

Design to Discovery



**Aeroquest
International
Limited**
Annual Report
2005



Aeroquest International Limited (TSX-V:AQL) is the parent company of Aeroquest Limited, a world leader in the development and operation of innovative and proprietary airborne geophysical surveying platforms servicing the mineral exploration, oil and gas, and environmental industries. AQL has 15,840,273 shares outstanding and 17,400,273 shares on a fully diluted basis.

This annual report includes certain forward looking statements, based on current market conditions, which are subject to risks and uncertainties beyond the company's ability to control or predict. Actual events or results may differ materially from anticipated in such forward-looking statements. Accordingly, undue reliance should not be placed on these forward-looking statements.

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The annual meeting of the shareholders of the Corporation will be held at Minden Gross Grafstein & Greenstein LLP, 111 Richmond Street W, 6th floor, Toronto, Ontario at 11am (EST) on Wednesday, September 14, 2005.



Aeroquest International Limited**Financial
Highlights**

For the Fiscal Years Ended April 30

	2005	2004
Revenue	\$ 7,974,180*	\$ 4,051,670
Gross margin	3,434,943**	2,159,604
Net cash from operating activities	1,051,931	584,222
Financial position		
Working capital	\$ 3,937,865	\$ 2,013,594
Total assets	8,773,201	4,569,962
Total long-term debt	—	2,262,717
Total shareholders equity	7,023,564	1,087,699
Common share data		
Outstanding shares	15,840,273	10,400,000
Fully diluted common shares	17,400,273	10,400,000
Weighted average common shares outstanding	13,116,433	10,400,000
Weighted average diluted common shares outstanding	13,868,100	10,400,000

*Revenues increased by 97%

**Gross margin at 43%

Message to Our Shareholders

Dear Valued Shareholder,

It is with pleasure that we report Aeroquest's 2005 results to you.

The past year has been one of tremendous growth for the company. Aeroquest commissioned five new AeroTEM systems, nearly doubled its revenue and preserved a strong cash position. Total sales for fiscal year-end, April 30, 2005 were \$8 million compared to \$4 million in the previous year. The significant increase in sales was a result of having additional systems available and a robust mineral exploration market.

The company recorded a gross margin of \$3.4 million (43%) and adjusted net profit (pre-tax) of \$510,123. Gross margin is consistent with the long term operating target of the company.

In 2005-2006, we expect to fulfil additional contracts and expand geographically, supplying systems to exploration projects in various foreign countries. We are well positioned to diversify beyond our existing technology as we direct efforts towards new markets with strong research and development initiatives. By the end of this fiscal year Aeroquest intends to have more than 10 surveying systems available, with up to half of them placed in countries around the globe.

Aeroquest's objective is also to introduce larger AeroTEM systems, 10-metre and 12-metre platforms, in addition to our current 5-metre diameter bird. These larger systems will allow us to survey areas where the targets are deeper and in some cases covered by conductive overburden, such as in Australia, Africa, India and Brazil.

The company will continue developing strategic partnerships with industry players who value our technology and understanding of how these systems can be integrated into mineral exploration projects.

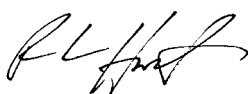
The resource exploration industry remains exceptionally strong complementing our dedication to growth and profitability as we mature into a services company focused on supporting the mineral, oil & gas, and environmental industries.

Thank you for your continued support. It is going to be another exciting year!

Sincerely,



Wally Boyko
Chairman



Roland Horst
Chief Executive Officer



Steve Balch
President

Management's Discussion & Analysis

The following is a discussion of the financial condition and consolidated results of operations of Aeroquest International Limited ("the Company") for the fiscal year ended April 30, 2005. This discussion should be read in conjunction with the Audited Consolidated Financial Statements of the Company and notes thereto.

Certain information in this "Management's Discussion and Analysis" contains forward-looking statements based on the Company's estimates and assumptions, which are subject to risks and uncertainties. This could cause the Company's actual results to differ materially from the forward-looking statements contained in the discussion.

The Company completed the proposed qualifying transaction with PiCorp. Capital Ltd. on October 28, 2004. Therefore, the consolidated financial statements presented are a combination of the results, assets, and liabilities of Aeroquest Limited and Aeroquest International Limited (formerly PiCorp. Capital Ltd.). The majority of operating results is supplied through Aeroquest Limited.

Selected Annual Information

	2005	2004	2003
Sales	\$ 7,974,180	\$ 4,051,670	\$ 2,979,537
Net (loss) income	(477,726)	406,307	69,962
Net (loss) income per share on a basic and fully diluted basis	(0.04)	0.04	699.62
Total assets	8,773,201	4,569,962	967,518
Total long-term financial liabilities	5,580	2,286,433	54,829
Cash dividends declared	N/A	5	N/A

The Company's sales have increased over the past three fiscal years due to increased demand in the mineral exploration sector and the introduction of new AeroTEM II systems in 2005. Net (loss) income decreased from 2004 to 2005 due to increased investment in the infrastructure of the Company for a larger increase in sales in the future. The Company has seen its number of shares outstanding increase from 10 in 2003 to 10,400,000 in 2004 to 15,840,273 in 2005. The increase in shares outstanding (due to the public offering and qualifying transaction) coupled with a decrease in net income has led to the decline in earnings per share on a basic and fully diluted basis. Total long-term financial liabilities have almost been completely extinguished due to the conversion of \$2,256,250 in convertible debentures that were automatically converted to shares upon the qualifying transaction in October 2004.

