



## **OSI Geospatial Inc.**

# **Fourth Quarter 2008 and Year-End Conference Call Transcript**

**Date:** Monday, February 23, 2009

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

**Speakers:** **Jane Hayward**  
Investor Relations

**Kenneth Kirkpatrick**  
President and Chief Executive Officer

**John Sentjens**  
Chief Financial Officer



OPERATOR: Hello. At this time, I would like to turn the conference over to Jane Hayward, Investor Relations. Please go ahead.

JANE HAYWARD: Thank you, Operator. Good afternoon, everyone, and thank you for joining us to discuss OSI Geospatial's 2008 fourth quarter and year-end results. We will also be discussing our 2009 strategic direction.

Our results were issued at 4:05 p.m. today, February 23, 2009. These documents are now available on our website at [www.OSIGeospatial.com](http://www.OSIGeospatial.com). We are also broadcasting this event live on our website. There is a link posted to that page.

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 John Sentjens, who will review the 2008 fourth quarter and year-end financial and operating results. Ken Kirkpatrick will follow with the 2008 highlights and the 2009 strategic plan. We will then 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 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 relative 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 US dollars and in accordance with Canadian GAAP.

With that, I will turn the call over to John Sentjens.

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

In the fourth quarter, we reported revenue of \$6.9 million, a decrease of approximately 16% over the fourth quarter revenue of \$8.3 million in 2007.

Our 2008 consolidated revenue was \$25.5 million compared to \$25.3 million in 2007, a slight decrease of 1% -- I'm sorry, a slight increase of 1%. Our revenue growth in 2008 was negatively impacted by currency exchange rates. The weakening of the Canadian dollar against the US dollar during the fourth quarter resulted in a decrease in reported revenue of approximately \$1 million from our Canadian operations.

Our Canadian operations have a functional currency of Canadian dollars, and as a result, their foreign currency exposures are mitigated against Canadian dollars. When their income statements are converted to our reporting currency of US dollars, it is done at the average rate for the period. For the fourth quarter of 2008, the Canadian/US currency exchange rate used has produced lower



revenues and earnings that would have been reported, had the Canadian/US currency exchange rate been consistent with prior quarters.

For the fourth quarter of 2008, the Company reported net earnings before tax of \$241,000 and after tax of \$782,000, compared to a net loss before tax of \$782,000 and after tax of \$798,000 for the same quarter in 2007. For the full year 2008, the net loss before tax of \$2.5 million and after tax of \$1.6 million compares with a net loss before tax of \$2.8 million and after tax of \$2.9 million in 2007. The net loss in 2008 was driven by the mix of contracts executed during the year, delays and contract awards, and the ramp up of staff in 2007 in anticipation of the growth in 2008 sales.

The weakening of the Canadian dollar against the US dollar during the fourth quarter also resulted in a decrease in reported net earnings of approximately \$250,000 from our Canadian operations.

Moving on to particulars. Our Marine Systems revenue increased \$1.1 million to \$11.3 million, primarily due to the timing of deliveries and installations on existing contracts, and the timing of new contracts awarded. We reported \$10.1 million of Land and Air Systems revenue, a decrease of 6% from the \$10.7 million generated in 2007. This decrease was largely attributable to delays in the contract awards.

Our Mapping Operations revenue decreased 7% to \$4.1 million from \$4.4 million in 2007. The revenue decrease is primarily the result of the weakening of the Canadian dollar in the fourth quarter.

For 2008, we reported a gross profit percentage of 36% compared to 39% for 2007. This lower percentage is primarily due to the decrease in revenue from our high gross margin Marines Software and Systems business and the mix of contracts in all of the business units.



General and administrative expenses decreased 12% to \$5.4 million. The comparative decrease is primarily due to the one-time costs that were incurred in 2007 and a reduction of our staffing over the course of the year. As a percentage of revenue, G&A expenses were down 3% from last year.

Engineering expenses decreased 16% to \$1.1 million, as more staff and related costs were charged to cost of sales to support revenue-generating projects. Also, certain development costs met the deferred criteria under Canadian GAAP, so that these expenditures were capitalized. The Company deferred \$256,000 of development costs incurred in 2008.

Sales and marketing expenses increased 2% to \$3.9 million, but remained constant at 15% of total revenue. Overall, we reported a loss of \$1.6 million compared to a net loss of \$2.9 million in 2007, a decrease of 45%. The net loss attributable to common shareholders was \$2.1 million or \$0.05 per share, compared to \$3.6 million or \$0.09 per share in 2007, a decrease of 40%.

