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Fundamental Research Corp.

Investment Analysis for Intelligent Investors

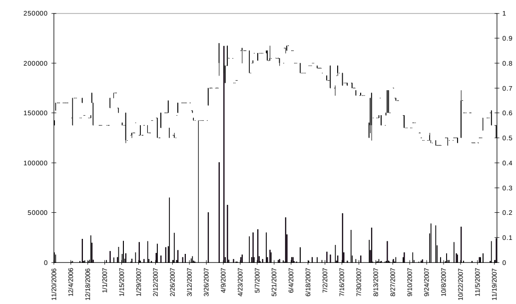
CON-SPACE Communications Ltd. (TSX-V: CCB) – YE Results and Notes From AGM

Sector/Industry: Safety Products/Communications **www.con-space.com**

Market Data (as of November 21, 2007)

Current Price	$0.50
Fair Value	$1.40
Rating*	BUY
Risk*	3 – AVERAGE
52 Week Range	$0.47 -$0.88
Shares O/S	14.8 mm
Market Cap	$7.4 mm
Current Yield	N/A
P/E (forward)	10.8x
P/B	0.86x
YoY Return	-9.1%
YoY TSX-V	5.1%

*see back of report for rating and risk definitions



YE2006 and AGM Highlights

- CCB recently announced sales results below expectation both on organic growth and SSI's contribution. However, we were pleased to see all other metrics, such as margins, EPS, and net income come in ahead of expectations.
- At the company's AGM, we were provided a breakdown of order volume by market. This information had not been provided in the past. The company is expecting growth to come primarily from Europe and the U.S. going forward. Canadian sales remain flat.
- Distribution and OEM have been impacted by a higher C$ and exposure to government budgets. The company is now making a push into more industrial sales.
- We continue to believe the SSI acquisition adds value to CCB in terms of revenue enhancement, margin improvement and a low purchase price. We are maintaining our fair value estimate of $1.40, and BUY rating. We note that the company is trading below book value and sales. At its current market cap of $7.4 million, it is trading at the annual sales of CCB without SSI. We believe current prices represent an excellent entry point for investors.

Key Financial Data and Statistics

(C$ 000's)	2005	2006A	2007A	2008E	2009E
Revenues	7,090.8	5,490.4	7,255.5	14,343.8	16,495.4
EBITDA	1,786.8	421.4	871.5	2,868.8	3,596.0
Net Income	1,135.6	195.0	213.5	696.0	1,176.6
Assets	4,785.1	4,542.7	18,728.4	19,156.2	20,268.0
Debt	87.1	-	7,436.7	7,257.2	7,066.6
Equity	3,989.3	4,272.2	8,596.8	9,532.0	10,708.5
Free Cash Flow to Equity	94.3	242.2	(6,333.4)	390.9	849.5
W/A Basic Shares O/S (000s)	10,686.0	10,724.2	14,773.4	15,100.8	15,100.8
EPS (Basic)	0.11	0.02	0.02	0.05	0.08
EPS (Fully Diluted)	0.11	0.02	0.02	0.05	0.08
EBITDA Margin	25.2%	7.7%	12.0%	20.0%	21.8%
ROE	28.5%	4.6%	2.5%	7.3%	11.0%

CON-SPACE Communications Ltd. ("Con-Space", "CCB" or the "Company") is a recognized worldwide leader in the design and manufacturing of specialized voice communication equipment for the purpose of providing safety and efficiency to workers in confined space work environments and the public safety market.

Sales below expectations

For the year ended June 30, 2007, CCB reported revenues of $7.26 million versus $5.49 million for the same period last year. This was below our expectations of $8.67 million. These results included 2.5 months of SSI revenues. In our previous report, we had assumed that based on CCB's press releases, SSI had annual revenues of about $10 million. Therefore, based on 2.5 months of SSI results being incorporated into CCB's, we were expecting SSI to contribute about $2.1 million in revenues for FY2007. According to CCB's filings, SSI only contributed about $1 million for the 2.5 month period, below our expectations.

