

AEROQUEST INTERNATIONAL

AQL – TSX \$0.87

November 22, 2010

Rating:

STRONG BUY

Target Price:

▲\$1.50 (from \$1.00)

Market Capitalization:

\$32.2 million

DIVERSIFIED INDUSTRIES

Peter Prattas, CA, CFA – Analyst

416.682.4243

pprattas@frasermackenzie.com

Kimberly Johnson – Associate

416.682.4241

kjohnston@frasermackenzie.com



Industry Fundamentals Continue to Improve

Increasing Target with Introduction of FY2012

Estimates

Share Information Summary

Recent Price (C\$)	\$0.87
12 mo. Price Target	▲\$1.50
52 week Range	\$0.43- 0.92
Average Daily Volume (3 mo.)	37,115
Shares Out – Basic (M)	37.0
Shares Out – Diluted (M)	38.9
Market Cap (C\$M)	\$32.2
Annual Dividend & Yield	N/A
FY End	September 30

Estimates Summary C\$

FYE Sep 30	08A	09A	10E	11E	12E
Rev (\$M)	55.0	28.0	34.2	54.0	60.0
EPS (\$/fd shr)	0.09	(0.32)	(0.20)	0.01	0.06
P/E	10.2x	NMF	NMF	NMF	13.5x
EBITDA (\$M)	11.3	(4.4)	(3.5)	7.9	10.8
EV/EBITDA	1.2x	NMF	NMF	3.1x	1.5x

Source: Fraser Mackenzie Limited

Company Description

Aeroquest is a Canadian provider of airborne geophysical surveys, using electromagnetic, magnetic, gravity and radiometric techniques. The company operates worldwide, using a mix of helicopter and fixed wing aircraft, running surveys for mineral and oil and gas exploration. Following a combination of organic and acquisition-driven growth the company is now one of the world's top three providers of these services.

- Within the last several weeks, shares of Aeroquest have advanced nearly 50% on the back of record prices for precious metals. This move resembles the upward momentum we have seen in our coverage of drillers servicing the mining industry. For example, Energold Drilling is up roughly 50% over a similar timeframe as gold reached new highs and optimism abounds that exploration activity will continue to improve throughout the remainder of calendar 2010 and into 2011.
- We believe that the recovery in Aeroquest's share price is in its infancy as sales have just turned the corner and are growing once again. The latest forecast by Metals Economics Group has 2010 exploration budgets growing 44% year-over-year with juniors growing at a rate of 60%. While this increase in spending is first earmarked for exploration targets identified back in the 2008 peak (which don't require new airborne surveys), new discoveries will need to be identified in short order to ensure future production targets are achieved (thus the need for new airborne surveys).
- We expect 2011 to be a near-record year for Aeroquest driven first by resurgence in demand for fixed wing services followed by increased utilization of the company's helicopter systems fleet. Recall, the company backlog as at June 30th was \$14.8 million (up from \$10.5 million three months earlier) with a heavy weighting toward fixed wing services. We forecast \$10.9 million in revenue for the fourth quarter ended September 30, 2010, reflecting upward momentum from the \$8.6 million of revenue in Q3 and the \$6.5 million in Q2.
- We continue to recommend the stock with a STRONG BUY rating and a revised target price of \$1.50 (up from \$1.00) based on our outlook which now extends through FY2012. Our target values the company at a 4.0x EV/EBITDA multiple against our 2012 projections. The shares currently trade at a significant discount to net book value (\$1.05/share) and have downside support from tangible book value (\$0.39/share). The company also has \$0.15/share in cash with no long-term debt.

Discussion

Below, we present historical results along with our forecasts for the remainder of 2010 through 2012. We expect that the company's revenue base and profit picture will continue to improve from a trough in Q2FY2010. Consolidated revenue will most certainly show year-over-year growth for FY2010 as a result of the Optimal Geomatics acquisition. Going forward, a recovery in the airborne geophysics segment will likely produce healthy growth in FY2011. We forecast 58% year-over-year sales growth in 2011 or around 24% from our forecasted Q4FY2010 run-rate. A boost in sales should also improve margins and cash flow as the company benefits from operating leverage. The company was essentially cash flow (from operations) neutral during the third quarter suggesting that it will be positive going forward as revenue builds.

