JENNINGS CAPITAL INC.

February 15, 2011

AEROQUEST INTERNATIONAL LIMITED (TSX-AQL $0.94)

Recommendation: BUY
Revised 12-Month Target: $2.00
Previous 12-Month Target: $1.50
Risk Rating: ABOVE AVERAGE

Q1/11 RESULTS

- **Summary – We are raising our 12-month target on AQL to $2.00 from $1.50 and maintaining our BUY recommendation**. The Company recently reported Q1/11 results. Revenue was in line with our estimate and continues to improve sequentially – up 20% q-q – driven primarily by growth in the airborne geophysics operations, while the aerial geomatics segment continues to lag at this point. With an improved mineral exploration environment, we expect grassroots exploration spending to improve this year and next, to AQL's benefit.
- **Q1/11 Results –** AQL reported Q1/11 revenue of $12.4 million (v. forecast of $12.0 million). AQL reported a loss per share of $0.03 (in line with our estimate), or $0.00, when excluding the impact of acquisition-related amortization. Margins are still well below their pre-recession levels, but have improved considerably from the 12% bottom to last quarter's levels of 30%. At quarter end, the Company had cash and equivalents of $6.0 million, up from $4.8 million in Q4/10.
- **Backlog and Fleet –** At quarter end, the backlog totalled $11.2 million, down $3.5 million from the prior quarter (Q4/10 ending backlog of $14.7 million), which we attribute to seasonality. The fleet remains at 26 systems (15 helicopter and 11 fixed-wing systems).
- **Outlook –** We have taken down our estimates for FY 2011, primarily to reflect uncertainty relating to the near-term business outlook in some African markets. However, we expect growth in the Helicopter business to be the main driver in FY 2012.
- **Estimates & Valuation –** With the introduction of our FY 2012 estimates, we are rolling forward our valuation. We apply an 8x adjusted EPS multiple (where we excluded the impact of acquisition-related amortization) and 5x EBITDA multiple to our FY 2012 estimates (from 10x and 5x, respectively, applied to FY 2011). This also represents an approximate 20% multiple discount to the 10x/6x multiples that we apply to Energold Drilling (TSXV-EGD, BUY recommendation, $7.00 target). On that basis, we are maintaining our **BUY** recommendation and raising our 12-month target to $2.00 from $1.50.

Sector: SPECIAL SITUATIONS

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Company Statistics	
52-Week Range	$0.99 - $0.43
Basic Shares O/S (MM)	37.1
Basic Market Cap ($MM)	$35.3
Cash ($MM)	$6.0
Total Debt ($MM)	$0.1
Net Cash ($MM)	$5.9

Earnings Summary				
FYE: September	**2009A**	**2010A**	**2011E**	**2012E**
Sales ($MM)	$28.0	$33.6	$50.1	$77.7
EBITDA ($MM)	($4.4)	($4.3)	$2.5	$15.4
EBITDA Margin	(15.7%)	(12.7%)	5.0%	19.8%
Diluted EPS	($0.32)	($0.24)	($0.11)	$0.18
Adjusted Diluted EPS*	($0.21)	($0.14)	($0.01)	$0.25
P/E	nmf	nmf	nmf	5.3x
P/Adj. E*	nmf	nmf	nmf	3.8x
EV/EBITDA	nmf	nmf	11.7x	1.9x

** Adjusted Diluted EPS excludes acquisition-related amortization.*

Aeroquest International Limited is a mining, 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.

Q1/11 Results:

Revenue was in line with our estimate and continues to improve sequentially, up 20% over the prior quarter, driven primarily by growth in the airborne geophysics operations. The aerial geomatics segment continues to lag at this point.

We present the highlights of the quarter and comparisons to prior quarters in Exhibit 1.

Exhibit 1. Q1/11 Results Highlights

	Q1/11E	Q1/11A	Variance	Q1/10A	Y-Y	Q4/10A	Q-Q
Revenue ($mm)	$12.0	$12.4	3%	$8.2	51%	$10.3	20%
EBITDA ($mm)	$0.7	$0.4	(46%)	($1.4)	nmf	($0.7)	nmf
EBITDA Margin	6%	3%	(291)bps	(18%)	nmf	(6%)	nmf
Diluted EPS	($0.03)	($0.03)	0%	($0.07)	(57%)	($0.06)	(50%)
Adjusted Diluted EPS	($0.01)	($0.00)	(100%)	($0.04)	(100%)	($0.04)	(100%)

Source: Company Reports, Jennings Capital Inc. (Adjusted Diluted EPS excludes acquisition-related amortization).

We present the breakdown between helicopter-based and fixed-wing operations in Exhibit 2.