At November 30, 2008, firm backlog, which consists of firm, fixed and signed orders at year-end, was \$46 million, compared to \$39 million at November 30, 2007. Of the \$46 million in firm backlog, we expect \$13 million to be executed in the fiscal year 2009.

I will now summarize the 2008 fourth quarter results. Consolidated revenue for Q4 2008 was \$6.9 million, a decrease of 16% compared to Q4 2007. This decrease was due to the effect of the US/Canadian exchange rate on revenue, and contract awards in customer schedules that slid into 2009. As I mentioned earlier, the significant weakening of the Canadian dollar against the US dollar resulted in lower-than-expected reported revenues by approximately \$1 million.



We stated in our Q3 conference call that we expected revenue to be in the range of \$8 million to \$10 million. When we provided this guidance, we could not have predicted the economic downturn and its effect on currency exchange rates.

Marine Systems revenue decreased to \$3.4 million from \$4 million or 14%. Land and Air Systems revenue in the fourth quarter was \$2.6 million, a 24% decrease over the \$3.4 million generated in 2007 -- in the fourth quarter of 2007. Lapping revenue increased marginally to \$933,000 from \$915,000 in fiscal 2007.

Gross profit was 40% compared to 43% in Q4 2007. Operating expenses decreased to \$2.6 million for Q4 2008 compared to \$4.4 million for the same period, reflecting the impact of staff and variable cost reductions, and one-time expenses we incurred in 2007. Net earnings were \$782,000 compared to a net loss of \$798,000 for the fourth quarter of 2007.

Now turning to our balance sheet. At November 30, 2008, current assets were \$10.8 million and current liabilities, \$5.6 million. Working capital was \$5.2 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. We have revolving credit facilities of \$3 million in Canada and \$1.2 million in the US. And at November 30, 2008, we had borrowed \$1.6 million against these facilities. We have enough cash and credit facilities to manage the business.

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

**KEN KIRKPATRICK:** Thanks, John. As John has stated, in 2008, we generated revenue of \$25.5 million, a net loss before tax of \$2.5 million and after tax of \$1.6 million. In the fourth quarter, we generated revenue of \$6.9 million, earnings before tax of \$241,000, and net earnings after tax of \$782,000. The significant decline in the value of the Canadian dollar against the US dollar in the fourth negatively



impacted our revenue and earnings by approximately \$1 million and \$250,000, respectively.

In 2008, we were successful in closing more than \$40 million of new business, and continue to develop and position the Company for large project opportunities in all of our key markets. We continue to make solid progress in building our existing customer relationships. The majority of our 2008 revenue was generated from our established customer base, and we believe that this is sustainable moving forward.

I am disappointed with the progress that we have made in closing the large project opportunities that we have been developing over the last two years. These projects are critical for us to take this Company to the next level and achieve our growth objectives. We have spent considerable time in 2008 evaluating all of the opportunities available to our Company to determine the projects that we believe we are best positioned to win.

This process has resulted in a realignment of our strategic focus, and will directly reduce the number of opportunities that we are proactively pursuing, but will increase our chance of winning and ultimately better position the Company to meet our objectives and provide our shareholders the return they deserve.

In response to the delays in closing key projects and the added risk of the uncertain economic times, we have implemented cost reduction initiatives across the Company throughout 2008 and into 2009. The narrowing of our strategic focus has enabled us to significantly reduce our stock base across the Company, with little or no impact on our ability to develop and close the business that is critical to our short and long-term success.

The positive impact of the staff reduction program and other initiatives are evident in our fourth quarter financial results. We will realize further benefits from



these initiatives leading into 2009, and this will position the Company to generate positive earnings with revenues in the same range as generated in 2008. This will ensure the Company will generate positive earnings at a conservative revenue base, but we are confident that our restructured cost base will support our growth objective.

In 2008, we remain focused on our key objectives. Our efforts to develop large project opportunities has resulted in the successful closing of a contract valued at approximately \$10 million with the US Army; to further develop and deliver our Soldier Systems technology. We continued to strengthen our partnerships with the large defense contractors in support of our Marine business, and developed a new partnership with a major defense contractor that will be critical to provide us access to the Soldier Modernization Program market.