Overall Performance, Results of Operations, and Summary of the Fiscal Year

Aeroquest International Limited posted sales figures of \$7.9 million for the fiscal year compared to \$4.1 million in 2004, an increase of 97%. Gross margin for the year was \$3.4 million or 43% of sales compared to \$2.2 million or 53% last year. Net (loss) income after tax was \$(477,726) compared to \$406,307 in 2004. Included in 2005 income is a non-cash stock-option adjustment amount of \$925,950 which significantly impacted the reported net income for the Company.

Working capital increased from \$2.0 million in 2004 to \$3.9 million in 2005. The majority of this increase is a result of financing through the public offering combined with increased sales.

Sales for 2005 were generated with the use of multiple AeroTem systems ranging from one for the first quarter, two systems in the second quarter, one for the third quarter, to up to four in the fourth quarter. The variability in equipment usage during the last three quarters was due to seasonality in the Canadian survey industry. Aeroquest plans to mitigate the effect of the seasonality by performing surveys internationally next year. The increase in sales compared to the same period last year is attributed to higher utilization rates and the introduction of several units during the year. The Company expects to have five AeroTEM II, two 10 metre diameter AeroTEM X, and two 12 metre diameter AeroTEM XII systems available for fiscal 2006 to increase sales substantially in future periods.

Gross margin of 43% of sales is lower than the previous year level of 53%. The decrease is due to increased production costs and the poorer weather compared to the same period last year.

To comply with current regulatory requirements and accounting standards with respect to stock-based compensation and other stock-based payments, Aeroquest International Limited expensed all the options granted upon going public using a Black-Scholes valuation model. The total expense amount totaled \$925,950 and adversely affected the reported net income in 2005. It is important to note that this total is a non-cash item and excluding this item, the Company has a net income after tax of \$448,224.

General and administrative expenses accounted for \$1.7 million or 21% of revenue for the year ended April 30, 2005. The costs are considered normal for the Company and should not increase proportionally with any increase in sales.

Amortization expense for the year was \$610,704 or 8% of revenue. This increase over the same period last year is a result of the increased investment in capital assets and the amortization of intellectual property and deferred costs.

Net (loss) income for the year was (\$477,726) compared to \$406,307 last year. (Loss) Earnings per share for the period was (\$0.04) on a basic and fully diluted basis compared to \$0.04 on a basic and fully diluted basis in 2004. The full benefit of the increased revenue wasn't realized during the year due to the expensing of the stock options, increased general and administrative expenses and a lower gross margin.

The Company had net proceeds of \$3,321,219 from the common share issue in October 2004. From this amount \$3,032,618 remained available at year end. The Company has not yet expended a significant portion of the proceeds however the amount spent has been invested in capital assets—more specifically the additional AeroTEM systems.

Summary of Quarterly Results

	October 31, 2004	January 31, 2005	April 30, 2005
Sales	\$ 2,842,379	\$ 972,909	\$ 2,604,975
Net income	565,380	(337,483)	(731,590)*
Net income per share	\$ 0.04	\$ (0.02)	\$ (0.05)
Net income per share—diluted	\$ 0.03	\$ (0.02)	\$ (0.04)

*net income for the quarter was \$194,360, excluding expensing of the stock options (see below)

Sales decreased in the quarter ended January 31, 2005 due to the seasonality in the Canadian exploration industry. This is considered normal and to mitigate against this seasonality, the Company plans to pursue more international contracts in the forthcoming year.

Net income for the quarter ended January 31, 2005 decreased mostly due to seasonality. The net income for the quarter ended April 30, 2005 was decreased by the recognition of the stock option expense of \$925,950 during the quarter. This item is a non-cash expense. The operational net income of the Company outside of this expense was \$194,360.

Liquidity and Capital Resources

Working capital increased from \$2 million at April 30, 2004 to \$3.9 million at April 30, 2005. This increase can be attributed to the following:

1. \$3,321,219 in net proceeds from the public offering during the year comprised of 2 million shares which were sold at \$2.00 per share. Increased sales during the fiscal year to date also helped improve working capital.
2. The Company has \$1.9 million in accounts receivable, an increase of \$1.5 million since April 30, 2004. \$985,000 was outstanding greater than 90 days but Aeroquest has subsequently received \$839,000, written off \$39,000, and management has had assurances from its clients that the outstanding balance is collectible.

