

CON-SPACE Communications Ltd. (TSX-V: CCB) – Q3 2007 Update

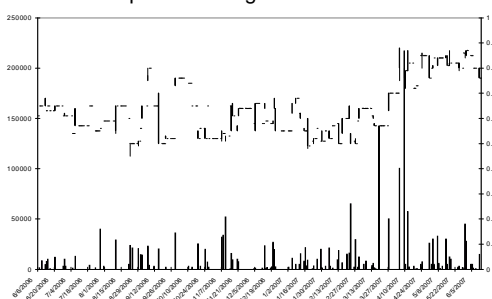
Sector/Industry: Safety Products/Communications

www.con-space.com

Market Data (as of June 13, 2007)

Current Price	\$0.76
Fair Value	\$1.40
Rating*	BUY
Risk*	3 – AVERAGE
52 Week Range	\$0.45 - \$0.88
Shares O/S	14.8 mm
Market Cap	\$11.2 mm
Current Yield	N/A
P/E (forward '08)	8.4x
P/B	2.6x
YoY Return	20.6%
YoY TSX-V	22.8%

*see back of report for rating and risk definitions



Q3 2007 Highlights

- CCB reported Q3 2007 revenue growth of 61.5% on strong U.K. and U.S. sales. YTD, sales are up 17.3%, slightly below our expectations of 20%.
- Since the SSI acquisition closed in April 2007, Q3 results did not include the results of SSI.
- Gross margins YTD of 40% are below our expectations of 44%. However, we are leaving our GM assumptions unchanged as we believe SSI's higher margins will make up for the shortfall.
- The company continues to introduce new products and form alliances with key distributors.
- We are looking forward to year-end results to see the impact of the SSI acquisition on CCB in terms of revenue enhancement, margin improvement, and capital structure. We are maintaining our fair value estimate at \$1.40, and our BUY rating.

Key Financial Data and Statistics

(C\$ '000's)	2002	2003	2004	2005	2006A	2007E	2008E
Revenues	3,176.9	4,787.1	5,529.5	7,090.8	5,490.4	8,668.5	18,322.2
EBITDA	436.4	830.3	836.4	1,786.8	421.4	563.5	3,664.4
Net Income	207.2	779.3	698.2	1,135.6	195.0	127.1	1,339.7
Assets	1,545.6	2,292.0	3,023.3	4,785.1	4,542.7	16,909.1	18,928.9
Debt	1,032.9	881.4	663.0	87.1	-	7,695.0	7,695.0
Equity	28.2	1,091.0	1,841.8	3,989.3	4,272.2	8,491.4	10,070.3
Free Cash Flow to Equity	(11.8)	110.9	108.2	94.3	242.2	(4,441.5)	(946.3)
W/A Basic Shares O/S (000s)	8,190.0	8,190.0	9,258.2	10,686.0	10,724.2	14,773.4	15,100.8
EPS (Basic)	0.03	0.10	0.08	0.11	0.02	0.01	0.09
EPS (Fully Diluted)	0.02	0.09	0.08	0.11	0.02	0.01	0.09
EBITDA Margin	13.7%	17.3%	15.1%	25.2%	7.7%	6.5%	20.0%
ROE	734.6%	71.4%	37.9%	28.5%	4.6%	1.5%	13.3%

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.

Strong Q3 Revenue Growth

CCB reported Q3 2007 revenues of \$1.78 million versus \$1.11 million in the same period last year, an increase of 61.5%. Year to date, revenues have grown 17.3% versus the comparable period last year.

Over half of the growth was attributed to strong sales in the U.K. which were reported to have grown by 73.5%. Other areas of growth were in the U.S. where sales were reported to have grown by 23.7%. We were pleased to see progress in these areas as the company has recently made efforts to expand its presence in these geographic locations. Obviously its efforts are paying off.

The company continues to invest in product development and introduce new products. We believe this is a key component of the company's growth. R&D expenses YTD have increased 51.8% versus the same period last year. Also, towards the end of Q3, the company launched its Modular Radio Accessory Product Line at the International Wireless and Communications Exhibition. The new line is expected to contribute to revenues starting in Q1 of 2008.

CCB has also announced new distribution and OEM agreements.

