

## Management's Discussion & Analysis For the three months ending December 31, 2008

*Issued on February 5, 2009*

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 three months ended December 31, 2008 ("Q1-F09") compared with our operating results for the three months ended December 31, 2007("Q1-F08"). It also compares our balance sheet as at December 31, 2008 to our September 30, 2008 fiscal year-end balance sheet.

The consolidated financial statements presented here are those of the Aeroquest Group of Companies; Aeroquest International Limited and its wholly owned subsidiaries Aeroquest Limited, UTS Geophysics Pty Ltd, Geophex Ltd., Aeroquest (UK) Limited and AeroKaz LLP (collectively, "the Company"), with all significant inter-company balances having been eliminated on consolidation.

Additional information relating to our company is available on our website at [www.aeroquest.ca](http://www.aeroquest.ca) and on the System for Electronic Document Analysis and Retrieval (SEDAR) at [www.sedar.com](http://www.sedar.com). Unless otherwise noted, all amounts noted in this MD&A are in Canadian dollars.

### **1.1 FORWARD-LOOKING STATEMENTS**

Securities laws encourage companies to disclose forward-looking information so that investors can get a better understanding of a company's future prospects and make informed investment decisions. Certain statements in this MD&A are forward-looking statements or information, collectively "forward-looking statements". We are hereby providing cautionary statements identifying important factors that could cause our actual results to differ materially from those projected in forward-looking statements made in this MD&A. Any statements that express, or involve discussions as to, expectations, beliefs, plans, objectives, assumptions or future events or performance (often, but not always, through the use of words or phrases such as "will likely result," "are expected to", "will continue", "is anticipated", "estimated", "intend", "plan", "projection", "could", "may", "believes", "feel", "targeting", "look forward", "goals", "objective", "outlook" and similar expressions) are not historical facts and may be forward-looking and may involve estimates, assumptions and uncertainties which could cause actual results or outcomes to differ materially from those expressed in the forward-looking statements.

Without limitation, information regarding the volatility of the market for our services, worldwide political stability, factors that could result in significant or prolonged disruption to mining and oil & gas exploration worldwide, domestic and international economic conditions, other political and economic situations and uncertainties, changes in foreign currency exchange rates, the impacts of changes in industry priorities and spending on exploration activities related to our services, major technology changes, timing of product introductions, competition, our ability to replace lost revenue of a customer significant to an operating division, our ability to attract and retain key employees, and the possibility

that such efforts will not have as great an impact on our operating results as is currently anticipated, is forward-looking information.

Readers should also refer to our continuous disclosure materials filed with Canadian Securities Regulatory Authorities for additional information with respect to certain of these risk factors, including the our most recent Annual Information Form.

Although we believe that the expectations reflected in such forward-looking statements are reasonable, there can be no assurance that such expectations will prove to have been correct. Important factors that could cause actual results to differ materially from our expectations (“**Cautionary Statements**”), including changes in general economic, market and business conditions, fluctuations in the cost of borrowing, political and economic development, our ability to receive timely regulatory approvals, competitive actions of other companies, the occurrence of unexpected events such as equipment failures and other similar events affecting us or other parties whose operation or assets directly or indirectly affect us, and those risks set forth under the heading “Risks & Uncertainties” below.

All subsequent written and oral forward-looking statements attributable to Aeroquest or persons acting on behalf of Aeroquest are expressly qualified in their entirety by the Cautionary Statements. The forward-looking information contained herein is current only as of the date of this document. New factors emerge from time to time, and it is not possible for management to predict all of such factors and to assess in advance the impact of each such factor on our business or the extent to which any factor or combination of factors may cause actual results to differ materially from those contained in any forward-looking statements. We disclaim any intention or obligation to update or revise any forward-looking statements or comments as a result of any new information, future event or otherwise unless such disclosure is required by law.

## **1.2 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, cash operating costs, and stock-based compensation expense, 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.

### **APPARENT TAX RATE**

We define apparent tax rate as the total income tax expense (current and future) as a percentage of income before taxes. More information on our income tax expense and the reconciliation between income

tax expense and our statutory tax rate is contained in Note 11 to the consolidated financial statements for the period.

#### CASH OPERATING COSTS

We define cash operating costs to be those operating expenses in our income statement that involve, or will involve, an inflow or outflow of cash. At present, cash operating costs are the sum of general and administrative expenses, development expense, and gain or loss on foreign exchange.

