market you're going to be booking those through in your Land & Air revenue line this year, is that right?

KENNETH KIRKPATRICK: That's correct.



BLAIR ABERNATHY: Ok. The second question I had was just around the SUSA technology, and I know you've been developing that for a couple years; can you give me some sense as to how quickly you could roll out and be able to recognize revenue under that contract if you did get a significant order? Is it something that would take you a year to sort of fulfill? Or is it something that you guys could do in a matter of a couple of quarters?

KENNETH KIRKPATRICK: No, I think what we, as you noted, that's something that we've been working on ever since OSI acquired CHI Systems in, how do we take some of their leading-edge technology and evolve it to more of a product and commercialize that product. So I think we've made tremendous progress in creating a software baseline and hardware baselines to support that product. And in parallel to that, we've ramped up our sales and marketing capability significantly to support identifying opportunities for that technology. So I think we're well positioned to see some significant contributions in 2008 from that technology.

BLAIR ABERNATHY: Okay. That's great, thanks very much.

KENNETH KIRKPATRICK: Sure. Thanks Blair.

OPERATOR: At this time there are no further questions. I'll turn the call back to Mr. Kirkpatrick for any closing remarks.



KENNETH KIRKPATRICK: Thanks again for joining us today. I look forward to speaking to you again in July when we release our second quarter results for fiscal 2008.