



**2006 First Quarter Financial Results Conference Call
April 11, 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 2006 first quarter financial 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 web site 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 you a copy right away. We are also broadcasting this event live on our web site.

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 the progress we've made on our goals for the year. John Sentjens will follow with the financial and operating highlights. We will then open the call for your questions.

During the call, we will be making forward-looking statements about OSI's business. 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.



First Quarter Business Review: Ken Kirkpatrick, President and CEO

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

I am pleased to report that we are on track to meet our goals for 2006. These goals include:

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

I will review the progress we have made towards achieving our goals since our last conference call, but first I will comment on our Q1 financial performance.

The Q1 financial results were in line with our expectations. Our first quarter is typically affected by a slow down in contract awards due to the holiday season.

Our consolidated revenue of \$4.2 million grew 87 percent, compared to the same period last year. The increase is primarily due to additional revenue from our U.S. systems acquisition. We reported a loss of \$1.5 million on the quarter compared to a loss of approximately \$220,000 in Q1 05. Our bottom line will improve significantly in the coming quarters and we expect to be profitable in 2006.

Now I will review our recent accomplishments. As I mentioned at the start of the call, we are on track to meet the goals we have set for 2006. Our first quarter results were as we had forecasted and we are on track to deliver our first goal which is annual revenue of between \$28 million and \$32 million. To accomplish this, we are focused on building our critical mass, strengthening our leadership in the international defense market, and demonstrating our ability to penetrate the U.S. defense and homeland security markets.

For our next goal we are working towards securing a significant U.S. Navy contract. In the first quarter, we completed our U.S. systems acquisition, which greatly improves our market position among the U.S. defense community. By providing market access, we expect our strong presence to drive contract wins in the U.S. defense and homeland security markets for both our navigation systems and our command and control products.

Later in the quarter we announced our participation in a number of U.S. Department of Defense programs testing future capabilities on advanced combat vessels. At this time, these trials are not significant revenue generators. However, it is a substantial win to be able to demonstrate our technology to key decision-makers in the U.S. defense community.



Also aimed at strengthening our U.S. strategy – we appointed two defense industry executives to the board governing our U.S. systems operations and we look forward to benefiting from their impressive experience and contacts. Dr. Marvin Sambur is a retired U.S. Air Force assistant secretary for acquisition and former CEO of ITT Defense, and George Sawyer is a retired U.S. Navy admiral, a founding partner of J.F. Lehman & Company, and former CEO and vice chairman of Sperry Marine. We expect Marvin and George to support and provide strategic counsel advancing our goal to increase business with the U.S. military.

Our third goal for 2006 focuses on market development with existing customers and in particular – our ability to secure a significant prime contract with the British Royal Navy. The British Royal Navy is an extremely important customer for OSI. They have standardized on our warship navigation product, and we continue to work with them to develop and enhance our technology. Currently we are working closely with the Royal Navy and our UK partner on a navigation-related engineering study and prototype project which will provide the Royal Navy substantial operational improvements. We are in the early stages of this project, but we anticipate that successful results will not only benefit the Royal Navy but will also deliver advantages that we can integrate into our products and deliver to our other customers.

Our fourth goal is to secure a new customer in each of the three defense domains: air, land, and sea. We have already seen some success with the recent award of the SATURN project by the Office of Naval Research and we look forward to working with this new customer to build expertise in high-level data fusion and automated intelligence analysis.

Partnerships are very important to our continued success, and we are making good progress towards achieving our fifth goal, to close a teaming agreement with a top-tier defense contractor that will expand our U.S. and international market opportunities.

Our final goal for 2006 is to diversify our product offering into new market sectors by leveraging our core technology, and we have already seen some success with our initiatives with the British Royal Navy and the U.S. Office of Naval Research.