We asked management why SSI appeared to underperform post-acquisition and were informed that:

- SSI revenues were and are expected to continue being in the $10 million range;
- Monthly revenues are volatile (which can be expected due to the contract nature of SSI and CCB's business); management hopes to smooth out such fluctuations;
- During the six month acquisition processes, a lot of SSI's resources shifted from their business to dealing with acquisition related matters; SSI was a family run business, and according to CCB, they ran the business from a humanitarian point of view as their products were designed to save lives;
- Post acquisition, CCB refocused on rebuilding the backlog, and dealing with other acquisition related matters such as relocating facilities etc; These all had an impact on business;
- The weak US$ (which affects the company's consolidated results).

Even though management is optimistic about SSI's prospects going forward, we choose to remain more conservative. We are going to reduce our estimate of SSI's revenue contribution for FY2008 from $10 million, to $6 million. We believe it will take time for the company's new sales staff and administration to fully ramp up sales again. After 2008, we are going to assume that SSI grows at the overall growth rate of CCB, which we have assumed to be 15%, down from our previous estimate of 20%. At the company's recent AGM, it disclosed that SSI had a backlog of about $1.3 million.

If we strip out SSI's contribution to revenues for FY2007, organic revenue growth was about 13.9%, below the company's historical growth rate of about 20%. The table below presents revenue results by geographic segment.

CON-SPACE - Sales by Geographic Segment
($000's)

	2005	2006	2007	05 % of Total	06 % of Total	07 % of Total	Growth 05/06	Growth 06/07
Canada	3,303.0	2,184.8	2,199.8	46.6%	39.8%	30.3%	-33.9%	0.7%
U.S.	3,195.9	2,544.3	3,918.1	45.1%	46.3%	54.0%	-20.4%	54.0%
U.K.	592.0	761.3	1,137.6	8.3%	13.9%	15.7%	28.6%	49.4%
Total	7,090.8	5,490.4	7,255.5	100.0%	100.0%	100.0%	-22.6%	32.1%

Canadian sales have been virtually flat YoY after a steep decline in 2005-2006. From our discussions with management, we believe that this will continue to be the case going forward, and that the bulk of the growth opportunity will come from the U.S., Europe, and Internationally. According to management, potential Canadian customers have a much slower adoption rate and sales in the market are sluggish though not mature.

In contrast, U.S. and U.K. sales have grown by 54% and 49% respectively from 2006-2007. This was partly due to the SSI acquisition. However, this has also been due to deliberate efforts by CCB to bolster its sales in the U.S. and U.K. For example, it opened a sales office in Nebraska and added sales staff in the U.K. We gained greater insight into CCB's sales and prospects, by market, at CCB's AGM. The chart below is from a presentation given at the AGM; the information was not previously available in CCB's filings.

Source: CCB

For 2007, the company's distribution business generated orders of $2.585 million versus $2.547 last year, an increase of 1.5%. The distribution business's revenues are largely dependent on government grants, and 95% of this segment's sales are in the U.S. This presents two problems: 1) sales are tied to volatility in government budgets, and 2) the strong US$ affects sales. The first problems was a large part of the reason sales declined so much from 2005 to 2006. During this period, a lot of government funds were reallocated from Homeland Security to Hurricane Katrina relief. The company is trying to mitigate this by expanding into industrial markets. In order to mitigate the second problem, the company is trying to shift its costs from the current structure of 80% Canadian and 20% U.S., to 40% Canadian and 60% U.S. The company is also reviewing its product pricing.