Our new port security initiatives are progressing well, and we have secured four additional risk assessment projects and closed the first contract to provide our small boat Command and Control System for port security operations. We have made significant progress in developing our small boat Command and Control technology that directly enhances ship and shore-based security operations.

The UK Navy continues to provide follow-on contrast to develop and enhance our warship AIS, or Situational Awareness Command and Control technology that we delivered in 2007.

We continue to develop our Soldier Systems technology for the Special Operations Forces market, and in support of this opportunity, we have launched our new DC4S, or Dismounted Close Combat Command and Control System. I am pleased with the progress that we have made on all fronts, and believe that all of these initiatives will provide benefits to our Company in 2009 and in the future.



As discussed earlier, we made the decision in 2008 to narrow the Company's strategic focus, and focus our resources in developing business opportunities that best position the Company to leverage our core strengths and ultimately increase our chances of success. As indicated, this decision has enabled us to implement several cost reduction initiatives across the Company.

The most significant of these initiatives was a reduction in our total headcount from 148 to 118 employees or approximately 20%. This action and others has positioned the Company to generate positive earnings in 2009. In 2009, the Company will focus its resources on developing niche markets, primarily in the Marine sector, and will leverage its strong partnerships with large companies to pursue business opportunities outside of these niche markets.

The following will provide an explanation and further insight to our strategic direction for 2009.

In 2001, the Company qualified a niche market opportunity to develop and provide a disruptive technology that would change how naval navigation for warships had been done for over 200 years. We established the aggressive objective to become the leader in this market and control the intellectual property that would be critical to achieving this goal.

I'm proud to say that we are a leader in this market, and now have eight Navies and more than 350 warships navigating with our technology. It has been proven that this technology significantly enhances naval operations and directly reduces the likelihood of collisions and groundings.

We estimate that there are over 70% of the world's Navies still navigating their warships with paper charts, and we are confident that we will add more Navies to our impressive customer list in 2009 and in the future. It is no longer about if a Navy will embrace this technology, but rather when.



The decision to proceed with the procurement of this technology requires an investment well above the cost to acquire and install the warship navigation systems. There is a need to build the infrastructure to support and maintain the technology, and provide the initial and ongoing training for their naval officers.

These costs, in most cases, far exceed the cost of the actual systems. This provides our Company the foundation to establish a long-term business relationship with each of our customers that always leads to substantial follow-on business, and the opportunity to work with our customers to identify and explore new disruptive technologies that could greatly improve operational performance.

Our warship navigation leadership position has provided us the unique opportunity to leverage our strong customer relationships and core technology, to develop and enter new market niches that present equal or greater potential than our warship navigation niche market. We plan on repeating this success, and we are well on our way to making this happen.

In late 2006, we announced a prime contract with the UK Navy to develop and deliver 77 warship AIS, our Situational Awareness Command and Control Systems. The development of this technology was primarily focused on providing advanced situational awareness capabilities to the UK Navy to improve maritime interdiction and forced protection operations. The majority of these systems are now installed and operational. The UK Navy has been operating these systems in support of Middle Eastern operations, and feedback to date from our customer has been extremely positive.

We have continued to develop and enhance this technology through both internal investment and follow-on contracts from the UK Navy. We determined that the highest priority for our Company in developing this new market opportunity was to ensure that our first project was a huge success, and I'm pleased to report that we have a very happy customer. The success of this project will ensure we have



a strong customer reference, and not to mention a 26-year maintenance contract that will provide us a competitive advantage when pursuing new projects.

This technology provides operational benefits to both ship and shore-based operations, and we are convinced that there is a significant market opportunity for our Company. We are well-positioned for success in 2009 and in the future.

In mid-2007, we announced the launch of our Layered Security Solutions Division and the award of a contract to complete an integrated vulnerability assessment or IVA for three ports in the Sabine-Neches region of Texas. The project was successfully completed in early 2008 and followed by the award of four additional IVA port projects by the end of 2008.

The US government is spending hundreds of millions of dollars to mitigate the security risks, and the IVA process is the first step that is required to determine how the money should be spent. The IVA is a process to identify the security risks and developing the plans necessary to mitigate the risks identified.

Our strategy is not to develop a large consultancy company but rather, to develop build a core team of experts from the port security domain that can provide market access, customer relationships, and expertise to support the Company in the successful transition of our naval technology to meet port security operational requirements.