3. The Company invested over \$2.4 million dollars in capital assets during the current fiscal year primarily in the construction of four new AeroTEM II units. All of the units are in operation. The Company is also nearing completion on the next generation of larger AeroTEM X and AeroTEM XII systems.

The liquidity position is expected to remain strong throughout the next fiscal year. Aeroquest International Limited expects to be able to fund all anticipated capital projects out of working capital.

The contractual obligations to be incurred by Aeroquest International Limited are summarized as follows:

Contractual Obligations	Total	Less than 1 year	1-3 years	4-5 years	After 5 years
Long-term debt	\$ 5,580	\$ 5,580	Nil	Nil	Nil
Operating Leases	\$ 262,500	\$ 86,000	\$ 111,500	\$ 65,000	Nil
Total contractual obligations	\$ 268,080	\$ 91,580	\$ 111,500	\$ 65,000	Nil

Transactions With Related Parties

During the period, the Company paid \$460,000 to companies owned by certain directors for management consulting services. These transactions are in the normal course of operations and are measured at the exchange value (the amount of consideration established and agreed to by the related parties), which approximates the arm's length equivalent value for services performed.

Accounting Policies

The Financial Statements for the fiscal year ended April 30, 2005 have been prepared using the same accounting policies as described in the Company's 2004 audited Financial Statements.

Share Capital

As at the date of this report the number of Common Shares of the Company issued and outstanding is 15,840,273.

As at the date of this report, fully vested and exercisable Common Share stock options held by directors, officers and employees, and brokers are as follows:

	Number of Options	Exercise Price	Expiry Date
Held by brokers to Company	300,000	\$ 2.00	October 28, 2006
Held by directors, officers, employees, and consultants under the Company's stock option plan	975,000	\$ 2.00	October 31, 2009
	200,000	\$ 2.00	October 28, 2009
Held by employees and consultants under the Company's stock option plan	60,000	\$ 2.00	February 28, 2010
	25,000	\$ 2.00	January 31, 2010
Total	1,560,000		

Therefore on a fully diluted basis the Common Shares of the Company would be 17,400,273.

Management's Responsibility for Financial Reporting

To the Shareholders
of Aeroquest International Limited

The accompanying consolidated financial statements of the Company have been prepared by management in accordance with accounting principles generally accepted in Canada, and within the framework of the summary of significant accounting policies in these consolidated financial statements. Management is responsible for all information in the annual report. All financial and operating data in the annual report is consistent, where appropriate, with that contained in the consolidated financial statements.

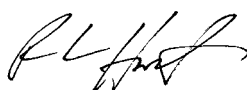
A system of internal accounting control is maintained in order to provide reasonable assurance that assets are safeguarded and that transactions are properly recorded and executed in accordance with management's authorization. This system includes established policies and procedures, the selection and training of qualified personnel and an organization providing for appropriate delegation of authority and segregation of responsibilities.

The Audit Committee of the Board of Directors meets periodically with management and the Company's independent auditors to review the scope and results of their annual audit and to review the consolidated financial statements and related financial reporting matters prior to submitting the consolidated financial statements to the Board of Directors for approval.

The consolidated financial statements have been audited on behalf of the shareholders by the Company's independent auditors, BDO Dunwoody, LLP, in accordance with Canadian generally accepted auditing standards. The auditors' report outlines the scope of their audit and their opinion on the consolidated financial statements.



Wally Boyko
Chairman



Roland Horst
Chief Executive Officer



Steve Balch
President

Auditor's Report

To the Shareholders
of Aeroquest International Limited

We have audited the consolidated balance sheets of Aeroquest International Limited as at April 30, 2005 and 2004 and the consolidated statements of operations and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at April 30, 2005 and 2004 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

(signed) "BDO Dunwoody LLP"

Chartered Accountants
Toronto, Ontario
May 31, 2005

Aeroquest International Limited
**Consolidated
 Balance Sheets**

April 30	2005	2004
Assets		
Current		
Cash and cash equivalents	\$ 3,034,338	\$ 491,123
Marketable securities (Note 2)	—	1,983,961
Accounts receivable	1,939,571	407,926
Income taxes receivable	136,447	—
Prepaid expenses	—	102,130
Contracts in process	513,433	198,750
Loan receivable (Note 3)	63,713	49,250
	\$ 5,687,502	\$ 3,233,140
Long-term investment (Note 4)	\$ 16,001	\$ 24,004
Deferred costs (Note 5)	—	221,793
Capital assets (Note 6)	2,740,931	747,246
Intellectual property (Note 7)	218,767	343,779
Future income taxes (Note 10)	110,000	—
	\$ 8,773,201	\$ 4,569,962
Liabilities and Shareholders' Equity		
Current		
Accounts payable and accrued liabilities	\$ 1,026,808	\$ 677,546
Income taxes payable	—	171,442
Deferred revenue	717,249	346,842
Current portion of long-term debt (Note 8)	5,580	23,716
	\$ 1,749,637	\$ 1,219,546
Long-term debt (Note 8)	—	2,262,717
	\$ 1,749,637	\$ 3,482,263
Shareholders' equity		
Share capital (Note 9)	\$ 5,986,176	\$ 498,535
Contributed surplus (Note 9(c))	925,950	—
Retained earnings	111,438	589,164
	\$ 7,023,564	\$ 1,087,699
	\$ 8,773,201	\$ 4,569,962

