

**AEROQUEST INTERNATIONAL LIMITED  
(TSX-AQL C\$1.17)**

**Recommendation: BUY  
12-Month Target: C\$5.00  
Risk Rating: Above Average**

**AEROQUEST ANNOUNCES PROPOSED  
TRANSACTION WITH ANGLO AMERICAN**

- **Summary:** Last week, AQL announced a non-binding letter of intent (LOI) with Spectrem Air Limited, a member of the Anglo American group of companies (LSE-AAL). Under this agreement and related CAPEX plans, AQL obtains a turnkey airborne geophysical operation in Africa, additional airborne technology that improves its competitive position, a long-term outsourcing agreement with Anglo American with annuity-like potential, and an expanded technology partnership. We view the transaction positively and continue to rate AQL a **BUY** with a 12-month target price of \$5.00. At current levels, AQL trades at 2x this year's EBITDA and 6x this year's adjusted EPS.
- **The Real Value of the Transaction:** We view this transaction positively for two primary reasons. First, it strengthens AQL's competitive position by expanding its technology suite. Second, the outsourcing agreement with Anglo American represents a strong validation of AQL's service capabilities and gives AQL an annuity-like revenue stream from a major mining company.
- **Transaction Affordable with Existing Balance Sheet:** This transaction will involve a US\$4.0 million payment to Anglo American for the African operation, of which US\$1.5 million is payable in cash and the remaining US\$2.5 million is payable in survey credits (i.e., AQL would 'work off' that US\$2.5 million). AQL would also spend US\$12.0 million in developing and acquiring additional system technology. In summary, for a cash outlay of US\$13.5 million over two years (and US\$2.5 million in survey credits), AQL will acquire a revenue base of approximately \$22 to \$32 million/year.
- **Maintaining Revenue/EPS Estimates:** The LOI contemplates that closing of the agreement will occur on or before December 31, 2008 (i.e., by the end of AQL's Q1/09). We therefore expect this transaction to generate partial benefits in FY 2009 (the end of our current forecast period), with full benefits accruing in subsequent periods.
- **Maintain BUY Recommendation:** We continue to rate AQL a **BUY** with a 12-month target price of \$5.00.

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| Company Statistics               |                 |
|----------------------------------|-----------------|
| 52-Week Range                    | \$3.90 - \$0.88 |
| Basic Shares O/S (MM)            | 34.6            |
| Basic Market Cap (\$MM)          | \$40.5          |
| Fully Diluted O/S (MM)           | 38.7            |
| Cash (\$MM)                      | \$17.0          |
| Total Debt (\$MM)                | \$0.8           |
| Management & Directors Ownership | 20%             |

| Earnings Summary      |         |        |        |
|-----------------------|---------|--------|--------|
| FYE: September        | 2007A** | 2008E  | 2009E  |
| Sales (\$MM)          | \$19.9  | \$55.7 | \$83.8 |
| EBITDA (\$MM)         | \$4.6   | \$12.1 | \$26.1 |
| EBITDA Margin         | 23.3%   | 22.3%  | 31.1%  |
| Diluted EPS           | \$0.11  | \$0.07 | \$0.29 |
| Adjusted Diluted EPS* | \$0.11  | \$0.19 | \$0.38 |
| P/E                   | 10.5x   | 16.0x  | 4.0x   |
| P/Adj. E*             | 10.5x   | 6.2x   | 3.1x   |
| EV/EBITDA             | 5.2x    | 2.0x   | 0.9x   |

\* 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 Proposed Transaction:

Last week, AQL announced a non-binding LOI with Spectrem Air Limited, a member of the Anglo American group of companies. The LOI contemplates closing of the agreement by December 31, 2008, which is the end of AQL's Q1/09 reporting period.

### What Does AQL Obtain?

We summarize the benefits to AQL as follows:

- 1) **Turnkey African Operation** – AQL obtains an operating airborne geophysical business in Africa, including people, logistics and equipment. This essentially represents a platform for further expansion in Africa. As part of this acquisition, AQL obtains two AeroTEM systems sold to Spectrem by AQL several years ago, as well as Spectrem's own proprietary technology, the Spectrem 2000. This is a fixed-wing electromagnetic system with a depth capability of 800 metres (and possibly more). We estimate the annualized revenue potential from the systems to be acquired at \$7 to \$12 million. This is broken down as follows:
  - a. Two AeroTEM systems – approximately \$2.0 million/year. We expect one of the two systems to be used primarily for internal R&D purposes for the foreseeable future.
  - b. Spectrem 2000 system – approximately \$5.0 to \$10.0 million/year, with a portion of that coming through the outsourcing agreement with Anglo American (see point 3 below).
- 2) **Technology** – AQL acquires the Spectrem 2000 system, and will also work to develop a next generation system (Spectrem 2010) over the next two years. The Company will also separately purchase an Airborne Gravity Gradiometer, a highly sensitive survey system with a limited number in operation (approximately 10 worldwide). It is a fixed-wing system for which we believe AQL will be able to charge line km rates approximately ten times more than it charges on its current fixed-wing surveys, reflecting the system's degree of sophistication. We believe this system will have an annual revenue generating capability of up to \$10 million.
 