The OEM business has suffered significantly with orders dropping 17.9% during 2006-2007, from $1.95 million to $1.6 million. The company attributes this to 1) Its OEM customers are also dependent on government grants, and 2) a drop in sales to one major OEM customer last year due to an acquisition. As in their distribution business, the company is mitigating the first factor by trying to expand its sales to more industrial customers. In terms of the second factor, the company has opened an office in Nebraska to specifically expand it OEM customer base. This strategy is starting to show some progress with the signing of a number of companies, such as EF Johnson (subsidiary of EFJ Inc.; NASDAQ: EFJI), as OEM customers.

In the U.K., orders grew 14.5 % from $921,000 to $1.055 million during 2006-2007. The U.K. and Europe is where the company sees the greatest opportunity for growth. As mentioned in a previous report, the company had already been selling SSI's products in the U.K. prior to the acquisition. Many of the people buying SSI's products had never heard of CON-SPACE. Therefore, due to the acquisition, the company can now leverage this by selling SSI's customers CCB products as well.

Percentage wise, international orders recorded the strongest growth in 2006-2007, of 237.1% from $89,000 to $300,000. However, a large bulk of this was due to a sale to one customer – Petrobras in Brazil (NYSE ADR: PZE), and we do not believe we can project future sales growth based on this. At the AGM, Alan Jakobsen, the company's Vice President of sales and marketing, mentioned that confined space regulations are just starting to come into discussion or effect in various countries internationally. He cited Brazil as an example. While we believe this presents evidence of potential future growth, it is too early to quantify exact figures.

Overall, management indicated to us that the integration of SSI was going well, and with the relocation of its facilities completed, CCB can now focus on building sales. For 2008, we are now expecting revenues of $14.3 million down from our previous estimate of $18.3 million. For 2009, we are expecting sales of $16.5 million.

Margins

The table below presents the company's actual margins for 2006 and 2007, and what we had expected for 2007.

Margins	2007E	2006	2007A
Gross	44.0%	45.8%	46.1%
EBITDA	6.5%	10.1%	12.0%
EBIT	5.2%	8.6%	8.7%
EBT	2.3%	5.4%	5.0%
Net	1.5%	3.6%	2.9%
G&A/Sales	37.5%	35.7%	34.1%

Gross margins for 2007, of 46.1%, improved over 2006, and came in ahead of expectations. As mentioned in a previous report, we believe that SSI has gross margins of upwards of 70%, versus CCB's historical margins of about 49%. We see evidence of this with the FY2007 results, and hence, we are leaving our 2008+ gross margin assumptions at 55%.

The company did a good job of controlling operating expenses. FY2007 G&A to sales was 34.1% versus our expectation of 37.5%. For 2008, we are maintaining our G&A to sales assumption of 35%, and maintained our 2009+ assumption of 33.2% as the company has confirmed that it continues to keep a tight control on all expenses. Interest expenses are inline with expectations though depreciation and taxes were higher than expected.

Net Income and EPS Ahead of Expectations

Overall, the company reported net income of $213,528 or $0.02 EPS, ahead of our expectations of $127,142 or $0.01 EPS. For 2008, we are expecting net income of $695,965 or EPS of $0.05. For 2009, we are expecting net income of $1.18 million or $0.08 EPS.

Other Notes From the AGM and Industry

On November 15, 2007, 3M (NYSE: MMM) announced that it had agreed to purchase Aearo Technologies Inc. for $1.5 billion, its largest acquisition in 2 years. Aearo has sales of about $508 million which means 3M paid about 3x sales for the acquisition. We believe this deal is important for the following of reasons:

- It gives us a back of envelope valuation on CCB. If CCB was bought out for 3x our 2008 sales estimate, it would place a value of $43 million on CCB. Subtracting debt gives an equity value of about $35.6 million or $2.41 per share. We note that we are not suggesting that CCB's shares are worth $2.40 because there would also be a discount for CCB's size relative to Aearo, value of control in the acquisition of Aearo etc., though it shows that CCB is clearly undervalued at current market prices.
- CCB has been trying to gain 3M as a customer for quite some time. This transaction increases the likelihood of that happening. This is because Aearo took part in the private placement that helped finance CCB's acquisition of SSI, and hence, owns about 15%+ CCB's outstanding shares. In fact, Rahul Kapur, who is a director of CCB, is also an SVP of Aearo.

