

Tuesday November 25, 2008

Aeroquest International (AQL-TSX \$0.30)	STRONG BUY	12 Mo. Target \$2.10	Market Cap \$10.4 Million	P/E 2008E: 5.0x P/E 2009E: 2.7x
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- On November 24, 2008 Aeroquest closed at \$0.30 – down 17% from its previous low. AQL has a current market capitalization of \$10.4M and with \$15.0M of cash on the balance sheet the current enterprise value is (\$3.6M). Yes, negative \$3.6M.
- Over the past six months AQL has fallen by 88.2%, almost double the 42.5% drop experienced by the TSX over the same period. What may account for this behaviour?
- First, there is a perception that AQL will face a significant revenue decline as junior mining companies lose access to fresh equity capital. We estimate junior mining companies account for about 30% of annual revenues. On the assumption of no growth in sales in FY2009 compared to FY2008, we would see revenue drop from \$55.0M to about \$38.0M – significantly above our estimated breakeven sales of \$28.0M.
- Second, we could also assume that none of the current backlog of \$17.0M of booked business comes to fruition – although AQL would likely be able to keep the customer deposit payments. Moreover, 25% of the current backlog comes from oil and gas clients, which seem less likely to cancel their exploration plans. The loss of \$15.0M of junior mining business would clearly be negative, but a \$75.0M drop in market capitalization exaggerates the likely financial impact.
- A third area of concern may exist over AQL’s commitments for its Spectrem acquisition. We note that the initial payment is of the order of \$1.5M and that Anglo American has contracted to use 50,000 line kilometres of services from AQL following completion of the transaction. Further capital expenditure is required to purchase an airborne gravity gradiometer, but the \$5.0M plus investment is predicated on Anglo being able to use the device as well as a wide range of other clients that cannot get access to an airborne gravity gradiometer.
- A final cause for concern is the outstanding Geotech lawsuit. While AQL believes it has robustly refuted Geotech’s claims, there is always the chance that Geotech will prevail. On the basis of our (non-legal) review of the counterclaim/statement of defence, we believe that AQL will be able to avoid material damages.
- AQL provided a preview of its FY2008 financial results at the end of October and will release the audited results on December 5, 2008 with a conference call to be held on Monday December 8, 2008 (time and dial in number to be confirmed).

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Friday October 17, 2008

Aeroquest International Ltd. (AQL-TSX \$0.63)	STRONG BUY	12 Mo. Target \$2.10	Market Cap \$21.8 Million	P/E 2008E: 10.5x P/E 2009E: 5.7x
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- The downward trend of the overall market is uncovering a number of true bargains, one of which is Aeroquest.
- AQL has \$16.9M of cash on its balance sheet, as at the end of Q2FY2008, no debt and is running EBITDA margins of over 20%. The stock is currently trading at 0.5X (yes, that is correct, less than one times) enterprise value to our forecast of EBITDA for FY2008 of \$11.2M.
- Valuation isn’t the only attention grabbing factor. AQL has recently signed an LOI with Anglo American to take over its airborne geophysical survey subsidiary and provide services on an outsourced basis, with minimum work commitments that will run out over 10 years. Moreover, the agreement gives AQL the opportunity to buy an airborne gravity gradiometer (one of only 10 worldwide) and offer high value gravity surveys to Anglo and other customers in both mining and oil and gas exploration. AQL will be one of the only airborne geophysical companies able to offer this capability.
- As part of a diversification strategy away from mining, AQL’s business mix is shifting. About 65% of business is now coming from mining – split 50/50 between juniors and seniors – 15% from government organizations and the balance of 20% from oil and gas companies, and growing. To date customers are continuing to place orders and write deposit cheques. AQL’s backlog of work is running just over \$17.0M or the equivalent of 30% of annual sales.
- We reiterate our STRONG BUY recommendation and \$2.10 target price.

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Thursday October 9, 2008

Aeroquest International Ltd. (AQL-TSX \$0.90)	STRONG BUY	12 Mo. Target \$2.10	Market Cap \$31.1 Million	Potential ROR 133%
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- After clarifying recent developments at Aeroquest with the company, we are removing our under review recommendation and reinstating the stock as a STRONG BUY with a \$2.10 price target, offering investors a potential return of over 100% from current levels.
- Our update on the company discusses five recent developments that are key to AQL's future:
 - The law suit initiated by Geotech should be viewed as a nuisance rather than a major impediment to business development. One proof point supporting this view is that AQL has been able to sign an LOI with Anglo American for a long term business relationship. If the suit were more than minor, we doubt that Anglo would have gone ahead.
 - The supply of new capital to the mining sector is slowing and with it exploration programs. This will result in AQL and its competitors seeing their book to bill ratios fall and with it the backlog of contracted work.
 - Offsetting the general mining sector slow down is the potential offered by AQL's pending agreement with Anglo, which should see AQL get as much as \$5.0M of business each year for the next 10 years from Anglo, alone. As we note in our update, AQL is free to use the assets acquired from Anglo with other customers.
 - Among that potential group of customers will be an increasing number of oil and gas companies. E&Ps are starting to make greater use of airborne survey data and through the Anglo deal, AQL will be able to offer airborne gravity gradiometer surveys, that have high value for oil and gas exploration.
 - Finally, AQL is getting into the multi-client airborne survey business in which ownership of collected data is retained by AQL. Under this type of arrangement data can then be re-licensed to other customers. The first survey on this basis will be a 100,000 line kilometre magnetic survey in the Barnett Shale, in Texas. We note that this operational model is a very attractive investment aspect of seismic data supplier Pulse Data (PSD-T).
- At recent price levels, AQL is trading at 8X our estimated earnings of \$0.11/share for FY2009, at 1.3X EV/EBITDA for FY2008 and at a price to tangible book value of 1.7X. With a move into oil and gas, a near global delivery capability and the Anglo deal poised to close the stock is very, very attractively priced.

