

**AEROQUEST INTERNATIONAL LIMITED  
(TSX-AQL \$0.38)**

**Recommendation: BUY**  
**Revised 12-Month Target: \$1.00**  
 Previous 12-Month Target: \$0.90  
**Risk Rating: ABOVE AVERAGE**

**Q3/09 REVENUE MISSES; ACQUISITION  
ADDS INFRASTRUCTURE BUSINESS**

- **Summary:** We are raising our 12-month target on AQL to **\$1.00/share from \$0.90/share**. The Company recently announced that quarterly revenue would fall well short of management's guidance, owing to ongoing demand weakness, specifically for helicopter-based surveys. However, demand appears to have bottomed, and the backlog has increased by approximately 29% during the month of July. The Company also announced plans to acquire Optimal Geomatics (TSXV-OPG), which will give AQL a strong presence in the infrastructure market, and help the combined company reduce administrative costs. On this basis, we have raised our FY 2010 estimates for revenue and earnings, and we are raising our target.
- **Q3/09 Results Disappointing, but Backlog on the Rise:** AQL provided a preliminary revenue estimate of \$3.7 million for the quarter ending June 30. This is well below management's prior revenue guidance (\$6 to \$10 million) and our prior estimate of \$7.5 million. However, the Company also reported that contract backlog has recently improved from \$6.6 million at June 30, to approximately \$8.5 million at July 28, an increase of approximately 29%. We view this as an indicator that demand is finally improving and that the Q3/09 results should mark the bottoming of demand for AQL.
- **The Optimal Geomatics Transaction:** AQL also announced plans to acquire OPG for 3 million shares of AQL, or approximately \$1.3 million based on the July 29 closing price. OPG is a geospatial mapping company with approximately \$15 million in revenue for the last four quarters. To date, it has primarily served energy utilities and government entities. This transaction, expected to close in late September, would give AQL a strong presence in the infrastructure space and help further diversify the Company's revenue base away from commodity-price dependent customers.
- **Valuation:** We are rolling our valuation forward from FY 2009 to FY 2010 to reflect the addition of the OPG business. We use a 0.6x EV/Sales multiple and a 3.0x EV/EBIT DA multiple (both discounts from the comparable group average) to arrive at a valuation estimate of \$0.99/share, which we round to \$1.00 to arrive at our target price. **We are therefore raising our 12-month target on AQL to \$1.00/share from \$0.90/share.**

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Company Statistics	
52-Week Range	\$1.90 - \$0.27
Basic Shares O/S (MM)***	36.6
Basic Market Cap (\$MM)	\$13.7
Cash (\$MM)**	\$8.0
Total Debt (\$MM)**	\$0.6
Net Cash (\$MM)	\$7.4
Net Cash / Share	\$0.19
Management & Directors Ownership	19%

Earnings Summary			
FYE: September	2008A	2009E	2010E
Sales (\$MM)	\$55.0	\$30.9	\$57.6
EBITDA (\$MM)	\$11.3	(\$1.2)	\$8.9
EBITDA Margin	20.5%	(3.9%)	15.5%
Diluted EPS	\$0.09	(\$0.19)	\$0.00
Adjusted Diluted EPS*	\$0.21	(\$0.08)	\$0.10
P/E	4.4x	nmf	120.2x
P/Adj. E*	1.8x	nmf	3.8x
EV/EBITDA	0.6x	nmf	0.7x

\* Adjusted Diluted EPS excludes acquisition-related amortization.

\*\* Cash and Total Debt are estimates, as of Q3/09 (June 30th).

\*\*\* Share count assumes closing of the OPG transaction.



**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.

### Q3/09 Preliminary Results:

AQL reported that Q3/09 revenue (ending June 30) would be approximately \$3.7 million, well below management guidance (\$6 to \$10 million) and our estimate of \$7.5 million. The revenue shortfall was due primarily to a continued slowdown in helicopter-based system activity as well as startup problems relating to fixed-wing contracts in Australia. The latter factor has since been resolved, and we therefore expect revenue to fall into Q4/09. The Company also reported that cash and equivalents stood at approximately \$8.0 million at the end of the quarter, down from \$10.4 million at the end of Q2/09, owing to continued low activity levels. The Company continues to review opportunities to trim operating costs, and senior management will be taking a 10% salary cut for the next year. We believe that AQL's cash break-even revenue base will be approximately \$5 million.

On a more positive note, activity seems to be picking up. Management indicated that its backlog, which stood at \$6.6 million at the end of Q3/09, has since improved to a current (July 28) level of \$8.5 million. We find the increase in the backlog encouraging and note that it could mark Q3/09 as the bottom for AQL's revenue base. We believe that backlog is roughly split between mining and petroleum work, with the mining segment being predominately from intermediates/majors.

The Company will report its full financial results before the market open on August 6, with a conference call to follow at 11AM EDT that day (dial-in numbers 1-888-789-0089 and 416-695-9701).