Exhibit 2. Operational Breakdown

Helicopter	Q1/11A	Q1/10A	Y-Y	Q4/10A	Q-Q
Revenue (C$mm)	$2.8	$2.2	29%	$2.9	(5%)
Line Km Flown (000s)	20.1	22.7	(11%)	26.3	(24%)
Revenue/Line Km	$138.31	$94.93	46%	$111.60	24%
Gross Margin	22%	15%	658bps	25%	(269bps)

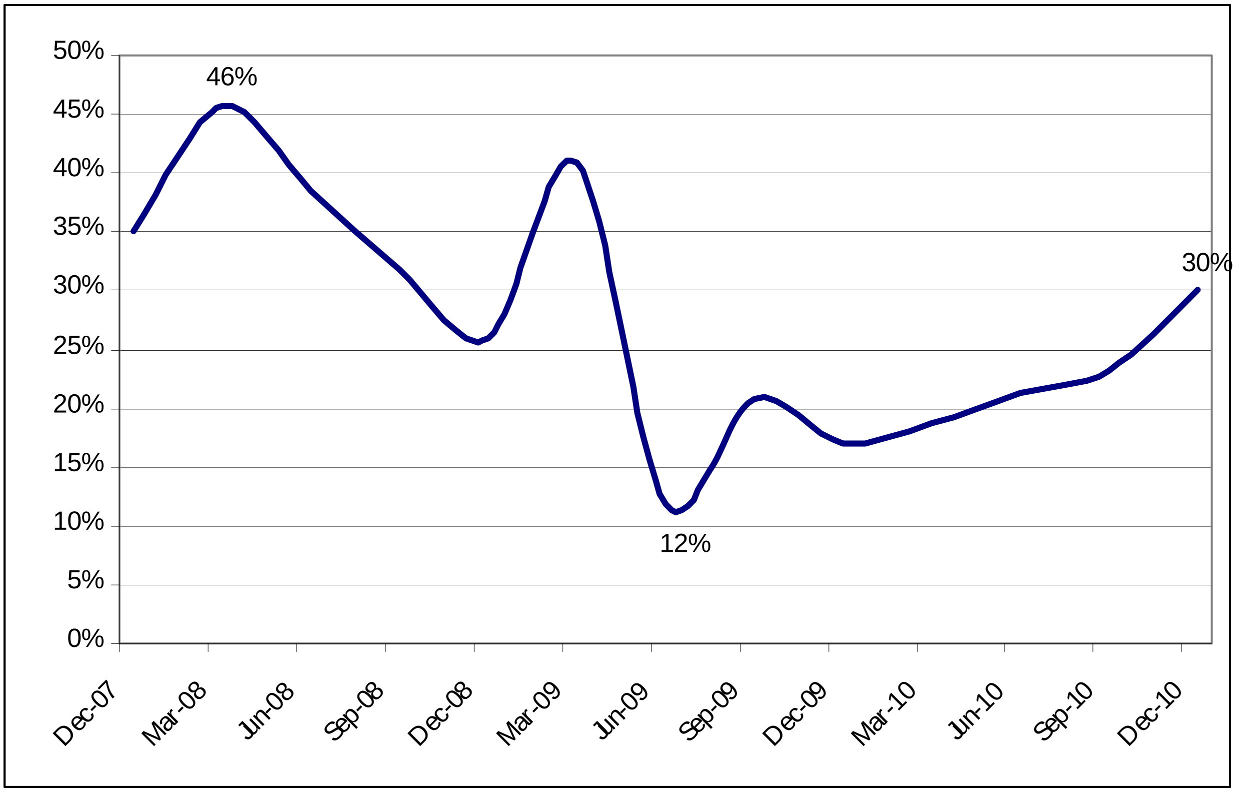
Fixed Wing	Q1/11A	Q1/10A	Y-Y	Q4/10A	Q-Q
Revenue (C$mm)	$6.1	$3.6	70%	$5.4	12%
Line Km Flown (000s)	405.0	267.0	52%	389.0	4%
Revenue/Line Km	$15.02	$13.42	12%	$13.97	7%
Gross Margin	30%	17%	1,281bps	21%	852bps

Source: Company Reports, Jennings Capital Inc.