NOTE TO FOLLOW

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Thursday September 25, 2008

Aeroquest International Inc. (AQL-TSX \$1.25)	UR	12 Mo. Target N/A	Market Cap \$43.1 Million	Potential ROR N/A
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- On September 24, 2008, Aeroquest announced that it has entered into a non-binding LOI with Spectrem Air Limited regarding a long-term outsourcing arrangement. The deal involves Spectrem outsourcing the majority of its current airborne geophysical surveying business to AQL. The LOI is subject to due diligence, definitive legal documentation and board approval by both companies. Spectrem Air is a wholly-owned subsidiary of Anglo Operations, part of the Anglo American group. Management and logistics are run out of Johannesburg, and this would give AQL a permanent base in Southern Africa providing wider logistical support to African operations.
- The agreement brings a number of benefits. AQL gets guaranteed business with Anglo American Group companies - up to 50,000 line kilometres per year use of AQL survey systems (potentially worth about \$6.0M per year) and AQL will also license Spectrem's IP related to its proprietary surveying systems. AQL will pay a royalty to Anglo for the latter. The transaction will also see AQL pick up some staff and equipment, including an airborne device for fixed wing aircraft, two AeroTEM systems, for a consideration of US\$4.0M in a combination of future survey credits, and up to \$1.5 million in cash at Spectrem's option.
- AQL estimates that future cash commitments required to fulfil the LOI will be about US\$12 million. Given that AQL flew 530,000 line kilometres in Q3FY2008, the guarantee to fly 50,000 km per year for Anglo American companies represents a relatively small portion of AQL's annual business.
- This announcement confirms that AQL's management continues to focus on business expansion, rather than being distracted by the \$50 million lawsuit brought against it by Geotech. AQL has now filed its Statement of Defence and has counterclaimed for \$20.0M with \$1.0M in damages. The Spectrem announcement is very positive, but we continue to keep our recommendation and target price under review.

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Friday July 18, 2008

Aeroquest International Ltd. (AQL-TSXV \$1.70)	UR	12 Mo. Target UR	Market Cap \$59.1 Million	Potential ROR N/A
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- On 17 July 2008, Aeroquest made a preliminary announcement of its revenues for Q3FY2008 - period ended June 30. Total revenue for Q3FY2008 was \$14.5 million. \$6.8 million of revenue came from helicopter operations, \$7.4 million from fixed wing surveys and \$0.3 million from other services such as R&D. This marks the first period in which fixed wing surveys generated more revenue than helicopter surveys. We note that AQL is now also performing non-mining work and that an Arctic petroleum survey is currently in progress. Oil and gas industry exploration spending is almost 10 times greater than spending on mining exploration, hence the company's interest in this market.
- Traditionally, the majority of Aeroquest's helicopter surveys have been in Canada. At quarter-end, AQL had AeroTEMs active in or on their way to seven different countries. Geographical diversification has benefited AQL as survey activity in Canada has slowed compared to the same period last year. On the other hand, far flung operations increase the cost and complexity of servicing and repairing equipment. On balance, a combination of the diversification of types of survey and increasing international operations has helped the company's growth. In periods of rapid growth management and human resources can be running to catch up with the business and we believe it likely that margins may have dipped in the quarter as a result. We anticipate that these will bounce back in future periods.
- Aeroquest added four net new systems to its fleet during the quarter, bringing its airborne system count to 27. The company expects to add another three helicopter systems in Q4. Manufacturing a new "bird" is less complicated than its subsequent testing and tuning for field use. As AQL becomes more proficient with its testing and tuning process, the company should be capable of manufacturing one system per month.
- AQL expects revenue between \$16 and \$18 million in Q4FY2008, for full year revenues between \$55 and \$57 million. We have placed our target price and rating under review, pending further updates to our model and additional discussions with the company. The company will report its full Q3FY2008 results on August 13.

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Thursday, May 8, 2008

Aeroquest International Ltd. (AQL-TSXV \$2.60)	STRONG BUY	12 Mo. Target \$4.00	Market Cap \$90 Million	Potential ROR 54%
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- Aeroquest announced it has entered into a "significant" contract to complete a fixed wing magnetic survey in the Canadian Arctic. The survey length is in excess of 100,000 line kilometers (Aeroquest flew 400,000 line kilometers of fixed wing surveys in the quarter ended Dec 30).
- The data will be used by the client for seismic programs aimed at delineating various undersea arctic basins for hydrocarbon exploration.
- The contract is significant for Aeroquest as this is their Aeroquest's first survey where the data will be used for energy exploration. Aeroquest estimates that the size of the petroleum exploration market is approximately 10 times that of the mineral exploration market, or \$200 billion.

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