### Optimal Geomatics Transaction

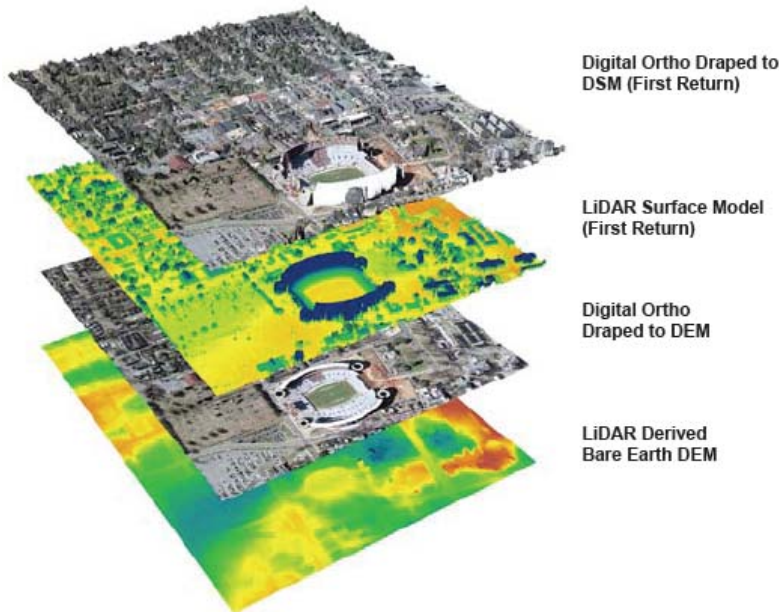
Transaction Details: The Company also announced an agreement to acquire Optimal Geomatics (TSXV-OPG) for \$1.3 million in stock (3.0 million shares of AQL at \$0.43/share based on the July 29 closing price). We estimate that AQL is paying 0.1x revenue and 0.7x adjusted EBITDA—which reflects part of the expected cost savings of the combined company—based on trailing 12-month results. On a raw basis, OPG was operating at a small EBITDA loss.

The transaction will be structured as a Plan of Arrangement, with OPG shareholder approval to be sought at a meeting in mid-September (2/3 vote required), and closing targeted for late September. OPG's Board of Directors has already unanimously recommended that shareholders vote in favour of the transaction. It will also be subject to exchange approval and court approval. Assuming the transaction closes in late September, it would have a full year impact on AQL's FY 2010, which begins October 1<sup>st</sup>, 2009.

More on OPG: OPG is a geospatial mapping company based in Vancouver, B.C. The Company specializes in gathering, analyzing, interpreting, distributing and using geographic information. To date, OPG has served primarily energy utilities and government entities/agencies.

- **Customers Include** – the U.S. Army Core of Engineers (USACE), gas pipeline utilities, electric power line utilities, and state transportation departments. The vast majority of the Company's current revenue comes from the U.S. market. Customers have used OPG to help them better manage and monitor transmission/distribution assets, identify structural anomalies and plan additional construction projects.
- **Services/Technologies Include** - LiDAR acquisition and processing, conventional and GPS surveying, aerial photography, topographic and planimetric mapping, GIS services, digital terrain modelling (DTM), digital elevation modelling (DEM), and digital orthophotography. In Exhibit 1, we present a diagram illustrating how some of these technologies can be used in concert to obtain a detailed composite.

**Exhibit 1. Imagery Stack**

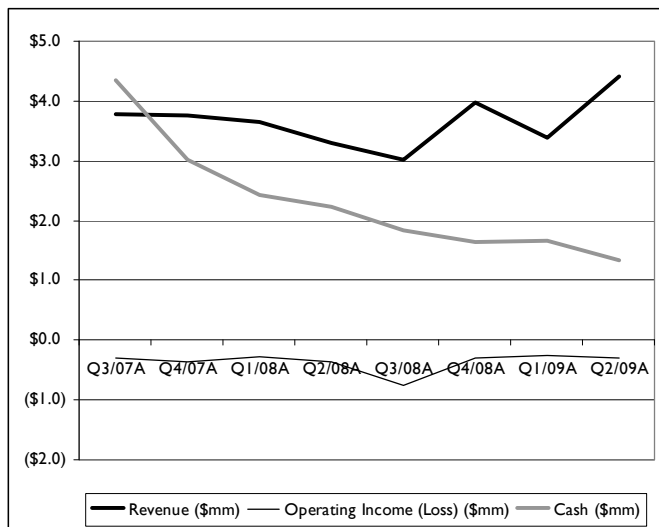


*Imagery Stack (Digital Ortho Draped over LiDAR)*

Source: OPG Website

- Financial Performance – OPG revenue performance has been very consistent, and while the Company has worked to reduce its operating costs and focus on core businesses, it has continued to run operating losses that have reduced the Company’s cash position (see Exhibit 2).