During the company's AGM presentation, CCB showed some applications of SSI's products and we asked about the competitive environment for such products. Management believes that its competitive advantages are first mover advantages and quality. This is especially true in international markets where we were informed that even if someone originally buys based on price (CCB is priced as a premium product), the cheaper product will usually break and customers will switch to SSI.

The company has continued to introduce new products and tweak its existing products. It also continues to find new markets for its products. One drawback of the company's high quality is that products may not be replaced too often. At the AGM, management informed the audience that SSI's products are upgraded, on average, about every five years, which allows the company the opportunity to regenerate sales.

Capital Structure and Cash Flow

While the CCB has gone from being debt free to a debt to capital ratio of 46.4%, we are not concerned with the increase in debt because it still maintains a healthy cash position, EBITDA interest coverage and cash from operations (CFO) is positive. Given CCB's debt repayment schedule, we do not expect CCB will have trouble paying its obligations.

Comment on Balance Sheet Items: We do wish to make a comment on two line items on the company's balance sheet. The company has capitalized about $2.56 million in product development costs and another $1.14 million in other assets (consisting of patents, customer lists, and non-compete agreements). These represent about 20% of the company's total assets.

While we always prefer companies to be conservative and write-off these types of intangible items, we asked the company's controller, at the AGM to explain them and were informed that:

1. **Product Development Costs –** The bulk of these relate to new product development costs incurred by SSI. According to CCB's controller, SSI had spent a lot of money on new products that were yet to be commercialized. They wanted to be compensated for the amount they had spent, but had yet to benefit from. These were capitalized as R&D costs. We have amortized them over 5 years in our models.
2. **Other Assets –** These also relate to the acquisition and were for various intangible assets acquired.

Valuation

Based on the above revisions to our models, the following is our new DCF valuation of CCB.

CON-SPACE Communications - DCF Model
(C$ 000s)

	2008 F	2009 F	2010 F	2011 F	2012 F	2013 F	2014 F	Terminal
FFO	1,365.0	1,858.3	2,237.2	2,672.5	3,173.1	4,028.2	4,675.7	5,421.3
-increase in w/c	(582.8)	(605.7)	(696.5)	(801.0)	(921.1)	(1,059.3)	(1,218.2)	(1,400.9)
=CFO	782.2	1,252.7	1,540.7	1,871.5	2,251.9	2,968.9	3,457.5	4,020.4
-capex	(200.0)	(200.0)	(200.0)	(200.0)	(200.0)	(200.0)	(200.0)	(200.0)
- net debt repayment	(191.3)	(203.1)	(215.7)	(229.0)	(6,243.1)	-	-	-
=FCFE	390.9	849.5	1,125.0	1,442.6	(4,191.2)	2,768.9	3,257.5	3,820.4
PV	357.0	687.5	806.8	916.8	(2,360.2)	1,381.7	1,440.4	17,150.7

Discount Rate	13%
Terminal Growth	3%
Shares O/S (000's)	14,773
PV Equity	21,554
Value Per Share	$ 1.46

This is virtually unchanged from our previous DCF valuation.

The table below presents our revised comparables valuation of CCB.

Sector/Industry	**P/E**
Communications Equipment	25.2
Defense	19.5
Average	22.4
CCB Trailing	25.0
CCB Forward	10.8
Implied Value 08 EPS	$ 1.03
Implied Value 09 EPS	$ 1.74
Current Price	$ 0.50

Source: FRC, Reuters

As the table above shows, CCB is undervalued based on forward EPS. We also note that CCB trades below book and sales. As CCB is profitable, this should not be the case and is further evidence of undervaluation.