These port security contracts provide the Company the financial resources to build our core team of experts that will support the US government to mitigate port security risks, and provide our Company direct input into the development of our port security technology. To date, this process has provided significant insight to the challenges facing this industry and the opportunity that could be available to our Company.



In early 2008, we announced we were developing a disruptive technology that would provide advanced Command and Control capabilities for warship's small boat operations. Most Navies have established operating procedures that limit small boat operations from leading the line of sight of the mothership. Our technology was designed to enable Naval operations to conduct small boat operations out of the line of sight of the mothership, and provide capabilities that significantly improve the effectiveness of small boat operations.

Most warships operating -- operate one to three small boats, depending on their size and mission. The small boat Command and Control system is designed to have a base station installed on the warship and a system installed on each of the small boats that support warship operations. The small boat system can be integrated to one of our 350 warship navigation systems currently installed across eight Navies, or a stand-alone base station for a Navy that has selected another company's navigation system.

All of our existing customers have indicated significant interest in this capability, and most have completed sea trials to evaluate the effectiveness of these systems. To date, we have received extremely positive feedback from our customers, and we are very excited about the opportunity that this presents for our Company. We expect to show some positive results in 2009.

In November 2008, we announced a contract to provide our small boat Command and Control system to a Canadian Navy port security unit. The base station of the Command and Control system will be installed in a shore-based facility, and several systems will be installed on small boats that will directly support port security operations. This success provides the evidence that there is a requirement to more effectively command and control small boats that support port security operations.

Our efforts in the US port security IVA market has confirmed this requirement, and we see this as a significant opportunity to sell this technology to both military



and civilian customers with port security requirements. We are optimistic that this will be a substantial growth opportunity for our Company and expect to achieve further success in 2009.

The Company will continue to develop and build our advanced technology military research and development business. This business provides us with a steady stream of revenue and earnings that helps to offset the impact of our more volatile systems business. Our R&D business enables us to leverage government-funded projects to enhance our existing technologies and develop new and leading-edge technologies. It is not uncommon for us to leverage our core technologies to support winning and executing R&D projects.

This provides us the opportunity to enhance our technology and develop a better understanding of potential future applications. In addition, it presents the Company an opportunity to participate in advanced technology research projects that could ultimately lead the Company to significant new market opportunities that would support the commercialization of this technology by our Company, or even other companies.

A great example of this is our efforts to productize and commercialize our advanced Dismounted Soldier Systems technology, which is progressing very well, and I will discuss in more detail in a few moments. We have recently been exploring the possibility of divesting technologies that have been developed through the R&D process, that present solid commercialization opportunities, but are not aligned with our strategic direction.

This effort could provide us with the capital to pursue growth opportunities that are aligned with our strategy. We remain focused on the US military technology R&D market as a priority, but we will begin the development of the Canadian military R&D market in 2009.



As mentioned earlier, the Company has been working hard over the last several months to leverage our advanced Command and Control technology that has been developed for dismounted soldier operations, to position the Company in the Special Operations Forces market niche and the major Soldier Modernization Programs market.

We are approaching the Special Operations Forces market in the exact same manner as the WECDIS market. We have developed and launched our DC4S or Dismounted Close Combat Command and Control System that we believe is the most advanced technology available in the world. We are focused on the US soft market as a priority, and estimate that there is a requirement for a minimum of 25,000 systems over the next three to five years.

We have signed a strategic partnership with a major defense contractor that we strongly believe is well-positioned to effectively compete in the Soldier Modernization Programs market. This was a critical milestone, and we have been working hard to close this partnership for over a year.

These programs are of the size and scale that makes it impossible for us to pursue this business directly, but our software will be the engine that drives the systems that will be delivered to meet the requirements under these programs. I am confident that this strategy will lead to success in 2009 and in the future.

In support of our decision to build on our core strengths and align our business activities with our strategic direction, we have decided to begin the process to explore options to divest our Mapping Operations. It is clear that this business is not aligned with our strategic direction, and we believe that it is to the best interest of the Company and our shareholders to seriously consider this option.

This will enable management to focus 100% of our attention on our strategic direction, and generate additional capital resources to support our high-priority



growth initiatives. We will keep you posted as we make progress against this initiative.

In addition, we have been developing opportunities to divest technologies developed by our R&D business that can present considerable value to other companies, but are not aligned with our strategic direction. We are currently pursuing opportunities that are looking quite positive. We are focused on achieving results in 2009.