Before I turn the call over to John I would like to talk about a significant milestone we achieved in our product diversification strategy. Last week we announced a new product for the commercial shipping market. It is an integrated navigation system and Simplified Voyage Data Recorder – commonly called an S-VDR. An S-VDR is the marine equivalent of an aircraft's "black box". The system records data collected from sensors and systems across the ship. This is an exciting development for OSI. Our new S-VDR product will meet the newly mandated International Maritime Organization carriage standards requiring all existing ships over 3,000 gross tons engaged in international voyages to be fitted by July 1, 2010. We estimate that more than 30,000 ships will require S-VDR systems and the majority of these vessels are just beginning to make plans for compliance. We intend to aggressively pursue this new opportunity.

In support of this initiative, we are working with the Radio Holland Group to establish a partnership to provide our customers with installation, maintenance and certification services in key international ports. Radio Holland is an independent, global group of companies, located



along all major shipping routes. They specialize in the supply, installation, and service of maritime electronics.

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.

Financial Review: John Sentjens, Vice President Finance

Thanks Ken and good afternoon everyone.

As Ken mentioned, this is the first earnings report to include the acquisition of CHI Systems, completed December 14, which now constitutes our U.S. systems operations. In light of our recent acquisitions, we have changed some of our reporting conventions to reflect how we analyze our expanded business.

Now I would like to review our first quarter financial and operating results.

Consolidated revenues of \$4.2 million increased 87 percent from Q1 2005. This includes \$2.1 million in land and air systems revenue gained through our U.S. systems acquisition and increased mapping revenue. Marine systems revenue declined 24 percent due to the timing of contract awards and the delivery of existing contracts.

This quarter we reported a gross profit percentage of 33 percent compared to 55 percent for Q1 2005.

Lower gross profit was largely due to a reduction in software revenue compared to the prior year's quarter and the addition of lower margin revenue generated in our recently acquired operations. This quarter, approximately 50 percent of our revenue was at a gross profit percentage of 23 percent for engineering services conducted by our U.S. systems operations. We expect consolidated margins to improve as marine systems revenue increases through 2006.

Operating expenses were \$2.9 million for Q1 2006 compared to \$1.7 million for Q1 2005. This quarter, our newly acquired U.S. operations added expenses totaling approximately \$500,000. In addition, R&D costs were approximately \$300,000 higher related to new product launch activities versus Q1 2005 where approximately \$225,000 in engineering labor costs were charged to cost of sales to support specific customer orders. G&A increased by approximately \$200,000 reflecting increased staff levels to support our growth plans, and we reported a foreign exchange differential of approximately \$160,000 which reflects a strengthening Canadian dollar when compared to the U.S. dollar.

Overall we reported a net loss of \$1.5 million or five cents per share for Q1 2006 primarily due to lower gross profit and higher operating expenses. This compares to a net loss of approximately \$220,000 or one cent per share in Q1 2005.



As at February 28, 2006, total backlog was \$31.3 million compared to \$19.8 million at February 28, 2005. Firm backlog – which consists of firm, fixed, and signed orders at quarter-end – was \$13.9 million compared to \$7.0 million for February 28, 2005. Option backlog – which is unexercised or unfunded contract provisions - was \$17.4 million compared to \$12.7 million at February 28, 2005.

Now turning to our balance sheet.

At February 28, 2006, current assets were \$11.8 million and current liabilities were \$3.6 million. Working capital decreased \$9.6 million to \$8.2 million at quarter-end due to the outflow of cash for our U.S. systems acquisition. We generated cash from operations of \$1.0 million this quarter, an improvement of \$1.7 million from Q1 05 primarily due to a significant decrease in accounts receivable. Our cash and marketable securities totaled \$1.6 million at quarter-end. The decrease in our cash position is mainly due to a net outflow of cash of approximately \$9.1 million to acquire our U.S. systems operations. We have enough cash to manage the business and expect to continue to generate positive cash flows through 2006.

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

Closing: Ken Kirkpatrick, President and CEO

Thanks John. We are encouraged by our progress in the first quarter. To summarize, our first quarter results were as we had forecasted, and we remain on track to deliver the goals we have set for the year. We look forward to announcing our progress in the coming quarters. With that John and I would be pleased to take your questions.