On behalf of the Board:



Roland Horst
 Director



Ann Dumyn
 Director

Aeroquest International Limited

Consolidated Statements of Operations and Retained Earnings

For the years ended April 30	2005	2004
Sales	\$ 7,974,180	\$ 4,051,670
Cost of sales	4,539,237	1,892,066
Gross margin	\$ 3,434,943	\$ 2,159,604
Expenses and other items		
Amortization of capital assets	\$ 448,727	\$ 130,623
Amortization of intellectual property	125,012	31,253
Amortization of deferred costs	36,965	—
Development expenses	644,652	110,172
General and administrative	1,695,802	1,319,957
Gain on foreign exchange	(34,341)	(24,747)
Stock option expense	925,950	—
Writedown of long-term investment	8,003	16,039
	\$ 3,850,770	\$ 1,583,297
Income (loss) before income taxes	\$ (415,827)	\$ 576,307
Income taxes (Note 10)		
Current	\$ 76,899	\$ 170,000
Future (recovery)	(15,000)	—
	\$ 61,899	\$ 170,000
Net income (loss) for the year	\$ (477,726)	\$ 406,307
Retained earnings , beginning of year	589,164	182,862
Dividends	—	(5)
Retained earnings , end of year	\$ 111,438	\$ 589,164
Earnings (loss) per share:		
Basic and fully diluted (Note 14)	\$ (0.04)	\$ 0.04

Aeroquest International Limited**Consolidated Statements
of Cash Flows**

For the years ended April 30

2005

2004

Cash provided by (used in)**Operating activities**

Net income (loss) for the year	\$ (477,726)	\$ 406,307
Adjustments required to reconcile net income (loss) with net cash from operating activities		
Amortization of capital assets	448,727	130,623
Amortization of intellectual property	125,012	31,253
Amortization of deferred costs	36,965	—
Write down of long-term investment	8,003	16,039
Stock option expense	925,950	—
Future income taxes	(15,000)	—

	\$ 1,051,931	\$ 584,222
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Changes in non-cash working capital balances

Accounts receivable	\$(1,531,645)	\$ 122,780
Prepaid expenses	102,130	—
Contracts in process	(314,683)	(198,750)
Accounts payable and accrued liabilities	349,262	116,532
Income taxes	(307,889)	164,830
Deferred revenue	370,407	184,742

	\$ (280,487)	\$ 974,356
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Investing activities

Loan receivable	\$ (14,463)	(49,250)
Increase in capital assets	(2,442,412)	(654,983)
Sale (purchase) of marketable securities	1,983,961	(2,000,000)

	\$ (472,914)	\$(2,704,233)
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Financing activities

Repayment of long-term debt	\$ (24,603)	\$ (24,646)
Net proceeds from long-term debt issue	—	2,256,250
Net proceeds from common share issue	3,321,219	138
Deferred costs	—	(200,663)

	\$ 3,296,616	\$ 2,031,079
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Increase in cash and cash equivalents during the year

2,543,215

301,202

Cash and cash equivalents, beginning of year

491,123

189,921

Cash and cash equivalents, end of year

	\$ 3,034,338	\$ 491,123
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Supplementary information (Note 15)

Summary of Significant Accounting Policies

Nature of Business

Aeroquest International Limited (formerly PICorp.) was incorporated by Certificate of Incorporation issued pursuant to the provisions of the General Corporation Law of the State of Delaware on September 21, 2001. On April 29, 2004, the Company was continued under the ABCA and on October 27, 2004 continued under the OBCA in conjunction with the Qualifying Transaction. The Company is a public company trading on the TSX Venture Exchange.

The Company's wholly owned subsidiary, Aeroquest Limited is incorporated under the laws of Ontario and is engaged in the operation of providing airborne geophysical services to the mining, oil & gas, environmental and geologic engineering industries as well as government agencies worldwide.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, Aeroquest Limited. All significant intercompany transactions and balances have been eliminated on consolidation.

Use of Estimates

These financial statements have been prepared in accordance with generally accepted accounting principles in Canada. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates as additional information becomes available in the future. The financial statements have, in management's opinion, been properly prepared using careful judgment within reasonable limits of materiality and within the framework of the accounting policies summarized below.

Revenue Recognition

Revenue is recognized when fieldwork is substantially complete, the contract revenue is fixed and determinable and collectibility is reasonably assured. Contracts range for less than a one year period. Costs related to contracts for which field work is incomplete at year end are classified as contracts in process whereas customer deposits received in advance for these contracts in process are classified as deferred revenue.

