

**AEROQUEST INTERNATIONAL LIMITED
(TSXV-AQL C\$2.75)**

Recommendation: BUY
Revised 12-Month Target: C\$6.50
 Previous 12-Month Target: C\$7.00
Risk Rating: Above Average

SOLID Q1/08 RESULTS FOLLOW FINANCING

- **The Quarter:** Aeroquest reported Q1/08 (ended December 31, 2007) revenue of \$11.2 million, raw EPS of \$0.00 and adjusted EPS of \$0.03. Although we did not publish formal estimates for this period, we view these as solid results. This period is typically slower due to seasonality, so we expect sequential revenue and EPS improvement from here, particularly given our forecast for expansion of the system fleet. **The contract backlog improved from \$16.3 million at the end of September to \$19.0 million at the end of this quarter**, confirming our view that industry demand is still very strong.
- **Financing Completed:** Aeroquest recently completed a \$20.0 million bought deal equity financing at \$3.00/share. After allowing for the repayment of debt and working capital requirements, we estimate that AQL has \$12.5 million in excess cash (approximately \$0.32/share, fully diluted).
- **Estimate Revisions:** We have adjusted our model to reflect the dilutive impact of the financing, and revised our revenue and earnings. **We now anticipate adjusted EPS of \$0.25 in FY 2008** (down from \$0.28 pre-financing) **and \$0.44 in FY 2009** (down from \$0.50). The reduction in our diluted EPS estimates is due entirely to the impact of the financing, partially offset by stronger revenue growth assumptions, as our outlook for AQL remains positive. We have not included any potential acquisitions in our forecast, given the inherent uncertainty surrounding timing, size, etc., although we will revisit our estimates as this part of the story unfolds.
- **Valuation:** **We are reducing our 12-month target from \$7.00 to \$6.50.** Based on our revised estimates, we still believe AQL offers compelling upside at current levels, particularly given that the share price has come down 30% from its 52-week high of \$3.90 in October 2007. We believe the demand outlook remains strong and that the recent financing should allow AQL to accelerate growth via acquisitions. Applying a 14x multiple (unchanged) to our FY 2009 adjusted EPS estimate of \$0.44 implies a business value of \$6.16. Adding the \$0.32/share in excess cash implies a per share value of \$6.48. We therefore rate AQL a **BUY** with a new 12-month target of \$6.50, representing a potential return-to-target of 136%.

Sector: SPECIAL SITUATIONS
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Company Statistics	
52-Week Range	\$3.90 - \$1.06
Basic Shares O/S (MM)	34.8
Basic Market Cap (\$MM)	\$95.8
Fully Diluted O/S (MM)	39.1
Cash (\$MM) *	\$15.8
Total Debt (\$MM) *	\$0.9
Management & Directors Ownership	20%

* Jennings estimates, post-Q2/08 (post-financing).

Earnings Summary				
FYE: September	2006A***	2007A***	2008E	2009E
Sales (\$MM)	\$9.1	\$19.9	\$63.4	\$95.1
EBITDA (\$MM)	(\$0.2)	\$4.6	\$16.7	\$30.7
EBITDA Margin	(2.7%)	23.3%	26.4%	32.3%
Diluted EPS	(\$0.07)	\$0.11	\$0.16	\$0.37
Adjusted Diluted EPS**	(\$0.07)	\$0.11	\$0.25	\$0.44
P/E	nmf	24.7x	17.1x	7.5x
P/Adj. E**	nmf	24.7x	10.9x	6.3x
EV/EBITDA	nmf	15.8x	4.8x	2.6x

** Adjusted Diluted EPS excludes acquisition-related amortization.

*** Results reported for fiscal years ending April 30.



Aeroquest International Limited is a mining and energy services company providing commercial airborne geophysical surveys for use in mineral and oil and gas exploration. Aeroquest is also developing applications for its proprietary time domain electromagnetic systems in the environmental services and ground water exploration industries.

The Results: AQL reported Q1/08 (ended December 31, 2007) revenue of \$11.2 million, diluted EPS of \$0.00 and adjusted diluted EPS of \$0.03. We adjust the raw diluted EPS figure to back out the impact of the amortization related solely to the acquisition of UTS last year. This amortization reflects an accounting classification of the purchase price, is non-cash and non-deductible for tax purposes. The amortization amount for Q1/08 was \$0.9 million, or approximately \$0.03/share. The Company also reported stock compensation expense of \$0.4 million, or approximately \$0.01/share, relating to an annual grant of stock-based incentives.