In 2008, we made significant progress in restructuring our business in support of our refined strategic direction, and we are well-positioned to return the business to a profitable position in 2009. We have successfully developed several niche markets, and we're implementing a proven strategy that we strongly believe will deliver results.

The Company has the resources to effectively develop these market opportunities, and we have established partnerships with large companies that will provide our Company access to major international programs. We strongly believe that the Company is well-positioned for short and long-term success. It is critical that we provide our shareholders the return they deserve, and we are committed to making this happen in 2009 and in the future.

I would now be happy to take your questions.

OPERATOR: The first questions from Dev Bhangui of Haywood Securities. Please go ahead.

DEV BHANGUI: Just wanted to -- I guess based on your commentary in terms of the strategic direction for '09 and the cutting of some of the R&D and OpEx reduction and so on, just wanted to confirm a few things.



So, the three focus areas of 2009 going forward, if I'm not mistaken, for the Company would be the Soldier Modernization, for example, DC4 systems -- one. The second one would be the small boats operations. And third one would be the LSS IVA port security assessments. Is that correct?

KEN KIRKPATRICK: That's a subset. Just to clarify, as we obviously continue to focus on our WECDIS market --.

DEV BHANGUI: Yes, we do the UK Navy stuff. I mean, that has been there traditionally, but I'm saying -- among all the new streams, these would be the three streams that would augment and supplement what is coming out of your traditional WECDIS market, with the UK Navy being one of the largest customers and more so in 2009. Right?

KEN KIRKPATRICK: Yes. That's a fair comment.

DEV BHANGUI: Okay. And then just, I guess, a question to you Ken or to John, would be -- in terms of OPEX Reduction in 2008, I guess when we see it on a quarterized-basis, and we have to kind of impute the fourth quarter from your annualized financials, would it be fair to say that the OPEX reduction in fourth quarter, on a quarter-over-quarter basis, would be approximately \$300,000 to \$350,000?

KEN KIRKPATRICK: Just to clarify your question, Dev -- so, as it relates to the fourth quarter compared to the third quarter?

DEV BHANGUI: Yes, I mean, I went from \$2.7 million to \$2.4 million or so, so I thought the net reduction was \$300,000. Is that right or --?

KEN KIRKPATRICK: I think in that range. And we'll see more, because what's happened as we have implemented our staff reduction program, it has been implemented across the



year. And we're just now starting to see the full benefits of that. And we'll see more of that take hold in the first quarter of '09 and throughout '09.

DEV BHANGUI: Okay. So just for guidance purposes, if at all you were to assume, what kind of annualized additional reduction does the Company expects to be able to achieve on a conservative basis in 2009?

KEN KIRKPATRICK: I'd say if you use around the \$500,000 mark.

DEV BHANGUI: For the year?

KEN KIRKPATRICK: No. From a -- as a comparison to Q3, in that range, to Q4.

DEV BHANGUI: Yes. So, \$500,000 mark, meaning \$500,000 additional reduction per quarter in 2009?

JOHN SENTJENS: In that range, again, just at a high level.

DEV BHANGUI: That will be on a like-to-like basis, I guess, based on your commentary about the mapping being divested. This particular kind of \$400,000 or thereabouts, the reduction would be -- assuming that the mapping was there -- if mapping goes, then there's going to be an additional one, right? An additional reduction in terms of OPEX, is that correct?

JOHN SENTJENS: That's correct, yes.

DEV BHANGUI: Now, you also said earlier that more or less, the revenues would be maintained on a like-to-like basis between 2008 and 2009. And in 2009, depending on, I guess, how early you are able to successfully divest mapping, which is on an annualized basis, somewhere around \$4 million or so in revenues, if that revenue goes away, you would still be able to maintain the 2008 revenue run rate in 2009. Is that the correct understanding?



JOHN SENTJENS: Just let me maybe clarify that, is -- what I was trying to explain is that we have restructured the Company from a cost base to ensure profitability at a similar revenue level to that of 2008. Obviously, we don't view that as success, and our goal is obviously to grow the business in 2009. But I guess the message I was trying to give to the market is that through our cost reduction programs, we have now built an organization that can generate a profit at that level, when compared to 2008, when we generated a \$2.5 million loss.