Revenue on sale of equipment is recognized when the equipment is delivered to the customer, the amount is fixed and determinable and collectibility is reasonably assured. The related cost of the equipment is recognized in cost of sales.

Financial Instruments

Unless otherwise noted, it is management's opinion that the Company is not exposed to significant interest, currency or credit risks arising from its financial instruments.

The fair values of these financial instruments approximate their carrying values, unless otherwise noted.

Foreign Currency Translation

Foreign currency accounts are translated into Canadian dollars as follows:

At the transaction date, each asset, liability, revenue and expense is translated into Canadian dollars by the use of the exchange rate in effect at that date. At the year end date, monetary assets and liabilities are translated into Canadian dollars by using the exchange rate in effect at that date. The resulting foreign exchange gains and losses are included in income in the current period.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash on hand and short-term investments readily convertible to cash with original maturities of 90 days or less.

Marketable Securities

Marketable securities are carried at the lower of cost and market value.

Deferred Costs

Deferred costs include the costs related to the fees incurred in connection with the reverse take-over ("RTO") and costs to negotiate and finance the debentures.

Deferred costs related to the RTO have been charged to equity. Costs to negotiate and finance the debentures were deferred and amortized until they were converted to equity.

Long-term Investments

Long-term investments are carried at cost unless an impairment in value exists that is other than temporary, in which case the long-term investment is written down to fair market value.

Capital Assets

Capital assets are stated at cost less accumulated amortization. Cost is net of related investment tax credits and government grants. Amortization based on the estimated useful life of the asset is calculated as follows:

Airborne and geophysical equipment	30 % diminishing balance basis
Automotive equipment	30 % diminishing balance basis
Data processing equipment	30 % diminishing balance basis
Leasehold improvements	shorter of estimated economic life or lease term
Office equipment	20 % diminishing balance basis

Intellectual Property

Intellectual property is recorded at cost and amortized on a straight line basis over 3 years. The value of the intellectual property is regularly evaluated by reviewing the returns of the related business, taking into account the risk associated with the investment. Any impairment of permanent nature in the value of the intellectual property is written off against earnings.

Long-lived Assets

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which carrying amounts of the assets exceed the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less cost to sell.

Research and Development

All research costs are charged to operations in the year of expenditure. Development costs are capitalized if they meet the criteria for capitalization and are amortized over the period of the expected life. Development costs are written off when there is no longer expectation of future benefits.

Income Taxes

The Company follows the liability method of tax allocation in accounting for income taxes. Under this method, future income tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities, and measured using the substantively enacted tax rates and laws expected to be in effect when the differences are realized.

Stock-based Compensation

Effective May 1, 2003, the Company adopted the recommendations of the CICA with respect to stock-based compensation and other stock-based payments. These standards require that direct awards of stock and liabilities based on the price of common stock be measured at fair value at each reporting date, with the change in fair value reported in the statement of operations, and encourages, but does not require, the use of the fair value method for all other types of employee stock-based compensation plans.

The Company decided to adopt the fair value based method of accounting for all its stock-based compensation. Accordingly, the fair value method of accounting is applied for stock options granted to directors, officers, employees and consultants whereby the weighted average fair value of options granted is measured as of the earlier of the period the options are vested or the performance is complete and are recognized in the financial statements in accordance with the nature of the services or the assets received. When the awards are exercised, share capital is credited by the sum of the consideration paid together with the related portion previously credited to contributed surplus.

Notes to Consolidated Financial Statements

01

Reverse Take-Over

On October 28, 2004, Aeroquest International Limited and its principal shareholders entered into a reverse take-over with PICorp. Capital Ltd. (previously Phoenix International, Inc.) ("PICorp.") wherein all of the issued and outstanding shares of the Company were sold, by way of share exchange, to PICorp. (the "Transaction").

Pursuant to the proposed acquisition, PICorp. consolidated its common shares on a three-for-one basis such that the 3,166,665 shares were consolidated to 1,055,555 shares. Holders of issued and outstanding common shares of Aeroquest received one share of PICorp. for each Aeroquest share held.

At the time of closing the Transaction ("Closing date"), Aeroquest International Limited had 12,773,607 shares outstanding, including 2,373,607 shares issued upon conversion of the debentures set out in Note 8 which were deemed to be converted into common shares immediately prior to the Closing date. Upon completion of the Transaction, there were 13,829,162 common shares outstanding of PICorp.

Completion of the Transaction and the financing resulted in the shareholders of Aeroquest Limited holding the majority of the issued and outstanding common shares of PICorp. and renaming the Company Aeroquest International Limited. Accordingly, the Transaction was treated for accounting purposes as a reverse take-over ("RTO") and has been accounted for in accordance with EIC10 as a capital transaction resulting from the recapitalization of PICorp.