As a result of the change in fiscal year, the most comparable period for which results have been published is the November 2006 – January 2007 period (what was then AQL's Q3/07). In that quarter, the Company reported revenue of \$4.1 million and diluted EPS of \$0.01. On a y-y basis, AQL produced total revenue growth of 173%, which included organic revenue growth of 54%. While diluted EPS declined y-y, that is attributable almost entirely to a combination of the stock compensation expense mentioned above and the increased share count due to the acquisition of UTS last summer. The gross margin decline from 38.7% to 35.0% is due largely to the lower gross margin of the fixed-wing operation acquired last year. We expect near term gross margin improvement driven by increased fleet utilization as the business enters a seasonally stronger period.

At the end of September, the Company had cash and equivalents of \$7.4 million and total debt of \$6.0 million, for net cash of \$1.4 million. For the Q2/08 period ending March 31, 2008 (which reflects the financing and corresponding debt repayment), we expect AQL to report cash of \$15.8 million and no debt beyond \$0.9 million in capital leases.

Outlook: We believe that demand is still very strong, as reflected by the increase in backlog from \$16.3 million at the end of September 2007 to \$19.0 million at the end of December. In our view, the biggest challenge currently facing the Company is expanding its system fleet quickly enough to capitalize on existing demand, and the key to accomplishing this is accelerating the manufacturing process such that AQL can produce one new helicopter-based system each month. Our original forecast contemplated the Company reaching this goal by the fall of 2008, but we now expect management to reach that point in spring 2008.

We therefore believe that customer demand is still very intense, and that management is well on its way to catching up with it.

Estimate Revisions: We have revised our estimates to reflect the dilutive impact of the financing, and have revised our revenue model and margin assumptions. We present below a table that reflects our prior estimates, revised estimates reflecting only the dilutive impact of the financing, and final estimates that reflect revisions to our revenue and margin assumptions.

Exhibit 1. Revised Estimates

	Pre-Financing		Post-Financing Only		Final	
	FY 2008E	FY 2009E	FY 2008E	FY 2009E	FY 2008E	FY 2009E
Helicopter-based	\$36.9	\$58.6	\$36.9	\$58.6	\$41.2	\$61.3
Fixed Wing-based	\$24.8	\$34.1	\$24.8	\$34.1	\$22.1	\$33.8
Revenue	\$61.8	\$92.7	\$61.8	\$92.7	\$63.4	\$95.1
EBITDA	\$16.6	\$28.5	\$16.6	\$28.5	\$16.7	\$30.7
EBITDA Margin	26.9%	30.8%	26.9%	30.8%	26.4%	32.3%
Net Earnings	\$4.4	\$12.1	\$4.4	\$12.1	\$5.9	\$14.4
Adjusted Net Earnings	\$8.9	\$15.8	\$8.9	\$15.8	\$9.2	\$17.1
Diluted EPS	\$0.14	\$0.38	\$0.12	\$0.30	\$0.16	\$0.37
Adj. Diluted EPS	\$0.28	\$0.50	\$0.24	\$0.39	\$0.25	\$0.44

Source: Jennings Estimates (Adjusted Diluted EPS excludes acquisition-related amortization)

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The key changes to our model are as follows:

- The Revenue Model – our prior model assumed that AQL would achieve management's target of a manufacturing rate of one new helicopter system/month beginning Q4/08 (beginning July). We now expect the Company to reach this production level beginning Q3/08 (beginning April). This results in an additional helicopter system contributing to revenue for part of FY 2008 and all of FY 2009, relative to our prior estimates.
- The Share Count – as a result of the financing, our fully diluted share count increases from 31.9 million shares to 39.1 million shares, an increase of 23%.

We have otherwise made no significant changes to our assumptions. We continue to expect strong revenue and EPS growth owing to expansion of the system fleet combined with strong operating leverage.

Valuation: Applying a 14x earnings multiple (unchanged) to our new adjusted diluted EPS estimate for FY 2009 of \$0.44 (down from \$0.50), we arrive at a per share value of \$6.16. Adding back the \$0.32/share in excess cash, we arrive at a value of \$6.48/share.

We are therefore reducing our target price from \$7.00 to \$6.50. At current levels, this represents a potential return-to-target for investors of 136%.

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Companies

Aeroquest International Limited

Ticker

TSXV-AQL

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Note: We initiated coverage on **Aeroquest International Limited** on October 18, 2007 with a **STRONG BUY** recommendation, an **ABOVE AVERAGE** risk rating and a **C\$6.50** target price. Share price at that time was **C\$2.91**. On November 1, 2007 we changed our recommendation to **BUY** as a result of changes to our internal stock rating system. Share price at that time was **C\$3.60**. On December 10, 2007 we increased our target price to **C\$7.00**. Share price at that time was **C\$2.99**.

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Revised Monthly

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