## 2 Overview

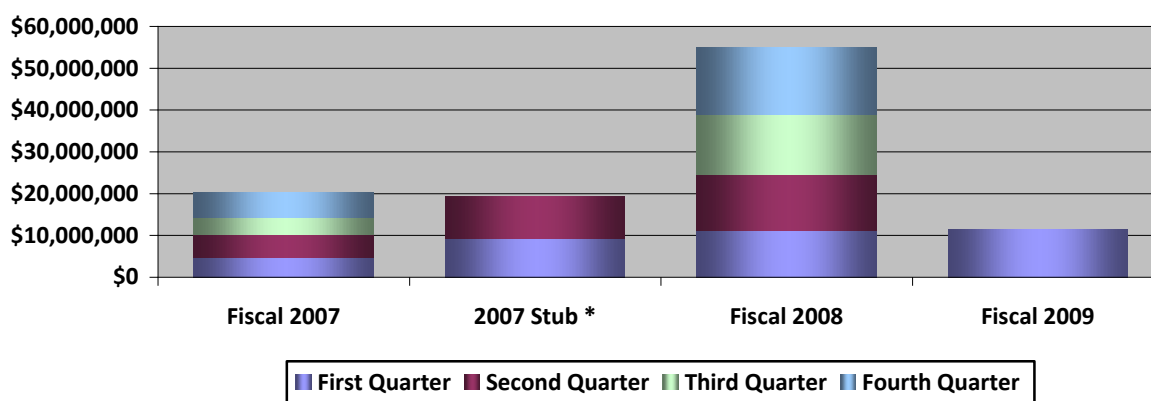
### 2.1 AEROQUEST'S BUSINESS

We are a world leader in the development and operation of innovative and proprietary airborne geophysical surveying platforms servicing the mineral exploration, petroleum, and environmental industries. We use two separate delivery platforms, helicopter and fixed wing, and provide our clients with a broad range of geophysical measurement techniques including magnetic, electromagnetic, gravimetric and radiometric surveys.

We operate a large fleet of airborne geophysical survey systems utilizing both helicopters and fixed wing aircraft. Our geophysical survey technologies include both time-domain and frequency-domain electromagnetics (including our proprietary AeroTEM, time-domain, electromagnetic technology), gravity, magnetic, and radiometric systems. Our combination of geophysical technologies and airborne platforms give us one of the broadest array of product and service offerings in our industry in the world today.

In this report we will provide to the extent practical, results for each survey platform, namely, helicopter services, fixed wing services and other services.

#### THREE YEAR REVENUE GROWTH SUMMARY



\* 2007 Stub is composed of a three month period ending July 31, 2007 and a two month period ending September 30, 2007

## 2.2 BUSINESS STRATEGY

Our strategy has not changed materially over the past three years; we want to become the preferred supplier of airborne geophysical survey technologies and services in the world. Our strategy has three components:

1. **Establish ourselves internationally** – this means having enough airborne systems to cover the world, and a broad enough range of technologies and platforms to appeal to exploration companies on all continents, all climates and all terrains.
2. **Find new applications for our technologies** – this means expanding our addressable market of clients. We began this with Petroleum Services and will continue it with Environmental Services applications such as UXO remediation and groundwater exploration.
3. **Explore other, complimentary, technologies** – this means looking for new technologies that are either complimentary with our existing technologies, or complimentary with our existing service delivery model.

## SELECTED FINANCIAL INFORMATION

(in thousands of Canadian dollars)	Quarter Ended		Change
	31-Dec-08	31-Dec-07	
<b>Revenue</b>	<b>11,298</b>	11,197	101
<b>Net Income/(loss)</b>	<b>(1,514)</b>	121	(1,635)
<b>Total assets</b>	<b>68,660</b>	59,331	9,329
<b>Long Term Liabilities</b>	<b>386</b>	3,126	(2,740)

While revenue increased only marginally (one percent), our net income declined from \$0.1 million in Q1-F08 to a loss of \$1.5 million in Q1-F09. This is primarily due to reduced margins (especially in our fixed wing business) and increase general and administrative costs resulting from increased staffing that took place throughout 2008 and a significant provision against collectability of a large receivable balance. These issues are discussed in more detail throughout this MD&A.