The consolidated balance sheet combines the assets and liabilities of PICorp. as an acquisition under the purchase method. The net assets acquired at fair value at October 28, 2004 are as follows:

Asset		
Cash		\$ 49,425
Less: liabilities assumed		(6,118)
<hr/>		
Total consideration attributable to PICorp.		\$ 43,307
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Represented by: 1,055,555 shares of PICorp.		\$ 43,307
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02

Marketable Securities

	2005	2004
Guaranteed investment certificates ⁽ⁱ⁾	\$ —	\$ 1,000,000
Mutual funds (market value \$983,961)	—	1,000,000
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Write down of mutual funds	—	2,000,000
	—	16,039
<hr/>		
	\$ —	\$ 1,983,961
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(i) Guaranteed investment certificates earn interest in the range of 2% to 2.25% maturing between August 2004 to February 2005.

03 Loan Receivable

The loan receivable is due from a shareholder, is non-interest bearing and due on demand.

04 Long-term Investment

The Company owns shares in Canadian public companies. The market value of these shares at April 30, 2005 was \$50,000 (\$35,000 in 2004).

05 Deferred Costs

	2005	2004
Financing costs	\$ —	\$ 201,448
RTO costs	—	20,345
Net book value	\$ —	\$ 221,793

06 Capital Assets

	2005	2004
Airborne and geophysical equipment	\$ 2,726,359	\$ 833,086
Automotive equipment	373,051	127,752
Data processing equipment	213,788	98,291
Leasehold improvements	87,993	26,971
Office equipment	82,032	13,028
Accumulated amortization	\$ 3,483,223 (1,049,150)	\$ 1,099,128 (600,422)
Equipment in process	\$ 2,434,073 306,858	\$ 498,706 248,540
Net book value	\$ 2,740,931	\$ 747,246

Equipment in process relates to work in process on airborne equipment that was not ready for use at year end.

07 Intellectual Property

	2005	2004
Intellectual property	\$ 375,032	\$ 375,032
Accumulated amortization	(156,265)	(31,253)
	\$ 218,767	\$ 343,779

08 Long-term Debt

	2005	2004
Loans payable in consideration for an expected debenture issue ⁽ⁱ⁾ (Note 1)	\$ —	\$ 2,256,250
Finance contract payable 0%, due March 1, 2005, monthly payments of \$1,318 principal	—	14,504
Finance contract payable 5.9%, due December 4, 2005, monthly payments of \$825 principal and interest	5,580	15,679
	5,580	2,286,433
Less: current portion	\$ 5,580	\$ 23,716
	\$ —	\$ 2,262,717

(i) On May 31, 2004, debentures were issued with interest accruing at 10% commencing 6 months from the date of the original transfer of funds. As indicated in Note 1, when the Company entered into a reverse take-over, the entire principal amount was deemed to be converted into common shares at rates of \$.90 to \$1.00. Since the Company went public before the deferred interest was payable, no interest was accrued or payable.

09 Share Capital

(a) Authorized:
Unlimited number of voting common shares.

(b) Issued and outstanding:

Pre-reverse take-over issued common shares of PICorp.

	Number of common shares	Share capital
Balance at May 1, 2003	3,166,665	\$ 280,040
Consolidation of common shares on a 3 for 1 basis	(2,111,110)	—
Pre-reverse take-over issued common shares of PICorp.	1,055,555	\$ 280,040

09

Share Capital, cont'd

Pre-reverse take-over issued common shares of Aeroquest Limited

	Number of common shares	Share capital
Balance at May 1, 2003	100	\$ 100
Shares issued for stock dividends	4,863,310	5
Stock options granted	—	123,260
Shares issued on stock options granted	1,369,565	138
Shares issued in exchange for intellectual property	4,167,025	375,032
<hr/>		
Pre-reverse take-over issued common shares of Aeroquest Limited	10,400,000	\$ 498,535

Issued from the date of the RTO

	Number of common shares	Share capital
Share capital is comprised of the number of issued and outstanding common shares of PICorp. and the stated capital of Aeroquest Limited	1,055,555	\$ 498,535
Common shares issued on the RTO (Note 1)	10,400,000	43,307
Debentures converted to Aeroquest International Limited shares, net of issue costs (Note 8)	2,373,607	2,071,423
Exercised options of Aeroquest International Limited shares	11,111	5,000
Public offering of Aeroquest International Limited shares	2,000,000	4,000,000
Costs relating to share issue net of income tax effect	—	(632,089)
<hr/>		
	15,840,273	\$ 5,986,176

c) Stock Options

The Company has a Stock Option plan under which the directors of the Company may grant options to acquire shares of the Company to qualified directors, officers, employees and persons providing ongoing services to the Company. The strike price of these options will not be less than the market price of the common shares at the time of the grant. The options vest upon grant and have a term of five years.

The following table reflects the continuity of options granted under the stock option plan for the year ended April 30, 2005.

	Number of options	Average exercise price
Outstanding, beginning of year	—	\$ —
Granted	1,560,000	2.00
<hr/>		
Outstanding and exercisable, end of year	1,560,000	\$ 2.00

The following table summarizes information about stock options outstanding at April 30, 2005.