- In May, CCB announced that they had signed a manufacturer's rep agreement with a company in Brazil. Although the company has known about CCB's products since 1999, they are now increasing their efforts at promoting CCB's products in Brazil.
- Also in May, CCB announced that it had signed a private label agreement with EF Johnson (Parent Company is EFJI on the NASDAQ) to offer CCB's radio accessories as part of EF Johnson's Project 25 compliant solution for public safety.

Although YTD growth of 17.3% is below our model growth of 20%, we are leaving our growth rate assumptions, and hence, our revenue estimates unchanged. We believe that the strong Q3 growth and SSI acquisition are indicators the company will be able to meet our expectations.

Margins

Q3, YTD, and forecast margins are presented in the table below.

Margins	2005 A	2007F	Q3 2006	Q3 2007	9MO 2006	9MO 2007
Gross	57.4%	44.0%	41.4%	37.4%	42.1%	40.0%
EBITDA	25.2%	6.5%	0.3%	1.3%	9.7%	3.4%
EBIT	24.4%	5.2%	-1.5%	0.2%	8.2%	2.2%
EBT	22.5%	2.3%	-1.7%	-1.3%	7.1%	2.1%
Net	16.0%	1.5%	-1.0%	-1.3%	4.5%	1.2%

As the table show, gross margins are below our expectations of 44%. However, because we suspect that SSI has higher margins than CCB, as mentioned in our previous report, we are leaving our margin assumptions unchanged. G&A to sales YTD came in slightly below expectations at 36.6% versus our model assumption of 37.5%

Earnings

Q3 2007 net income was (\$22,291) versus (\$11,571) in the same period last year. Although sales grew YoY, the lower gross margins had an offsetting effect on the bottom line. Net income YTD was \$54,840 (EPS of \$0.01) versus \$180,744 (EPS of \$0.02) in the same period last year. Lower gross margins and higher operating costs (as expected) contributed to the decline in profit.

Our net income and EPS estimates are unchanged.

NOTE on deductibility of interest on foreign acquisition – In its most recent Federal Budget, the government implemented rules specifying that Canadian companies borrowing money to finance foreign deals will no longer be able to deduct the interest costs against their Canadian income. Since then there have been varying opinions about applicability in various scenarios. CCB's management informed us that "the question of interest deductibility was a major issue we pursued after it was announced by the Federal Government. The conclusion of our accountants is that we do qualify". Therefore at this time, we make no adjustments to our models and assume that the SSI acquisition debt is fully tax deductible.

Capital Structure and Cash Flow

The company's capital structure remains solid at the end of Q3 though this will change once the SSI acquisition is accounted for in the next reporting period. See our April 20, 2007, report for a pro forma analysis of how we believe the acquisition will impact the company.

Cash flows for Q3 and YTD have fallen due to lower profit and larger investment in working capital.

Rating/Valuation

As there have been no changes to our models, there is no change to our valuation models on CCB. This will be the last quarter that CCB reports without the effects of SSI. After year-end results are released, we will get a better idea of how to adjust for the SSI acquisition. At this point, we continue to be positive that the company has acquired an entity which gives it revenue enhancement through marketing and strategic gains, and higher gross margins, all at a very low low price. Therefore, based on our review of CCB's most recent results we are maintaining our fair value estimate of \$1.40 and our BUY rating. We caution investors that our current financial and valuation models incorporating SSI are based on our best pro forma estimates using whatever information has been made public regarding SSI.

Risks

The potential for others to enter CCB's markets remains. As for SSI, according to CCB, SSI's main competitors were replicas with lower quality. However, with potential new entrants, CCB's estimated growth may be hampered though we believe CCB's 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 (e.g. China) 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)

