

**AEROQUEST INTERNATIONAL LIMITED
(TSXV-AQL \$1.95)**

Recommendation: BUY
Revised 12-Month Target: \$5.00
 Previous 12-Month Target: \$6.50
Risk Rating: ABOVE AVERAGE

PRELIMINARY Q3/08 RESULTS; REDUCING TARGET

- **Preliminary Q3/08 Results:** Aeroquest recently reported preliminary Q3/08 (ended June 30) revenue of \$14.5 million. While we had not published quarterly estimates, this preliminary result was below what we had anticipated. Management cited delays in starting helicopter surveys in the quarter as having negatively impacted results. No margin results were disclosed, although management commented that margins are still in the range of those in prior quarters.
- **Q4/08 Guidance:** Management guided to Q4/08 revenue between \$16.0 and \$18.0 million, which would produce FY 2008 total revenue of \$55.0 to \$57.0 million. This guidance is below our prior forecast for Q4/08 and FY 2008 (revenue of \$61.1 million). We believe that this is the first time that management has provided formal revenue guidance. The Company is entering Q4/08 with 27 systems in its fleet, behind our prior estimate. AQL finished the quarter with a backlog of \$17.0 million, down marginally from \$18.0 million at the end of Q2/08.
- **Business Demand Still Strong:** Perhaps most importantly, management commented that overall demand remains strong. While junior mining companies have become more cautious in their exploration spending owing to weak capital markets, that slowness has been offset by increased spending by majors and intermediates. This macro view has been echoed by other companies in the mining services space. **Management attributed the Q3/08 results to addressable internal execution challenges and not weakening demand.**
- **Estimate Revisions:** We have adjusted our model to reflect updated estimates for system fleet expansion, based on the current fleet size and expected additions. We now expect AQL to exit FY 2008 with 30 systems (down from our prior estimate of 36 systems), and to exit FY 2009 with 44 systems (down from our prior estimate of 52). We now expect FY 2009 EBITDA of \$26.5 million and adjusted diluted EPS of \$0.38/share, down from our prior estimates for EBITDA of \$30.9 million and adjusted diluted EPS of \$0.44/share.
- **Valuation:** Applying a 12.5x earnings multiple (down from 14x to reflect lower multiples on comparable companies) to our revised FY 2009 diluted EPS estimate implies a per share value of \$4.75. Applying a 7x EBITDA multiple on our revised estimate implies a per share value of \$5.17. **We are therefore reducing our target to \$5.00** from \$6.50 and are maintaining our **BUY** recommendation. At current levels, AQL trades at approximately 4x this year's EBITDA.

Sector: SPECIAL SITUATIONS
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Company Statistics

52-Week Range	\$3.90 - \$1.65
Basic Shares O/S (MM)	34.7
Basic Market Cap (\$MM)	\$67.6
Fully Diluted O/S (MM)	38.8
Cash (\$MM)	\$16.2
Total Debt (\$MM)	\$0.9
Management & Directors Ownership	20%

Earnings Summary

FYE: September	2007A**	2008E	2009E
Sales (\$MM)	\$19.9	\$55.7	\$84.0
EBITDA (\$MM)	\$4.6	\$13.8	\$26.5
EBITDA Margin	23.3%	24.9%	31.5%
Diluted EPS	\$0.11	\$0.09	\$0.29
Adjusted Diluted EPS*	\$0.11	\$0.21	\$0.38
P/E	15.3x	20.7x	6.7x
P/Adj. E*	15.3x	9.3x	5.2x
EV/EBITDA	9.7x	3.8x	2.0x

* 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.

Q3/08 Preliminary Results:

AQL reported Q3/08 (preliminary) revenue of \$14.5 million, below what we had anticipated. Management commented that results were below its own expectations owing to delays in starting certain surveys during the quarter. While no additional financial details were disclosed for the quarter, management did indicate that margins are in the range of prior quarters.

FY 2008 Guidance:

Management guided to Q4/08 revenue between \$16.0 and \$18.0 million, which would produce FY 2008 revenue of \$55.0 to \$57.0 million. While below our prior forecast, we note that the Q4/08 guidance would still represent y-y growth of 18% to 32% from \$13.6 million in the three-months ended October 31, 2007 (the most directly comparable period, given the change to a September fiscal year end). This would also represent sequential revenue growth of 10% to 24% over Q3/08's preliminary result. In short, the business is still growing strongly, albeit at a more moderate pace than we had previously forecast.

The Macro Picture – Demand Is Still Strong:

Perhaps most importantly, management commented that overall demand remains strong. Management attributed the Q3/08 results to internal execution and not weakening demand.