Exercise Price	Number outstanding, April 30, 2005	Weighted average remaining contractual life (years)	Weighted average exercise price
\$2.00	1,560,000	4.52	\$ 2.00

The fair value of stock options granted during the 2005 fiscal year was estimated using the Black-Scholes option pricing model on the date of the grant with the following weighted average assumptions

Stock price at grant date	\$1.70 to \$2.00
Exercise price	\$2.00
Expected life of options	2 to 3 years
Expected stock price volatility	40%
Expected dividend yield	—
Risk free interest rate	2.9% to 3.8%

The stock option expense for 2005 was \$925,950 with a corresponding credit to contributed surplus.

10

Income Taxes

	2005	2004
Net income (loss) before income taxes	\$ (415,827)	\$ 576,307
Statutory income tax rate	36.12%	29.47%
Computed income tax payable (recovery)	(150,197)	169,838
Non-deductible expenses	341,446	7,292
Non-deductible amortization and depreciation	54,588	4,798
Rate difference before RTO	(50,813)	—
Actual recovery of prior year taxes	(117,891)	—
Other	(234)	(11,928)
Recognition of future tax assets	(15,000)	—
Income taxes	\$ 61,899	\$ 170,000

The tax effects of temporary differences that give rise to significant portion of the future tax assets at April 30, 2005 and 2004 are presented below:

	2005	2004
Future tax assets		
Capital assets	\$ 16,000	\$ —
Share issuance costs	95,000	—
Net future tax assets	111,000	—
Other	(1,000)	—
	\$ 110,000	\$ —

11 Related Party Transactions

During the year, the Company paid \$460,000 (\$875,000 in 2004) to companies owned by certain directors for management consulting services. These transactions are in the normal course of operations and are measured at the exchange value (the amount of consideration established and agreed to by the related parties), which approximates the arm's length equivalent value for services performed.

In addition to the above, a bonus payable to a shareholder of \$Nil (2004 \$315,000) is included in accounts payable at year end.

12 Commitments

The Company has operating leases for its two premises. The lease for one location is for \$4,667 per month, under a lease expiring in 2007. The other lease calls for payments of \$2,500 per month until 2007 and \$2,708 per month until 2010.

The minimum annual lease payments for the next five years are as follows:

2006	\$ 86,000
2007	79,000
2008	32,500
2009	32,500
2010	32,500
	<hr/>
	\$ 262,500
	<hr/>

13 Segmented Information

The Company has no distinct reportable business segments.

In 2005, two customers accounted for 35% of revenue. In 2004, five customers accounted for 82% of revenue.

Included in revenue is an amount of \$469,882 (2004 \$Nil) for the sale of equipment.

14 Earnings (Loss) per Share

Basic earnings (loss) per share has been calculated by dividing the net income (loss) by the weighted average number of shares outstanding during the year. The fully diluted earnings (loss) per share is similar to the basic earnings (loss) per share, except the denominator is increased to include the number of additional common shares that would have been outstanding if the dilutive potential common shares had been issued.

	2005	2004
Numerator:		
Net income (loss) for the year	\$ (477,726)	\$ 406,307
Denominator:		
Average common shares outstanding	13,116,433	10,400,000
Fully diluted common shares outstanding	13,868,100	10,400,000
Basic and fully diluted income (loss) per share	\$ (0.04)	\$ 0.04

The weighted average number of shares used in computing the earnings per share for the year was calculated based on the numbers of shares outstanding for the period from the beginning of the fiscal year to the date of the reverse take-over, deemed to be the number of shares issued by Aeroquest International Limited (formerly PICorp.) (the legal parent) to the shareholders of Aeroquest Limited (the legal subsidiary) and for the period from the date of the reverse take-over to the end of the fiscal year based on the number of shares issued by the Company. The earnings per share for the comparative period are based on the number of shares issued by Aeroquest International Limited (formerly PICorp.) in the reverse take-over transaction.

As the Company experienced a loss for 2005, all potential common shares outstanding from dilutive securities are considered antidilutive and are excluded from the calculation of loss per share.

15 Supplementary Cash Flow Information

	2005	2004
(a) Interest paid	\$ 3,164	\$ 4,615
(b) Interest received	66,823	7,516
(c) Income tax paid	583,784	3,612
Non Cash Transactions:		
(d) Settlement of accounts receivable in exchange of investment in Canadian public company shares	—	24,004
(e) Shares issued in lieu of dividends	—	5
(f) Share options granted (Note 9 (b))	—	123,260
(g) Debentures converted to common shares net of debenture issue cost (Note 9 (b))	2,071,423	—

16 Credit Facility

The Company has operating facilities totalling \$750,000 available for its use, bearing interest at prime plus 0.5%, and secured by a general security agreement. At April 30, 2005 no amounts have been drawn on the this facility.