DEV BHANGUI: Okay, thank you. No, that helps to, I guess, clarify things. And one last question to John was -- and then I guess turn back in the line -- was, in terms of the net earnings and net loss to shareholders, at least there appears to be some confusion in my mind, because you're looking at two figures here on the fourth quarter basis -- \$782,000 after taxes was the earnings number. And then in the fourth paragraph in your company release, you say that for the fourth quarter of 2008, that net income attributable to common shareholders was \$656,000 or \$0.01 per share.

Now if you can help me understand better the two figures, because they are both net earnings. I'm just wondering whether the first figure of \$782,000 included one for the common shareholders plus to other shareholders? Or how do you --?

JOHN SENTJENS: Yes. The difference is the cumulative dividends on the preferred shareholders. To calculate the net earnings attributable to the common shareholders, those need to be subtracted from the net earnings available, the total net earnings available.

DEV BHANGUI: Okay. I have more questions but I'll turn back in the line. Thanks for taking my questions.

OPERATOR: Robert Catellier, Clarus Securities.



ROBERT CATELLIER: Just a comment here. I'd like to point out that it looks like under the link to Q4 financial statements, the Q3 MD&A pops up on the website. So just point that out to you. Also I didn't get the credit facility available figure. What's available on the credit facility currently?

KEN KIRKPATRICK: Under our Canadian bank, we have a \$3 million facility, and in the US a \$1.2 million. As of the end of 2008, we were utilizing those facilities at about \$1.6 million.

ROBERT CATELLIER: Canadian?

KEN KIRKPATRICK: US.

ROBERT CATELLIER: Okay. Is there any way you could disclose the backlog for the Mapping division?

KEN KIRKPATRICK: Well, we're not -- no, I think we're not providing that. We provide consolidated backlog, but it's not significant.

ROBERT CATELLIER: Okay. Just -- what tone are you getting out of Washington in terms of military spending? Obviously, Barack Obama's comments on the importance of port security are good for that business, but he's also a stated deficit fighter and that has some obvious implications for defense spending. Are you getting any sense that there's a change in the funding available to some of your larger programs?

KEN KIRKPATRICK: No. I think the -- on the port security side, as you accurately point out, I think it's even more of a priority. And we're starting to see programs and government funding programs ramping up quite aggressively.



We haven't seen any real indication in the US that they're ramping down the spending on the military side at all. In fact, as we've seen some cases where it's actually quite the opposite. The market where we are starting to see some signs of the economic challenge is in the UK market. We're starting to see some signs that programs are sliding to the right and very much based on the economic situation.

But that seems to be the exception so far, because most of the other markets we've seen in Canada and the US and Australia and others -- no indication that the current economic situation is going to cause a downturn. Sorry I led you into the UK, but just wanted to give a bit of an example there.

ROBERT CATELLIER: Yes. No, that's the color we're looking for. And just -- Has there been any -- I don't know how to say this delicately, but any improvement in accessing funds? Generally, not just OSI, but for the industry generally, accessing funds under the Port Security Grant Program? It seemed to me in the past that the programs have always been well-funded, but it's been quite slow to materialize in the market opportunities.

KEN KIRKPATRICK: Yes, I think the -- we're starting to see some signs that that issue is improving. And as indicated, we have been awarded four new projects

that have been funded. And we are seeing many, many more projects ramp up, as we speak. So there's definitely a high priority being given. And I think there's been some recent -- I shouldn't think -- but there has been some recent announcements coming out saying that they are increasing the funding for some of these programs, quite significantly.



ROBERT CATELLIER: And what has your success rate been in converting successful vulnerability assessments into solution implementation?

KEN KIRKPATRICK: It's been slow in the sense of actually selling the technology into the customers that we've done the assessments for. But what has been very positive is the process of understanding what the issues are and what the challenges are. And we have programmed that into the development of our technologies. And that, I think, has led us to being able to offer effective solutions, such as the one we delivered to the Canadian Navy in late 2008.

But we still -- it's been a learning process, but we really feel optimistic that the port security space presents significant opportunities for our technology. And not just military -- the Canadian Navy operations are strictly shore-based port security operations, which is something that as a company, we have not done much of in the past. Most of our business has been based on ship-based systems.

So being able to successfully make that transition to have a Command and Control system in a shore-based facility, and operating and command and controlling small vessels is quite a success. And it really provides us some significant confidence that there is a real market there in military and civilian for port security purposes.

