AEROQUEST INTERNATIONAL LIMITED

MANAGEMENT'S DISCUSSION & ANALYSIS

For the period ending January 31, 2006

Management's Discussion and Analysis (MD&A) is intended to help readers understand the dynamics of our business and the key factors underlying our financial results. It explains trends in our financial condition and results of our operations for the quarter and year-to-date ended January 31, 2006 compared with our operating results for the corresponding periods ended January 31, 2005. It also compares our balance sheet as at January 31, 2006 to our balance sheet as at April 30, 2005. This MD&A should be read in conjunction with our unaudited interim consolidated financial statements and MD&A for October 31, 2005, July 31, 2005 and our audited consolidated financial statements and MD&A for April 30, 2005.

The consolidated financial statements presented here are those of Aeroquest International Limited and its wholly owned subsidiary Aeroquest Limited, with all significant inter-company balances having been eliminated on consolidation.

Additional information relating to our company is available on the System for Electronic Document Analysis and Retrieval (SEDAR) at www.sedar.com.

FORWARD-LOOKING STATEMENTS

Securities laws encourage companies to disclose forward-looking information so that investors can get a better understanding of the company's future prospects and make informed investment decisions. Statements that are not historical fact and are based on current expectations, estimates, and assumptions are forward-looking statements.

This MD&A contains forward-looking statements about our business. Inherent in these statements are known and unknown risks, uncertainties, and other factors that may cause the results, performance, or achievements of our company to differ materially from those expressed or implied by such statements. Such factors include, among others, general economic and business conditions, major technology changes, timing of product introductions, competition, and our ability to attract and retain key employees.

NON-GAAP FINANCIAL MEASURES

Certain financial measures used in this MD&A do not have any standardized meaning under Canadian generally accepted accounting principles (GAAP). Below is a definition of each of the non-GAAP financial measures used in this MD&A. At the point where each non-GAAP financial measure is first discussed, a table has been provided to reconcile that financial information to the most directly comparable GAAP measure.

EBITDA

Earnings before interest, taxes, depreciation and amortization (EBITDA) is a financial metric used to analyze operating results. We define EBITDA as revenue less cost of sales and operating costs, and we use it as a benchmark of operating performance. We caution you that EBITDA, as calculated by us, may not be comparable to similarly titled amounts reported by other companies.

OVERVIEW

AEROQUEST'S BUSINESS

We are 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. We operate a number of proprietary time-domain, sometimes called transient, electromagnetic (TEM) systems on platforms ranging from five metres to 12 metres in diameter, delivered under the trade-name AeroTEM. We also supply geophysical surveying platforms based on frequency domain electromagnetics (trade-name Impulse), total field magnetics, magnetic gradient, and radiometrics.

SECOND QUARTER 2006 OPERATING RESULTS

OVERVIEW

In the third quarter of 2006, we continued our work to re-position our company for profitability and are very pleased with our progress in a relatively short period of time. Our revenue is up significantly from the same quarter a year ago, our gross margin has improved, and we reached cash flow break-even, as measured by operating cash flow, in the quarter. We completed 12 contracts in the third quarter as compared to 11 in the previous quarter and five in the same quarter last year. As with the previous quarter, we ended the quarter with a healthy level of contracts in progress, as well as a good backlog for the final quarter of 2006.

Key Operating Metrics

	2006			2005	
	Q3	Q2	Q1	Q4	Q3
Platforms available for use at period-end	**7**	**7**	8	7	5
AeroTEM systems	**4**	**4**	5	4	3
Line kilometres flown during period	**12,700**	**16,300**	16,800	24,600	5,400
Contracts completed	**12**	**11**	9	10	6
Contracts in progress at period end	**7**	**6**	0	2	2

REVENUE

In the third quarter of 2006, our total revenue was $1,764 thousand, up $776 thousand, or 78 per cent compared to the same quarter last year. Revenue in our business is a function of changes in the number of systems we have available to fly and the average utilization of those systems. In the third quarter, we were able to utilize five systems, of which three were AeroTEM, for at least a portion of the quarter.

Our revenue is characterized by a relatively small number of large contracts, so the presence or absence of one or two contracts can have a meaningful impact on our sales level in a given quarter. In addition, the amount we charge for a survey is a function of the type of survey performed and this amount can vary significantly. In particular, we charge more for surveys using the AeroTEM platforms than we do for surveys on other platforms. In general, we have flown a higher number of contracts of shorter average duration in 2006 than we did in similar periods in 2005.