AQL is still very active, and its rate of expansion at this point is dictated more by its own internal capabilities than by weakening demand. While junior mining companies have become more cautious in their exploration spending owing to weak capital markets, that has been offset by increased spending by majors and intermediates. This macro view has been echoed by other companies in the mining services space.

Much of AQL's revenue from majors is generated outside of Canada, and while this has led to a more international focus (we believe that 70% of revenue now comes from outside Canada) that has diversified the Company's revenue base, it has also created logistical pressures.

Estimate Revisions:

FY 2008: We have adjusted our Q3/08 and Q4/08 assumptions to reflect the preliminary results, the current fleet size and management's guidance (see Exhibit 1). As in prior reports, we provide an adjusted diluted EPS estimate which removes the impact of the amortization attributed to the Company's acquisitions in calendar 2007. A significant portion of the purchase prices was attributed to intangible (non-goodwill) assets that are being written-off on an accelerated basis, negatively impacting diluted EPS.

Exhibit 1. Quarterly Results (Actual and Expected)

	Q1/08A	Q2/08A	Q3/08E*	Q4/08E	FY 2008
Revenue (\$mm)	\$11.2	\$13.3	\$14.5	\$16.9	\$55.7
EBITDA (\$mm)	\$1.6	\$3.5	\$3.7	\$5.0	\$13.8
EBITDA Margin	14.3%	26.3%	25.3%	29.9%	24.9%
Net Earnings (\$mm)	\$0.1	\$0.8	\$0.7	\$1.8	\$3.4
Diluted EPS	\$0.00	\$0.02	\$0.02	\$0.05	\$0.09
Adjusted Diluted EPS	\$0.03	\$0.05	\$0.05	\$0.07	\$0.21

Source: Company Reports, Jennings Estimates (*Q3/08E: Revenue reflects the preliminary results, with EBITDA and earnings results being Jennings Estimates)

FY 2009: System fleet expansion is the primary driver of our revenue model and earnings estimates. We are reducing our expectations for system fleet growth given the current fleet size and our expectations for growth next year. We now expect AQL to exit FY 2008 with a total of 30 systems (down from our prior estimate of 36), and to exit FY 2009 with 44 systems (down from a prior estimate of 52). We have not made any other material changes to our model.

As of the end of Q3/08, AQL had 27 active systems, which is behind our prior estimate. Based on management's guidance, we no longer expect AQL to add two more fixed-wing systems in Q4/08, although we still expect three more helicopter systems to be added in that period. While the Company will bring on two new fixed-wing systems in Q4/08, these will be replacing two older systems. Once that is complete, AQL can then look to grow the fixed-wing fleet again.

The focus of system fleet expansion will be (and has been) the helicopter business. Our model assumes that AQL continues to add one new system each month, for a total of 12 systems in FY 2009. Our model also assumes AQL adds two new fixed-wing systems in FY 2009 (down from four), although we believe that number could grow if demand warrants. This represents a total addition of 14 systems in FY 2009, down only slightly from our prior estimate of 16 systems.

In short, our reduced system fleet expansion estimates are driven primarily by the current fleet size rather than by reduced growth expectations for next year.

Exhibit 2. Revised FY 2008/2009 Estimates

	FY 2008		FY 2009	
	Prior	New	Prior	New
Revenue (\$mm)	\$61.1	\$55.7	\$95.1	\$84.0
EBITDA (\$mm)	\$16.2	\$13.8	\$30.9	\$26.5
EBITDA Margin	26.6%	24.9%	32.5%	31.5%
Net Earnings (\$mm)	\$4.8	\$3.4	\$13.8	\$11.4
Diluted EPS	\$0.13	\$0.09	\$0.35	\$0.29
Adjusted Diluted EPS	\$0.25	\$0.21	\$0.44	\$0.38

Source: Jennings Estimates

Valuation & Recommendation:

Applying a 12.5x earnings multiple (down from 14x to reflect the multiples on other mining services companies) to our new FY 2009 diluted EPS estimate implies a per share value of \$4.75. Applying a 7x EBITDA multiple to our FY 2009 estimate of \$26.5 million (down from \$30.9 million) implies a per share value of \$5.17. We continue to rate AQL a **BUY** with a 12-month target price of \$5.00/share, down from \$6.50.

At current levels, AQL trades at less than 4x this year's EBITDA, and approximately 2x next year's EBITDA. While we have reduced our EBITDA and earnings estimates to reflect revised growth expectations, we still expect considerable (90%) EBITDA growth and adjusted diluted EPS growth (81%) in FY 2009, and therefore believe that there is significant upside for investors at these levels.

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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**. On February 15, 2008 we decreased our target price to **C\$6.50**. Share price at that time was **C\$2.75**.

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Revised Monthly

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