We also note the following:

- Backlog – At quarter end, the Company's backlog stood at $11.2 million, down $3.5 million from the Q4/10 ending backlog of $14.7 million. The current backlog includes $7.4 million in airborne geophysical survey work, $3.5 million in aerial geomatics work and $0.3 million attributed to other business. With an improved mineral exploration environment, we continue to expect an increase in grassroots exploration spending this year and next, which should be to AQL's benefit.
- Balance Sheet – At quarter end, the Company had cash and equivalents of $6.0 million, up from $4.8 million in Q4/10, and little debt ($0.1 million in capital leases). AQL also has an undrawn credit facility of $2.0 million in place.
- The Fleet – There were no changes to the fleet during the quarter and it remains at 26 systems (15 helicopter and 11 fixed-wing systems).
- Gross Margins – As shown in Exhibit 3, margins are still well below their pre-recession levels, but have improved considerably from the 12% bottom to last quarter's levels of 30%.

Exhibit 3. Historical Gross Margins



Source: Company Reports, Jennings Capital Inc.

Our Outlook & Estimate Revisions

We have taken down our estimates for the current fiscal year to reflect uncertainty relating to the near-term business outlook in Africa. However, we expect improved activity/pricing in the Helicopter business to drive growth in FY 2012. We have made the following revisions to our model:

- FY 2011 – As a whole, the reduction in FY 2011 revenue is with respect to uncertainty relating to business in some African markets. The Company had been making some headway there, but political uncertainty in some regions puts subsequent quarterly revenue into question.
- Introducing FY 2012 – We have incorporated a small volume/margin improvement from the fixed-wing segment, but the big story here is the return of the Helicopter segment with greater grassroots exploration spending. These surveys are more expensive on a per-line km basis.

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We present our prior and revised estimates in Exhibit 4.

Exhibit 4. Prior & Revised Estimates

	FY 2011E		FY 2012E
	Prior	New	Intro
Revenue ($mm)	$67.8	$50.1	$77.7
EBITDA ($mm)	$11.4	$2.5	$15.4
EBITDA Margin	17%	5%	20%
Diluted EPS	$0.03	($0.11)	$0.18
Adjusted Diluted EPS	$0.13	($0.01)	$0.25

Source: Jennings Capital Inc. (Adjusted Diluted EPS excludes acquisition-related amortization)

We present our quarterly breakdown in Exhibit 5.

Exhibit 5. Quarterly Estimates

	Q1/11A	Q2/11E	Q3/11E	Q4/11E	2011E
Revenue ($mm)	$12.4	$8.5	$13.7	$15.6	$50.1
EBITDA ($mm)	$0.4	($0.9)	$1.0	$2.1	$2.5
EBITDA Margin	3.2%	(11.0%)	7.3%	13.1%	5.0%
Diluted EPS	($0.03)	($0.06)	($0.02)	($0.00)	($0.11)
Adjusted Diluted EPS	($0.00)	($0.03)	$0.00	$0.02	($0.01)

Source: Jennings Capital Inc. (Adjusted Diluted EPS excludes acquisition-related amortization)

Valuation

With the introduction of our FY 2012 estimates, we are rolling forward our valuation. We apply an 8x adjusted EPS multiple (where we excluded the impact of acquisition-related amortization) and a 5x EBITDA multiple to our FY 2012 estimates (from 10x and 5x, respectively, applied to FY 2011). We view these as conservative multiples, but justifiable given the revenue/earnings volatility of this business. This also represents an approximate 20% multiple discount to the 10x/6x multiples that we apply to Energold Drilling (TSXV-EGD, BUY recommendation, $7.00 target), reflecting both size and liquidity.

We present our implied valuation estimates in Exhibit 6.

Exhibit 6. Implied Valuation Estimates

Approach	Multiple	Value
2012E EBITDA	5.0x	$2.10
2012E Adj. P/E	8.0x	$2.00
Average		**$2.05**

Source: Jennings Capital Inc. (Adjusted Diluted EPS excludes acquisition-related amortization)

We are therefore maintaining our **BUY** recommendation and **raising our 12-month target to $2.00/share from $1.50/share.**

Jennings Capital Inc. Research Disclosures

Companies	Ticker
Aeroquest International Limited	**TSX-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. On July 18, 2008 we decreased our target price to C$5.00. Share price at that time was C$1.95. On October 31, 2008 we decreased our target price to C$2.00. Share price at that time was C$0.60. On February 6, 2009 we downgraded our recommendation to HOLD and reduced our target price to C$0.40. Share price at that time was C$0.36. On May 5, 2009 we upgraded our recommendation to BUY and increased our target price to C$0.90. Share price at that time was C$0.41. On August 4, 2009 we increased our target price to C$1.00. Share price at that time was C$0.38. On February 16, 2010 we increased our target price to $1.20. Share price at that time was C$0.59. On May 14, 2010 we increased our target price to C$1.50. Share price at that time was C$0.60.*

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TENDER TO OFFER	4%
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Revised Monthly

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