With the Spectrem 2000/2010 and the Gravity Gradiometer, AQL would bridge the remaining gaps in its technology suite relative to its key competitors. By being able to offer the full suite of technology types (i.e., truly becoming a one-stop shop), we believe this transaction could produce spillover benefits for the rest of AQL's business.
- 3) **Outsourcing Agreement with Anglo American** – AQL would become the exclusive provider to Spectrem and a preferred supplier to the rest of the Anglo American group. The agreement calls for AQL to guarantee the availability of systems to fly 50,000 line km/yr for 10 years, with automatic five-year renewal terms. Moreover, we believe this agreement can be expanded by Anglo, if demand warrants. In short, AQL would obtain an annuity-like revenue stream of \$5.0 million/year from a major mining company, with potential upside beyond that.
- 4) **Technology Partnership** – AQL will also be working with Anglo American on development and commercialization of next generation sensor technology.

The African operation represents a potential annual revenue base of \$7.0 to \$12.0 million, which would begin accruing to AQL when the transaction closes. The Spectrem 2010 (once developed) and the Gravity Gradiometer (once purchased) would each add potential annualized revenue of \$5.0 to \$10.0 million and \$10.0 million, respectively, as they begin operation over the next two years.

We therefore estimate the incremental revenue from this transaction at \$22.0 million, perhaps growing to \$32.0 million/year over the next five years.

### What Does it Cost AQL?

In our view, there are two related cost components:

- 1) **The Acquisition of the African Operation** – the cost would be US\$4.0 million, with \$1.5 million of that in cash at Spectrem’s option, and the remaining US\$2.5 million in survey credits that AQL would ‘work off’ under the outsourcing agreement.
- 2) **The CAPEX Component** – the cost of developing the Spectrem 2010 and purchasing the Gravity Gradiometer would be approximately US\$12 million.

The total cost of this transaction would then be US\$16.0 million, with a net cash outlay of US\$13.5 million over a two-year period. With approximately \$17.0 million in cash and equivalents at the end of Q3/08 (June 30), we believe the cash requirements are financeable with the Company’s existing balance sheet and internal cash flow.

### We Are Maintaining Our Estimates and Valuation at this Time

The non-binding LOI contemplates closing the transaction at the end of AQL’s Q1/09 (December 31, 2008). Moreover, the bulk of the annual revenue potential offered by the transaction would begin contributing to AQL’s results post-FY 2009, which is the end point of our current forecast period.

Therefore, we are maintaining our current estimates and valuation for now. We present recent historic and projected estimates in Exhibit 1.

#### Exhibit 1. Estimates and Valuation Ratios

|                      | Q1/08A            | Q2/08A | Q3/08A | Q4/08E | 2008E        | 2009E       |
|----------------------|-------------------|--------|--------|--------|--------------|-------------|
| Revenue (\$mm)       | \$11.2            | \$13.3 | \$14.5 | \$16.9 | \$55.7       | \$83.8      |
| EBITDA (\$mm)        | \$1.6             | \$3.4  | \$2.7  | \$4.4  | \$12.1       | \$26.1      |
| Diluted EPS          | \$0.00            | \$0.02 | \$0.01 | \$0.04 | \$0.07       | \$0.29      |
| Adjusted Diluted EPS | \$0.03            | \$0.05 | \$0.04 | \$0.06 | \$0.19       | \$0.38      |
|                      | <b>EV/EBITDA</b>  |        |        |        | <b>2.0x</b>  | <b>0.9x</b> |
|                      | <b>P/E</b>        |        |        |        | <b>16.0x</b> | <b>4.0x</b> |
|                      | <b>P/Adj. EPS</b> |        |        |        | <b>6.2x</b>  | <b>3.1x</b> |

Source: Jennings Estimates

At current levels, AQL trades at 2x this year’s EBITDA (and the Company has reported three quarters and provided revenue guidance on the fourth). Given our expectations for 115% EBITDA growth in FY 2009, we believe that AQL offers investors compelling value at current levels.

We are maintaining our **BUY** recommendation and 12-month target price at \$5.00.

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### Companies

Aeroquest International Limited

### Ticker

TSX-AQL

I, **Russell Stanley**, hereby certify that the views expressed in this report accurately reflect my personal views about the subject securities or issuers. I also certify that I have not, am not, and will not receive, directly or indirectly, compensation in exchange for expressing the specific recommendations or views in this report.

**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**. On July 18, 2008 we decreased our target price to **C\$5.00**. Share price at that time was **C\$1.95**.*

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|                        |     |
|------------------------|-----|
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**Revised Monthly**

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