AeroTEM is a best-in-class system

We believe that our AeroTEM system has many distinctive features that make it unique in geophysical exploration in general and airborne EM, in particular. These features, which are not available with many competing technologies, include a high signal-to-noise ratio, very high resolution, conductance discrimination, and the use of a receiver configuration that provides information on position, orientation, depth, and thickness of conductors.

Our goal is to continue to focus on adding AeroTEM systems as appropriate, focusing on incorporating our latest advances in electronics and in platform design into each new system, as well as increasing the utilization rate of the existing fleet. We expect to commission a new AeroTEM system in each of the next three quarters. These systems will be large—varying from 9 metres to 12 metres in diameter, with more powerful transmitters operating at lower base frequencies. As a result, we expect these systems to offer better depths of investigation than any system we have in use today.

Revenue & Gross Profit

(in thousands of Canadian dollars)	Three Months Ended 31-Jan-06	31-Jan-05	Year-to-Date 31-Jan-06	31-Jan-05	Change from prior year		Change from prior YTD	
Revenue	**1,764**	989	6,429	5,405	775	78%	1,024	19%
Cost of sales	**826**	607	4,034	2,935	219	36%	1,099	37%
Gross profit	**938**	382	2,395	2,470	556	146%	(75)	(3%)
Gross profit margin %	**53%**	39%	37%	46%		15%		(8%)

Cost of sales was $826 thousand in the third quarter of 2006, or approximately 47 per cent of revenue. This compares to $607 thousand in the same quarter last year representing 61 per cent of revenue in that quarter. Cost of sales was decreased by approximately $267 thousand in the third quarter to reverse an accrual from an earlier interim period in 2006. After eliminating the effect of this correction, cost of sales for the quarter would have been $1,094 thousand, or 62 per cent of revenue. On a year-to-date basis, cost of sales is approximately 63 per cent of revenue, as compared to 54 percent of revenue in the same period last year. The increase in year-to-date costs results from the requirement to use larger, more expensive helicopters to operate the large diameter systems.

The decrease in cost of sales as a percentage of revenue translated into a higher gross profit and a higher gross profit margin percentage for the third quarter. Gross profit was $938 thousand compared to $382 thousand in the same quarter last year, an increase of $556 thousand or 146 per cent. On a year-to-date basis, gross margin was 37 per cent, as compared to 46 percent in the same period last year. Our focus in the remainder of 2006 is to target our gross margin in the range of 45 per cent of revenue.

OPERATING COSTS

Overall, third quarter operating costs were $1,046 thousand, up from $792 thousand in the same quarter last year. The year-over-year increase of $254 thousand in operating costs is primarily due to an increase in personnel committed to sourcing and delivering surveys, as well as increases in research and development expenses to allow us to improve upon our existing product line, and increases in the level of depreciation expense.

Operating Costs

(in thousands of Canadian dollars)	Three Months Ended 31-Jan-06	31-Jan-05	Year-to-Date 31-Jan-06	31-Jan-05	Change from prior year		Change from prior YTD	
Research & development expense	**182**	172	749	358	10	6%	391	109%
General & administrative expense	**633**	499	1,999	1,395	134	27%	604	43%
Depreciation & amortization expense	**231**	121	713	359	110	91%	354	99%
Stock option expense	**-**	-	37	-	-		37	
Total operating costs	**1,046**	792	3,498	2,112	254	32%	1,386	66%
% of Revenue	**64%**	80%	56%	39%		(16%)		16%

Research and development expense was $182 thousand for the quarter, up $10 thousand, or 6 percent from the same period last year. However, research and development costs were $749 thousand on a year-to-date basis, up by 109 per cent from the level of $358 thousand last year. In the third quarter, we scaled back the level of discretionary expenditures, including research and development expenses, as a part of our efforts to reduce non-revenue producing or supporting activity, capping the growth rate of these expenses. Going forward, we expect to maintain research and development costs at approximately the level of the third quarter.

General and administrative expenses totalled $633 thousand in the quarter, up from $499 thousand in the same quarter last year. On a year-to-date basis, general and administrative costs are $1,999 thousand, up 43 percent, or $604 thousand from the level in the same period last year. General and administrative costs have risen over the past year as we have put in place an infrastructure to allow us to expand both geographically and in product scope, addressing opportunities in the oil and gas market, the unexploded ordinance (UXO) market, and the groundwater survey market. We expect that these additional costs will result in increased revenues in the remainder of 2006 and beyond.