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Chairman

Roland Horst
Chief Executive Officer
& Secretary

Steve Balch
President

Dr. Gary Black
Vice President – Instrumentation

Mark Botelho
Chief Financial Officer

Jonathan Rudd
Manager of Processing
& Interpretation

Bert Simon
Operations Manager

Quentin Yarie
Manager of Marketing
& Sales

Directors and Officers

Steve Balch
Aeroquest International Limited
President & Director

Dr. Gary Black
Aeroquest International Limited
Director
Aeroquest Limited
Vice President – Instrumentation

Mark Botelho
Aeroquest International Limited
Chief Financial Officer

Waldimer Boyko
Aeroquest International Limited
Chairman & Director

Ann Dumyn
Aeroquest International Limited
Director
Terra Cotta, Ontario

Monty Gordon
Aeroquest International Limited
Director
Toronto, Ontario

Roland Horst
Aeroquest International Limited
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Secretary & Director

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Board of Directors

Waldimer Boyko (Chairman)

Mr. Boyko has been a successful mineral explorationist for over 45 years, starting his career as a senior geologist reporting to Dr. Normal Keevil, Sr. of Teck Corporation. After becoming President of Interprovincial Helicopters, Mr. Boyko followed his lifetime passion to combine geology with geophysics to find mines, starting Aerodat, an airborne geophysical survey company in 1969, running the company successfully over 18 years before selling it in 1987. Mr. Boyko founded Aeroquest in 1988 and remains the largest shareholder of the company. Mr. Boyko holds a B.Sc. in Geological Engineering and a M.Sc. in Economic Geology from the University of Saskatchewan, and also did post graduate studies in geology at McGill University.

Steve Balch

Mr. Balch has over 20 years experience as an exploration geophysicist, mining exploration consultant and geophysical instrumentation developer. Mr. Balch began his career as a geophysicist with Morris Magnetics Inc. and subsequently developed geophysical instrumentation with IFG Corporation and Crone Geophysics, prior to joining Inco and Voisey's Bay Nickel Company as an exploration geophysicist. In 2001, Mr. Balch formed Balch Exploration Consulting Limited, which provides geophysical consulting services. Mr. Balch has combined his talents with Mr. Boyko and Dr. Black at Aeroquest to improve and market the AeroTEM system and became a major shareholder of Aeroquest. Mr. Balch holds a B.Sc. in Geophysics from the University of Western Ontario.

Gary Black

Dr. Black was appointed Director of Research and Development for Aeroquest in January, 2004 and VP Instrumentation in February, 2005 but has been involved in the development of the Aeroquest EM technology since 2001. He leads the further technology development of the AeroTEM and Impulse helicopter EM systems and spearheads the development of new instrumentation to enhance and enlarge the service and systems offerings of Aeroquest. He previously spent 32 years successfully developing leading edge electronic instrumentation technology for geophysical exploration applications, playing a significant role in the technological development of a majority of commercially available airborne EM exploration systems. Dr. Black is also an experienced business manager with 28 years in ownership and/or senior management positions with geophysical instrumentation companies and is a proponent of corporate growth through technology development. Dr. Black holds a Ph.D. and M.A.Sc. in Electrical Engineering from the University of Toronto and a B.Sc. in Electrical Engineering from Queen's University, Kingston, Ontario.

Ann Dumyn

Ann Dumyn is a business executive with over 35 years experience in business development, finance and contract negotiations. Following a 32 year career with Bank of Montreal, Ann was Vice-President of Aboriginal and Northern Affairs for SNC – Lavalin where she has continued as a consultant.

L. Lamont Gordon

Mr. Gordon was the founder and President of Gordon Securities Ltd. and is also the past Chairman of Sprott Securities, both institutional brokerage firms. Prior to this, Mr. Gordon was the former Director and Manager of the Stock Department of Nesbitt Thomson. Mr. Gordon has financed many successful high technology and natural resource companies.

Roland Horst

Mr. Horst has extensive experience managing and financing geophysical instrumentation and mining companies. Mr. Horst began his career as an exploration geologist with Inco Limited, followed by experience as an investment and corporate banker with Bank of Montreal, Nesbitt Thomson Inc. and Richardson Greenshields. Mr. Horst then became CEO of several publicly traded gold exploration and mining companies and was most recently CEO of Scintrex Limited and La Coste & Romberg – Scintrex, Inc., geophysical instrumentation firms. Mr. Horst holds degrees in geology from McGill (B.Sc.) and Laurentian (M.Sc.) Universities and an LLB and MBA from the University of Western Ontario.

Norman Paterson

Dr. Paterson is a geophysicist with more than 50 years experience exploring for minerals worldwide. Co-founder of Paterson, Grant & Watson Limited, a geophysical consulting firm, he served as president from 1973 to 1995. He is a successful mine-finder, having assisted in the discovery of at least 20 mineral deposits. In recognition of his contributions to science and to the industry he was elected to the Royal Society of Canada in 1977 and member of the Canadian Mining Hall of Fame in 1999.



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