Rating

We continue to believe that the market needs to see CCB implement on its growth initiatives. Although it still has a lot of market share opportunity, it must deliver results. We continue to believe SSI was an excellent acquisition for the shareholders of CCB. Therefore, based on our review of CCB's most recent year-end results, and AGM presentation, and our outlook for the combined entity, we are maintaining our fair value of $1.40 and BUY rating.

Risks

The potential for others to enter CCB's markets remains. As for SSI, according to CCB's CEO, SSI's main competitors were Chinese replicas with lower quality. With potential new entrants, CCB's estimated growth may be hampered. However, CCB's propensity for strong relationships with its customers, as evidenced by collaborative research and development, is a key advantage. CCB also has first mover advantage, as we see the company develop new markets and uses for its products. Furthermore, CCB's OEM production further mitigates large entrants, as these competitors' private-label equipment is currently produced by CCB. CCB is looking to target new markets where competition is more intense and where it will incur higher costs in anticipation of future revenues.

Currency exposure has increased. CCB has acquired an entity with about U$10 million in sales and now faces significant translation risk. We have not accounted for potential foreign exchange losses in our model.

We believe that the company's new acquisition increases CCB's risk profile as we do not have historical data on SSI. Furthermore, the company has incurred a significant amount of debt to fund the acquisition. There are also risks of integration, cost control etc. Liquidity is also a risk for any small cap.

The company's revenues are contract based and thus, may be lumpy due to timing of orders or shifts in spending. At this time, we are maintaining our risk rating of 3 (Average Risk).

Appendix

CON-SPACE Communications Ltd. Income Statement
(C$ 000s)

	2006A	2007A	2008F	2009F
REVENUE	$5,490	$ 7,256	$14,344	$16,495
Cost of Goods Sold	$2,975	$ 3,910	$6,455	$7,423
Gross Margin	$2,515	$ 3,346	$7,889	$9,072
General & Administration	$2,094	$ 2,474	$5,020	$5,476
EBITDA	$421	$ 872	$2,869	$3,596
Depreciation & Depletion	$82	$ 241	$157	$170
Product Development Costs	-	$ -	$512	$512
EBIT	$339	$ 630	$2,200	$2,914
Interest Expense	$42	$ 284	$1,116	$1,086
Other	$0	$ (16)	($21)	($40)
EBT	$297	$ 362	$1,105	$1,868
Current Taxes	$35	$ (62)	$409	$691
Deferred Taxes	$68	$ 211	$0	$0
Total Taxes	$103	$ 149	$409	$691
Net Income	$ 195	$ 214	$696	$1,177
Basic Shares O/S (000)	10,724	14,773	15,101	15,101
Fully Diluted Shares O/S (000)	10,724	14,773	15,101	15,101
EPS Basic	0.02	0.02	0.05	0.08
EPS Fully Diluted	0.02	0.02	0.05	0.08

CON-SPACE Communications Ltd. Balance Sheet
(C$ 000s)

	2006A	2007A	2008F	2009F
Assets				
Cash	$1,457	$692	1,322	2,171.9
Accounts Receivable	$950	$1,760	2,295	2639.3
Inventory	$1,308	$2,861	2,582	2,969.2
Other	$128	$462	$462	$462
Total Current Assets	$3,844	$5,776	6,662	$8,242.8
Fixed Assets	$365	$526	569	599.0
Demonstration Inventory	$148	$235	235	$235
Other	$186	$4,063	3,563	3,064
Goodwill	-	8,128	8,128	8,128
Total Assets	$4,543	$18,728	$19,156	$20,268
Liabilities				
Bank Indebtedness	$0		-	-
Accts Payable & Accrued Charges	$270	$1,167	839	965
Income Taxes Payable & Other	$0.0	$419.9	$420	$420
Current LT Debt	$0	$191	203	215.7
Total Current Liabilities	$270	$1,778	1,462	1,600.6
Long Term Debt	$0	$7,245	7,054	6,851
Capital Lease Obligations	$0	$0	-	0.0
Deferred Income Taxes	$0	$1,108	1,108	1,108
Other	$0	$0	-	0.0
Total Liabilities	$270	$10,132	9,624	9,559.4
Shareholders' Equity				
Capital Stock	$3,457	$7,631	7,870	7,869.9
Retained Earnings	$753	$966	1,662	2,838.6
Other	$63	$0		$0
Total Equity	$4,272	$8,597	9,532	10,708.5
Total Liabilities and Equity	$4,543	$18,728	19,156	20,268.0