Depreciation and amortization charges totalled $231 thousand, a 91 per cent increase from the same quarter last year. Depreciation and amortization has generally been rising as we build and deploy more AeroTEM systems. We expect this growth to continue although the rate of growth will slow over the next several quarters.

OPERATING PROFIT (LOSS)

Operating Profit (Loss) & EBITDA

(in thousands of Canadian dollars)	Three Months Ended **31-Jan-06**	Three Months Ended 31-Jan-05	Year-to-Date 31-Jan-06	Year-to-Date 31-Jan-05	Change from prior year		Change from prior YTD	
Operating profit (loss)	**(100)**	(411)	(1,066)	360	311	(76%)	(1,426)	(396%)
Depreciation & amortization	**231**	121	713	359	110	91%	354	98%
EBITDA	**131**	(290)	(353)	719	421	(145%)	(1,072)	(149%)
Writedown of discontinued project	-	-	73	-	-		73	
Contract cancellation costs	-	-	268	-	-		268	
EBITDA after unusual items	**131**	(290)	**(695)**	719	421	(145%)	(1,341)	(186%)
EBITDA as a % of Revenue	7%	(29%)	(5%)	13%				

Our operating loss was $100 thousand in the second quarter, an improvement of $311 thousand, or 76 per cent from the operating loss of $411 thousand in the same quarter last year. Consequently, we recorded EBITDA of $131 thousand in the third quarter, as compared to a loss of $290 thousand in the same period last year. Most of the $353 thousand improvement in EBITDA in the third quarter came from the above mentioned reversal of an earlier period accrual. Eliminating the effect of this correction, EBITDA improved by $85 thousand from the same period last year, driven mostly by the above mentioned increased sales volume, offset by increased costs.

NET INCOME (LOSS)

We recorded a provision for income taxes in the quarter of $21 thousand. As a consequence, we recorded a net loss in the quarter of $78 thousand, or ($0.005) per share, compared with a net loss of $337 thousand or $0.02 per share in the same quarter last year. It is our objective to get Aeroquest to, and maintain it as, a profitable enterprise within the next quarter.

Net Income (Loss)

(in thousands of Canadian dollars)	Three Months Ended **31-Jan-06**	Three Months Ended 31-Jan-05	Year-to-Date 31-Jan-06	Year-to-Date 31-Jan-05	Change from prior year		Change from prior YTD	
Operating profit (loss)	**(100)**	(411)	(1,066)	360	311	(76%)	(1,426)	(396%)
Writedown of development costs	-	-	73	-	-		73	
Contract cancellation costs	-	-	268	-	-		268	
Provision for income taxes (recovery)	**(21)**	(73)	(477)	106	52	(71%)	(583)	(549%)
Net income (loss)	**(78)**	(337)	(931)	254	258	(77%)	(1,184)	(467%)
Earnings per share - basic	**$ (0.005)**	$ (0.02)	$ (0.06)	$ 0.02	$ 0.02	(75%)	$ (0.08)	(394%)

CASH FLOW

CASH FLOW FROM OPERATING ACTIVITIES

Before changes in non-cash working capital, operating cash flow provided $153 thousand in the third quarter of 2006 a change of $369 thousand from the third quarter of 2005. Operating cash flow improved in part because of the Company's efforts to reduce activity to a level that is supported by the current business.

Cash Flow from Operating Activities

(in thousands of Canadian dollars)	Three Months Ended		Year-to-Date		Change from prior year		Change from prior YTD	
	31-Jan-06	31-Jan-05	31-Jan-06	31-Jan-05				
Net income (loss)	**(78)**	(337)	(931)	254	259	(77%)	(1,185)	(467%)
Depreciation & amortization	**231**	121	713	359	110	91%	354	98%
Stock option expense	**-**	-	37	-	-		37	
Writedown of development costs	**-**	-	73	-	-		73	
Operating cash flow	**153**	(216)	(108)	613	369	(171%)	(721)	(118%)
Change in non-cash working capital	**320**	(1,126)	370	(1,181)	1,446	(128%)	1,551	(131%)
Cash flow from operating activities	**473**	(1,342)	262	(568)	1,815	(135%)	829	(146%)

Changes in non-cash working capital added another $320 thousand resulting in cash flow from operating activities reaching $473 thousand in the quarter, as compared to a use of $1,342 thousand in the same quarter last year. The positive change in non-cash working capital came as a result of a concerted effort on our part to reduce the level of our non-cash working capital, through a reduction in accounts receivable. We were successful, with accounts receivable dropping to $898 thousand, from $1,816 thousand in the previous quarter—an improvement of $919 thousand. This review of accounts receivable uncovered a small number of accounts where there is a risk of collecting in full. We therefore included in our expenses for the quarter a charge of $55 thousand in bad debt expense.