## 3 First Quarter Operating Results

### 3.1 OVERVIEW AND HIGHLIGHTS

In Q1-F09, we recorded consolidated revenue growth of 0.9 per cent over Q1-F08. Helicopter services grew by 10.0% offset by a decline of 21.8% in fixed wing services. Other services (Geophex revenue) contributed \$0.5 million in revenue for the quarter. A more detailed discussion on these variances is noted below.

Gross profit in the quarter was \$3.0 million, or 26.8 per cent of revenue. Our gross profit percentage declined from 35.0 per cent of revenue in Q1-F08 due to (a) a significant decline in fixed wing revenue which resulted in reduced gross profit due fixed costs taking up a higher percentage of gross margin; and (b) ongoing reduced field productivity in the helicopter services segment and, to a lesser extent, start-up

costs related to gravity based fixed wing services which were introduced in the quarter. Issues related to productivity primarily relate to mobilizing helicopter systems to increasingly remote areas around the globe have been raised in prior quarters and, while productivity has improved are still not up to historic levels.

Cash operating costs increased in Q1-F09 compared to the Q1-F08 primarily due to increased general and administrative expense (primarily staffing costs as well as a large provision against collectability of a receivable) offset somewhat by favourable exchange rate variances. As a result, we reported a loss of \$1.5 million after tax, or \$0.04 per share. However, operating cash flow for the period remained positive at \$1.1 million, or \$0.03 per share.

In the quarter, the effect of the economic slowdown started to impact our operations with average revenue per line kilometer declining significantly in our fixed wing business and our backlog showing a decline to \$14.0 million at December 31, 2008. As a result, management has taken action after the end of the quarter reducing our overall workforce by approximately 20% in the form of permanent and temporary headcount reductions (see Outlook below for additional discussion).

### 3.2 FLEET EXPANSION

Beginning in the fall, we slowed the pace of expansion in anticipation of the slowing economy. A total field gravity system was fitted to one of our multi-sensor magnetic aircraft and began production in the South Pacific. A second gravity system is scheduled for delivery in February 2009. . Our active fleet is now comprised of 27 systems; 17 helicopter based and 10 fixed wing based.

#### AIRBORNE FLEET SUMMARY

	Helicopter	Fixed wing	Total
<b>AeroTEM</b>	13		13
<b>Impulse/GEM-2A</b>	2		2
<b>Magnetics</b>			
<b>single sensor</b>	1	5	6
<b>multi-sensor</b>	1	4	5
<b>multi-sensor + gravity</b>		1	1
<b>Total</b>	17	10	27

### 3.3 REVENUE BY GEOGRAPHY

The pace of globalization of our units continued from year-end into the first quarter. As of December 31, 2008, we had mobilized helicopter units in North and South America, Europe, Africa and Asia. During the same period, we continued to operate fixed wing units in Australia & the South Pacific, Africa and North America.

With the recent acquisitions of UTS Geophysics and Geophex Ltd., our revenue outside of Canada has grown significantly and in Q1-F09 represented 85 per cent of our total revenue.

## REVENUE BY GEOGRAPHY

Three Months Ended December 31, 2008

(thousands of Canadian dollars)

	Canada	Australia	RoW	Total	
Helicopter services	\$ 1,500	\$ 278	\$ 5,069	\$ 6,847	61%
Fixed wing services	155	1,653	2,111	3,919	35%
Other services	-	-	532	532	5%
<b>Total Revenue - Aeroquest Group</b>	<b>\$ 1,655</b>	<b>\$ 1,931</b>	<b>\$ 7,712</b>	<b>\$ 11,298</b>	<b>100%</b>
	15%	17%	68%	100%	

## 3.4 CONSOLIDATED RESULTS

In Q1-F09, consolidated revenue was \$11.3 million, up \$0.1 million or 1% over Q1-F08. Revenue from helicopter services was \$6.9 million, up \$0.6 million or 10% over Q1-F08. However, revenue from fixed wing services was \$3.8 million, a decline of \$1.1 million or 22% over Q1-F08.