ROBERT CATELLIER: Is the gap between the IVAs and the solution implementation a question of the customer just not reaching the implementation stage? Or has there been awards in that area and you just haven't secured the --?

KEN KIRKPATRICK: A big part of it is -- sorry, but, yes, sorry to interrupt -- but that is a big part of it, is the way the process works, as you know in government, it usually takes a long



time. But the process is, you do the IVA, and then through that process, that's the process that supports the next round of budget approval.

So they do a -- let's say they do a project for the Port of Buffalo. By the time they actually end up submitting their report, the IVA and the actual operational plan, to DHS for the next round of funding, you've got a year that's passed. By the time the additional funding is approved, you've got another six months.

So, it takes some time. The good news is the dollars that are being made available and that are getting approved are quick significant. And I believe we will be ready to provide our technologies in support of some of these requirements.

ROBERT CATELLIER: Okay. I'd just like to challenge you a little bit on the Soldier Modernization Program. We've seen, in the past, in other markets specifically related to force protection and specifically to the soldier force protection, where some of those programs have really slowed down. So next generation technologies for, let's say, body armor have been pushed to the right by a factor of two or three years.

So I'd just like to access your level of confidence in these -- in the US and Canadian Soldier Modernization Programs. Have you seen those RFP dates slip in the past? Or is this --?

KEN KIRKPATRICK: I guess from our experience, I guess the first thing is we have a two-path strategy -- where we're going aggressively after the soldier, the Special Operations Forces market, where that is a market that isn't going to be the one-off, \$100 million contract, but it's going to be a market niche and they're similar to some of the markets we've been pursuing in the past. And there, that is showing some real promise.

But to answer your question specifically on the Soldier Modernization side, as indicated in my conference call, we are now on a team that is aggressively going



after several programs. And honestly, we have not seen the slippage that you referred to in these programs.

They're huge programs and many different moving parts. But we haven't seen any significant slippage on any of these programs to date. And obviously, we're very focused with our partner on the US market. And that program itself is moving forward surprisingly at the schedule that's been published.

ROBERT CATELLIER: Okay. And just with respect to Q4 revenues. Obviously, as you point out, that currency had a big impact. But at the time of our conference call, which I guess was October 9, we had already seen over half the appreciation in the US dollar versus the Canadian dollar that -- of the total that we'd see for the full quarter.

So at that time, it occurred to me that you'd seen at least a good part of the full swing in FX that was going to be realized in the quarter. So, where there any areas where revenues were maybe a little bit softer, when you exclude the impact of foreign currency?

KEN KIRKPATRICK: We started to see, I guess, the real decline start to take place in the October timeframe. So I understand your point. But the other side of our equation is we gave a range of \$8 million to \$10 million. As always, we have lots of different contracts that timing-wise, are in question of when they'll actually close.

One of the contracts that we were expecting to see more revenue from was a US Coast Guard contract. And then supplier delivery problems pushed that revenue into the first quarter. So that was definitely one of the disappointments on the timing for revenue, outside of just the exchange hit that we took.

ROBERT CATELLIER: Okay. And has that contract been realized in the first quarter?

KEN KIRKPATRICK: It has, yes.



ROBERT CATELLIER: Okay. Those are all my questions, then.

OPERATOR: Our next question is from Dev Bhangui of Haywood Securities. Please go ahead

DEV BHANGUI: Ken, I just wanted to find out -- I guess, in responding to Robert's questions, you were saying that if at all (inaudible) the macroeconomic situation, you're seeing some softness in the UK market. So last year, we discussed a couple of times, on the call, regarding some of the potential large contracts with respect to UK -- large vessels, destroyers, and submarine program. So are you referring essentially to any of these big windfalls or potential windfalls that might have been affected by this particular slowdown?

KEN KIRKPATRICK: Yes, there are one or two key programs in the UK that have slipped to the right.

DEV BHANGUI: There are a number of assessments that you guys have done here which have been also in your fourth quarter. And Subsequent to fourth quarter, I guess you'll close about \$6.5 million or \$6.3 million in terms of additional contract announcements. Most of them are assessments.

Now, assuming that these assessments spin out into the second stage of the full-blown implementation, can you give us any kind of range in terms of what is the ratio? For example, if you signed \$5 million worth of assessments, can we think of the implementation being five times that? Six times that? Is there a range five to six times, like what sort of overall potential dollar figure are you looking at?