	2005A	2006A	2007F	2008F
REVENUE	\$7,091	\$5,490	\$8,668	\$18,322
Cost of Goods Sold	\$3,024	\$2,975	\$4,854	\$8,245
Gross Margin	<u>\$4,067</u>	<u>\$2,515</u>	<u>\$3,814</u>	<u>\$10,077</u>
General & Administration	\$2,280	\$2,094	\$3,251	\$6,413
EBITDA	\$1,787	\$421	\$563	\$3,664
Depreciation & Depletion	\$59	\$82	\$109	\$374
EBIT	\$1,728	\$339	\$454	\$3,290
Interest Expense	\$129	\$42	\$296	\$1,185
Other	\$0	\$0	(\$44)	(\$21)
EBT	\$1,599	\$297	\$202	\$2,127
Current Taxes	\$226	\$35	\$75	\$787
Deferred Taxes	\$238	\$68	\$0	\$0
Total Taxes	<u>\$463</u>	<u>\$103</u>	<u>\$75</u>	<u>\$787</u>
Net Income	<u>\$1,136</u>	<u>\$ 195</u>	<u>\$127</u>	<u>\$1,340</u>
Basic Shares O/S (000)	10,686	10,724	14,773	15,101
Fully Diluted Shares O/S (000)	10,686	10,724	14,773	15,101
EPS Basic	0.11	0.02	0.01	0.09
EPS Fully Diluted	0.11	0.02	0.01	0.09

CON-SPACE Communications Ltd. Balance Sheet

(C\$ 000s)

	2005 A	2006A	2007F	2008F
Assets				
Cash	\$1,173	\$1,457	\$707	(0)
Accounts Receivable	\$1,257	\$950	\$1,387	2,932
Inventory	\$1,673	\$1,308	\$1,942	3,298
Other	\$71	\$128	\$10,888	\$10,888
Total Current Assets	\$4,174	\$3,844	\$14,923	17,117
Fixed Assets	\$344	\$365	\$1,252	1,078
Demonstration Inventory	\$160	\$148	\$148	148
Other	\$107	\$186	\$587	587
Total Assets	\$4,785	\$4,543	\$16,909	18,929
Liabilities				
Bank Indebtedness	\$0	\$0	\$0	-
Accts Payable & Accrued Charges	\$483	\$270	\$631	1,072
Income Taxes Payable & Other	\$226	\$0.0	\$91.7	\$91.7
Current LT Debt	\$87	\$0	\$0	-
Total Current Liabilities	\$796	\$270	\$723	1,164
Long Term Debt	\$0	\$0	\$7,695	7,695
Capital Lease Obligations	\$0	\$0	\$0	-
Deferred Income Taxes	\$0	\$0	\$0	-
Other	\$0	\$0	\$0	-
Total Liabilities	\$796	\$270	\$8,418	8,859
Shareholders' Equity				
Capital Stock	\$3,432	\$3,457	\$7,457	7,696
Retained Earnings	\$558	\$753	\$880	2,219
Other	\$0	\$63	\$155	\$155
Total Equity	\$3,989	\$4,272	\$8,491	10,070
Total Liabilities and Equity	\$4,785	\$4,543	\$16,909	18,929

CON-SPACE Communications Ltd. Cash Flow

(C\$ 000s)

	2005 A	2006A	2007F	2008F
OPERATING ACTIVITIES				
Net Income from Continuous Operations	1,136	195	127	1,339.7
Depreciation & Amortization	59	82	109	374.0
Increase in Deferred Income Taxes	238	68	-	-
Other	63	-	-	-
Funds From Operations	1,494	345	236	1,713.8
Change in non-cash working capital	(1,155)	176	(618)	(2,460.1)
Cash and Equivalents from Operations	340	521	(381)	(746.3)
INVESTING ACTIVITIES				
Additions to PP&E	(63)	(104)	(60)	(200)
Disposal of Fixed Assets	-	-	-	-
Acquisition of Business	-	-	(11,695)	-
Demonstration Inventory	-	13	-	-
Other	-	(547)	-	-
Cash and Equivalents Applied to Investing	(63)	(638)	(11,755)	(200.0)
FINANCING ACTIVITIES				
Issuance (Repayment) of Long Term Debt	(182)	(87)	7,695	-
Issue (Repurchase) of Common Shares	949	88	4,000	239.2
Issue (Repurchase) of Preferred Shares	-	-	-	-
Increase (Repayment) of Capital Lease Obligations	-	-	-	-
Cash (used for) Discontinued Operations	-	-	-	-
Other (Derivatives)	-	-	92	-
Debt	-	-	-	-
Bank Debt	-	-	-	-
Cash Flow from Financing	767	1	11,787	239.2
Increase (Decrease) In Cash During the Period	1,043	(116)	(350)	(707.1)
Cash BOP	129	1,173	1,057	707.1
Cash EOP	1,173	1,057	707	(0.0)

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.

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