CON-SPACE Communications Ltd. Cash Flow
(C$ 000s)

	2006A	2007A	2008F	2009F
OPERATING ACTIVITIES				
Net Income from Continuous Operations	195	214	696	1,177
Depreciation & Amortization	82	285	157	170
Product Development Costs	-	-	512	512
Increase in Deferred Income Taxes	68	211	-	-
Other	-	(142)	-	-
Funds From Operations	345	567	1,365	1,858
Change in non-cash working capital	176	(9)	(583)	(606)
Cash and Equivalents from Operations	521	558	782	1,253
INVESTING ACTIVITIES				
Additions to PP&E	(104)	(277)	(200)	(200)
Disposal of Fixed Assets			-	-
Acquisition of Business		(8,682)	-	-
Demonstration Inventory	13	(115)		
Other	(547)	(1,372)		
Cash and Equivalents Applied to Investing	(638)	(10,445)	(200)	(200)
FINANCING ACTIVITIES				
Issuance (Repayment) of Long Term Debt	(87)	6,000	(191)	(203)
Issue (Repurchase) of Common Shares	88	3,933	239	
Issue (Repurchase) of Preferred Shares				
Increase (Repayment) of Capital Lease Obligations				
Cash (used for) Discontinued Operations				
Other (Derivatives)				
Debt		(411)		
Bank Debt			-	-
Cash Flow from Financing	1	9,522	48	(203)
Increase (Decrease) In Cash During the Period	(116)	(365)	630.1	849.5
Cash BOP	1,173	1,057	692.2	1,322.3
Cash EOP	1,057	692	1,322.3	2,171.9

Fundamental Research Corp. Equity Rating Scale:
Buy – Annual expected rate of return exceeds 12% or the expected return is commensurate with risk
Hold – Annual expected rate of return is between 5% and 12%
Sell – Annual expected rate of return is below 5% or the expected return is not commensurate with risk
Suspended or Rating N/A— Coverage and ratings suspended until more information can be obtained from the company regarding recent events.

Fundamental Research Corp. Risk Rating Scale:
1 (Low Risk) - The company operates in an industry where it has a strong position (for example a monopoly, high market share etc.) or operates in a regulated industry. The future outlook is stable or positive for the industry. The company generates positive free cash flow and has a history of profitability. The capital structure is conservative with little or no debt.

2 (Below Average Risk) - The company operates in an industry where the fundamentals and outlook are positive. The industry and company are relatively less sensitive to systematic risk than companies with a Risk Rating of 3. The company has a history of profitability and has demonstrated its ability to generate positive free cash flows (though current free cash flow may be negative due to capital investment). The company's capital structure is conservative with little to modest use of debt.

3 (Average Risk) - The company operates in an industry that has average sensitivity to systematic risk. The industry may be cyclical. Profits and cash flow are sensitive to economic factors although the company has demonstrated its ability to generate positive earnings and cash flow. Debt use is in line with industry averages, and coverage ratios are sufficient.

4 (Speculative) - The company has little or no history of generating earnings or cash flow. Debt use is higher. These companies may be in start-up mode or in a turnaround situation. These companies should be considered speculative.

5 (Highly Speculative) - The company has no history of generating earnings or cash flow. They may operate in a new industry with new, and unproven products. Products may be at the development stage, testing, or seeking regulatory approval. These companies may run into liquidity issues, and may rely on external funding. These stocks are considered highly speculative.