KEN KIRKPATRICK: Yes, that's an interesting question. It's difficult to try to break the business down based on a percentage such as that, because it very much depends on what is the technology gaps they have currently that need to be filled, in support of their risks that they've identified. And our primary focus today is more -- is delivering



our shore-based Command and Control technologies. So it's hard to put a hard number on it, I guess, is my point.

DEV BHANGUI: Okay, I guess -- okay, let me ask the question a different way. So now, based on, I guess you have over \$40 million backlog, of which John said that about \$16 million would be burned in this particular year.

JOHN SENTJENS: \$13 million.

DEV BHANGUI: \$13 million, sorry. And based on all these assessments, which are all in the usual range of \$1 million to \$2 million, what sort of potential additional backlog do you expect to come through, given all that you know right now, including the macroeconomic weakness in the UK market and some of the niche kind of markets and programs that are actually ramping up very well?

KEN KIRKPATRICK: I would say just at the high level to just try to give people some color, I think we're looking with fixed backlog and with contracts that we qualify as awarded, we're sitting at probably 80% to 85% of our 2008 revenues.

DEV BHANGUI: And that would represent, of the 2008 revenues, would be the additional contracts awarded? Or are you talking about --?

KEN KIRKPATRICK: I just -- I'm just trying to -- again, it's hard to break the business down into each of the pieces. But just getting you a little color of -- to give a little confidence on our ability to meet and exceed 2008. I think we're well -- yes, but I mean, the numbers in 2008, I think we're well-positioned, based on firm-fixed backlog and awarded contracts, to have confidence in achieving and exceeding what we accomplished in 2008.



Obviously, in addition to that, we are developing several new business opportunities that, with some timing falling our way for once, we could show some significant improvements.

DEV BHANGUI: Okay. And just in terms of -- usually you guys -- or in the past, you have kind of built this hard backlog, which is what the figures we have right now, and then the soft backlog. Would you like to give us any color on that? Or that is not something that you can tell us about?

KEN KIRKPATRICK: Well, yes, we made a decision three or four quarters ago that we're going to focus more on the hard backlog, simply because the soft backlog -- it's challenging sometimes to predict and forecast our fixed backlog, never mind our awarded, in soft backlog. So we decided to keep our focus on the fixed side of the equation.

DEV BHANGUI: Okay. And one last question to John, I guess before I'm done, would be -- in terms of this before taxes and after taxes kind of numbers, the fact that the after taxes -- I mean, the taxpayer's gain, can you give us some idea in 2009 as to what we can expect there? Because that is something that we would never be able to estimate.

JOHN SENTJENS: Yes. 2009 will likely be closer to what our historical rates are. In Q4 2008, we realized the benefit of some tax losses that we could carry forward. And those benefits were recognized in 2008.

DEV BHANGUI: Okay. That's all I have right now. Ken, and John, and Jane, all the best. Thank you for taking my questions.

OPERATOR: Our next question is from Robert Catellier of Clarus Securities. Please go ahead.



ROBERT CATELLIER: Just a quick follow up on the corporate development. You said that in the US, there's some R&D that might be divested. Can you sort of indicate the materiality of that? And also, what area might that be in?

KEN KIRKPATRICK: It's hard to quantify the numbers at this point in time. But as indicated, in the past, one of our key reasons for acquiring our US operations was not just market access, but was also to provide access to some pretty advanced technologies that they have been able to retain ownership of, through a small business innovator research program in the US. And one of those technologies we have decided, as a company, that we were going to commercialize for our own benefit, which is the Soldier Modernization and the Soldier Systems technology.

There are other technologies that they have that apply to land-based Command and Control technologies and training-based technologies that aren't necessarily aligned with our strategy, that we think presents significant value to other companies. And those are the opportunities that we're pursuing.

And not to create too high of expectations, but some of these things create, for the right company, significant market opportunities and could yield some significant results for the Company.

ROBERT CATELLIER: Okay. And just -- what was the figure for deferred development spending in '08?

JOHN SENTJENS: \$256,000.

ROBERT CATELLIER: And that's corporate, not just for this operation that's being divested, right? It's a consolidated number?

JOHN SENTJENS: Yes, it's a consolidated number.

ROBERT CATELLIER: Okay, thanks.



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OPERATOR: That concludes today's question-and-answer period. I'll turn the call back for any closing comments.

KEN KIRKPATRICK: Thank you very much and we look forward to speaking to you at our first quarter conference. Thank you.