CASH FLOW FROM INVESTING ACTIVITIES

Overall, investment activities in the third quarter used $85 thousand of cash. This compares to the third quarter of last year when investing activities provided cash of $649 thousand. Comparisons with the same period last year are influenced by sales of marketable securities in the third quarter of last year that were not repeated in the third quarter of this year.

Cash Flow from Investing Activities

(in thousands of Canadian dollars)	Three Months Ended		Year-to-Date		Change from prior year		Change from prior YTD	
	31-Jan-06	31-Jan-05	31-Jan-06	31-Jan-05				
Acquisition of capital assets	**(85)**	(521)	(766)	(1,567)	436	(84%)	801	(51%)
Sales of marketable securities	**-**	1,200	-	1,992	(1,200)	(100%)	(1,992)	(100%)
Change in loan receivable	**-**	(30)	3	(221)	30	(100%)	224	(101%)
Decline in value of long term investment	**-**	-	-	-	-		-	
Cash flow from investing activities	**(85)**	649	(763)	203	(734)	(113%)	(966)	(475%)
Capital expenditures as a % of revenue	5%	32%	12%	29%				

Acquisition of capital assets consumed $85 thousand, or 5 per cent of revenue, as compared to $521 thousand, or 32 per cent of revenue in the same quarter last year. Now that the significant build-up of AeroTEM systems is largely complete, we are targeting to keep ongoing capital expenditures at or less than 10 per cent of revenue. Capital investments were, and will be, made primarily to expand the fleet of AeroTEM systems.

Cash Flow from Financing Activities

In the quarter, financing activities were not significant. In past quarters, financing activity was dominated by the reverse take-over and subsequent issue of common shares in the second quarter of 2005.

Cash Flow from Financing Activities

(in thousands of Canadian dollars)	Three Months Ended 31-Jan-06	Three Months Ended 31-Jan-05	Year-to-Date 31-Jan-06	Year-to-Date 31-Jan-05	Change from prior year		Change from prior YTD	
Repayment of long term debt	**(1)**	(6)	(7)	(19)	6	(90%)	13	(66%)
Issuance of Common Shares	**-**	-	-	3,543	-		(3,543)	(100%)
Cash flow from financing activities	**(1)**	(6)	(7)	3,524	6	(90%)	(3,531)	(100%)

Liquidity and Capital Resources

Our liquidity, as measured by cash balances, has declined by $505 thousand from the start of the year. A large portion of this change is due to investments in capital assets, which have used $766 thousand over the three quarters.

Cash and short-term investments are generally invested in liquid Canadian dollar or U.S. dollar denominated securities with maturities no greater than ninety days.

Financial Position

At January 31, 2006, we had current assets of $4,602 thousand and current liabilities of $1,538 thousand. Net working capital was $3,064 thousand, a decrease from the $3,937 thousand at April 30, 2005. This $873 thousand change from the prior year-end is primarily due to investments in capital assets and the historical requirement to fund operating losses, offset partially by a reduction in accounts receivable.

Cash & Working Capital Changes

(in thousands of Canadian dollars)	31-Jan-06	30-Apr-05	Change from prior year end	
Cash	**2,529**	3,034	(505)	(17%)
Non-cash current assets	**2,073**	2,653	(580)	(22%)
Current assets	**4,602**	5,687	(1,085)	(19%)
Less: Current liabilities	**1,538**	1,750	(212)	(12%)
Net working capital	**3,064**	**3,937**	(873)	(22%)
Current ratio	**3.0**	3.2	(0.3)	(8%)

Transactions with Related Parties

During the period, we paid $105 thousand 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.

SHARE CAPITAL

As at the date of this report we had 15,840,273 Common Shares issued and outstanding.

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

	Number of options	Exercise price		Expiry date
Fully vested & exercisable options held by directors, officers, employees and consultants under the Company's Stock Option Plan	745,000	$	2.00	October 31, 2009
	60,000	$	2.00	February 28, 2010
	130,000	$	2.00	June 30, 2010
Total vested & exercisable under Stock Option Plan	935,000	$	2.00	
Fully vested & exercisable options held by Brokers	300,000	$	2.00	October 28, 2006
Total	**1,235,000**	**$**	**2.00**	