**Exhibit 2. OPG Operating Performance**



Source: OPG Company Reports

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Benefits to AQL: In our view, this transaction should yield the following benefits to the combined company:

- 1) Expansion into Infrastructure Segment – AQL will benefit by adding a new category of customers that is far less commodity-price dependent relative to its current client base. While OPG has had a remarkably steady revenue stream over the past eight quarters (see Exhibit 2 above), we expect management to expand this business, particularly as its infrastructure operations make it well positioned to benefit from ongoing stimulus spending in the U.S. market.
- 2) Cost Savings to Combined Company – we believe these should total at least \$600k to \$800k annually, once fully implemented. The anticipated cost savings would come in two buckets:
  - a. Administration – this includes public company costs, etc. of approximate \$300k to \$400k annually.
  - b. Fleet Rationalization – post-transaction, management will work to consolidate its fleet to ensure cost-effectiveness. This should yield at least as much as the Administration bucket, but will likely require more time to implement.

Moreover, we believe that some of OPG's technology can be used to help improve AQL's existing service offering, particularly its fixed-wing gravity systems.

### Estimate Revisions

We have made the following changes to our model.

- FY 2009 – we have adjusted our Q3/09 assumptions for activity levels and margins to reflect AQL's preliminary results. We have also adjusted the same assumptions for Q4/09 to reflect sequential improvement, although our revenue estimate for that quarter is now \$8.0 million, down from \$9.2 million previously.
- FY 2010 – we are assuming that the transaction with OPG will close in late September, so that it has a full year impact on AQL's FY 2010 financial results. We have reduced our Q1/10 estimate from the mining/petroleum segment slightly, but have otherwise left our key assumptions intact for that part of the business in FY 2010. We continue to believe that exploration budgets – particularly those of mining companies – will not increase meaningfully until calendar 2010. For OPG, we are assuming revenue of \$14.0 million in FY 2010, which is conservative relative to actual trailing 12-month revenue of \$14.8 million. We are also incorporating approximately \$600k of cost savings in our estimates, which are on the low end of the range (\$600k to \$800k plus) that we expect. We believe there is considerable upside potential to our estimates, particularly our revenue forecast given OPG's experience in infrastructure.

We present our revised FY 2009/2010 estimates in Exhibit 3.

### Exhibit 3. FY 2009/2010 Estimates

	FY 2009E		FY 2010E	
	Prior	New	Prior	New
Revenue (\$mm)	\$35.9	\$30.9	\$43.0	\$57.6
EBITDA (\$mm)	\$2.2	(\$1.2)	\$7.9	\$8.9
EBITDA Margin	6%	(4%)	18%	16%
Diluted EPS	(\$0.12)	(\$0.19)	(\$0.02)	\$0.00
Adjusted Diluted EPS	(\$0.02)	(\$0.08)	\$0.09	\$0.10

Source: Jennings Estimates

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Our quarterly estimates are shown in Exhibit 4. Owing to our revised revenue estimates, we have increased our Q3/09 net loss estimate to (\$0.08/share) from (\$0.03/share).

**Exhibit 4. FY 2009 Quarterly Estimates**

	Q1/09A	Q2/09A	Q3/09E	Q4/09E	2009E
Revenue (\$mm)	\$11.3	\$8.0	\$3.7	\$8.0	\$30.9
Growth (y-y)	1%	(40%)	(75%)	(50%)	(44%)
EBITDA (\$mm)	(\$0.3)	\$0.1	(\$1.9)	\$0.9	(\$1.2)
EBITDA Margin	(2%)	3%	(51%)	11%	(4%)
Diluted EPS	(\$0.04)	(\$0.03)	(\$0.08)	(\$0.03)	(\$0.19)
Adjusted Diluted EPS	(\$0.02)	(\$0.01)	(\$0.05)	\$0.00	(\$0.08)

Source: Company Reports, Jennings Estimates

**Valuation**

We previously valued AQL using a 0.6x EV/Sales Multiple applied to our FY 2009 estimates. Given the OPG transaction—and our expectation that it will close in late September—we are rolling our valuation forward to FY 2010.

Given that we do not expect AQL to be earnings positive in FY 2010, we continue to use an EV/Sales approach, and we are introducing an EV/EBITDA estimate as well.

Applying a 0.6x revenue multiple to our FY 2010 estimate implies a per share value of \$1.09. This multiple is a slight discount to the 0.7x average revenue multiple at which the comparables currently trade.

Applying a 3.0x EBITDA multiple to our FY 2010 estimate implies a per share value of \$0.89. The comparable group average for this multiple is 4.0x.

The simple average of these estimates is \$0.99, which we round to \$1.00/share to get our 12-month target.

We are therefore maintaining our **BUY** recommendation and **we are raising our 12-month target to \$1.00/share from \$0.90/share.**

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**Aeroquest International Limited**

### Ticker

**TSX-AQL**

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*Revised Monthly*

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