Exhibit 1 – Results and Forecasts (C\$ Millions)

FYE September 30	2008A	2009A	Q1A	Q2A	Q3A	Q4E	2010E	2011E	2012E
Revenue	55,046	28,012	8,175	6,487	8,646	10,900	34,207	54,000	60,000
Cost of sales	34,351	20,339	6,779	5,269	6,803	8,066	26,917	35,340	37,600
Gross margin	20,695	7,673	1,395	1,218	1,843	2,834	7,290	18,660	22,400
	37.6%	27.4%	17.1%	18.8%	21.3%	26.0%	21.3%	34.6%	37.3%
Expenses									
G&A expenses	9,442	11,845	2,668	2,423	2,660	2,600	10,351	10,400	11,200
Development expenses	80	-	-	-	-	-	-	-	-
Foreign Exchange Loss	(1,059)	(232)	81	100	(121)	-	60	-	-
Stock option expense	960	456	85	85	85	100	355	400	400
EBITDA	11,272	(4,396)	(1,439)	(1,390)	(781)	134	(3,475)	7,860	10,800
Capital asset depreciation	2,814	3,900	880	875	828	900	3,483	3,600	3,600
Impairment charges	-	2,880	-	-	-	-	-	-	-
Intangibles amortization	4,035	3,493	875	857	871	900	3,503	3,600	3,600
EBIT	4,423	(14,669)	(3,194)	(3,122)	(2,480)	(1,666)	(10,461)	660	3,600
Other costs/(income)	(224)	(127)	(103)	(131)	(51)	(11)	(296)	(54)	(129)
EBT	4,647	(14,542)	(3,090)	(2,991)	(2,429)	(1,655)	(10,166)	714	3,729
Total Taxes	1,804	(3,920)	(824)	(723)	(635)	(530)	(2,712)	229	1,193
Net Income	2,843	(10,622)	(2,266)	(2,268)	(1,794)	(1,125)	(7,454)	486	2,536
Earnings per unit									
Basic	\$ 0.09	\$ (0.32)	\$ (0.06)	\$ (0.06)	\$ (0.05)	\$ (0.03)	\$ (0.20)	\$ 0.01	\$ 0.07
Diluted	\$ 0.09	\$ (0.32)	\$ (0.06)	\$ (0.06)	\$ (0.05)	\$ (0.03)	\$ (0.20)	\$ 0.01	\$ 0.06

Source: Company filings, Fraser Mackenzie estimates

Valuation and Recommendation

In our view, Aeroquest shares represent compelling value with the shares trading at a substantial discount to net book value of \$1.05/share. Investors also should recognize the considerable downside support based on the company's tangible book value of \$0.39/share. Aeroquest has a strong balance sheet with \$0.15/share of cash and virtually no long-term debt. We maintain our STRONG BUY rating with a revised target of \$1.50 which values the company at a 4.0x EV/EBITDA multiple against our 2012 forecast.

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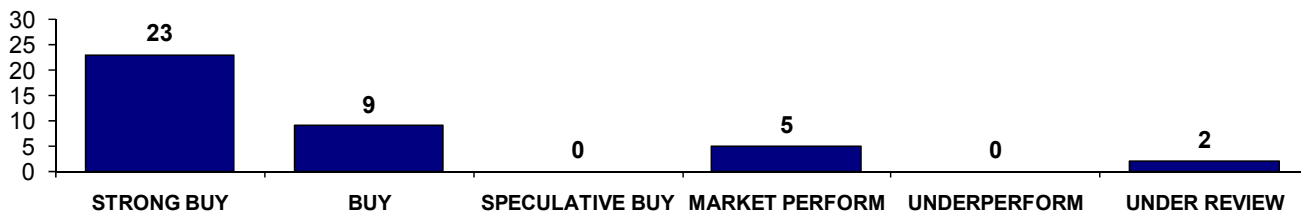
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