## REVENUE & GROSS MARGIN

(in thousands of Canadian dollars)	Three Months Ended		
	31-Dec-08	31-Dec-07	Change
<b>Revenue</b>			
Helicopter services	<b>6,943</b>	6,307	636
Fixed wing services	<b>3,823</b>	4,890	(1,067)
Other services	<b>532</b>	-	532
	<b>11,298</b>	11,197	101
<b>Cost of sales</b>			
Helicopter services	<b>4,844</b>	3,909	935
Fixed wing services	<b>3,360</b>	3,371	(11)
Other services	<b>166</b>	-	166
	<b>8,370</b>	7,280	1,090
<b>Gross profit</b>	<b>2,928</b>	3,917	(989)
<b>Gross margin</b>			
Helicopter services	<b>30.2%</b>	38.0%	
Fixed wing services	<b>12.1%</b>	31.1%	
Other services	<b>68.8%</b>		
Gross profit margin %	<b>25.9%</b>	35.0%	

Consolidated cost of sales was \$8.4 million in Q1-F09, or 74% of consolidated revenue, compared to \$7.3 million or 65 per cent of consolidated revenue in the Q1-F08. Gross margins in Q1-F09 declined by 9 percentage points to 26%, as compared to 35% in Q1-F08.

Gross margin in helicopter services was 30% in Q1-F09, as compared to 38% in the Q1-F08. The productivity issues experienced in the quarter with the AeroTEM units (as noted previously) have improved over the fourth quarter last year but still lag behind the first quarter's more historic levels and thus contributed to the compression in the gross margin of the helicopter services segment.

Gross margin in fixed wing services was \$0.5 million, or 12% of revenue in the current quarter as compared to 31% per cent in Q1-F08. The decline in fixed wing gross margin in the quarter is primarily attributable to higher fixed costs in fixed wing cost of sales combined with start-up costs related to the gravity based operations that resulted in reduced margins in the quarter.

### 3.5 CASH OPERATING COSTS

Cash operating costs in Q1-F09 totaled \$3.1 million, an increase of \$1.1 million, or 62% from \$1.9 million over Q1-F08. This increase is primarily due to the following: 1) increased staffing levels and other general and administrative costs of \$1.4 million resulting from increased staffing levels in our airborne services operations between December 31, 2007 and December 31, 2008 as well as the acquisition of Geophex on December 31, 2007 and 2) A provision against collectability of a large receivable owing to the Company of \$1.3 million. We are still addressing all options to collect this balance but it appears that the customer does not have the ability to pay the receivable and thus a provision was booked in the quarter against collectability.

Offsetting the increase in general and administrative expense was a net change in foreign exchange gain of \$1.1 million over Q1-F08. The foreign exchange gain resulted from the appreciation in the United States Dollar in the first quarter as much of our revenue is denominated in United States dollars.

#### CASH OPERATING COSTS

(in thousands of Canadian dollars)	Three months ended		
	31-Dec-08	31-Dec-07	Change
General & administrative expense	4,350	1,992	2,358
Foreign exchange (gain) loss	(1,205)	(56)	(1,149)
<b>Total cash operating costs</b>	<b>3,145</b>	<b>1,936</b>	<b>(1,149)</b>
% of revenue	27.8%	17.3%	

### 3.6 OPERATING PROFIT AND EBITDA

EBITDA in Q1-F09 was (\$0.3) million, a decrease of \$1.9 million over Q1-F08. EBITDA is down primarily due to the gross margin compression quarter over quarter combined with the increase in cash operating costs discussed previously. The decrease in stock-based compensation expense in Q1-F09 of \$0.3 million relates to both the timing and amount of the grants versus Q1-F08. This issue is discussed further in note 10 below.

Depreciation and amortization charges totaled \$1.7 million in Q1-F09, an increase of \$0.3 million from Q1-F08. The increase in depreciation and amortization in the period is a result of depreciation related to airborne systems acquired in the last fiscal year combined with the increased depreciation and amortization related to the Geophex acquisition.

Operating loss in Q1-F09 was \$2.0 million compared with an operating profit of \$0.2 million in Q1-F08.

## OPERATING PROFIT AND EBITDA

(in thousands of Canadian dollars)	Three months ended		
	31-Dec-08	31-Dec-07	Change
<b>Gross profit</b>	<b>2,928</b>	3,917	(989)
Cash operating costs	<b>3,145</b>	1,936	1,209
Stock-based compensation expense	<b>104</b>	382	(278)
<b>EBITDA</b>	<b>(321)</b>	1,599	(1,920)
EBITDA as a % of revenue	<b>(0.6%)</b>	8.3%	(107%)
Depreciation of capital assets	<b>802</b>	512	290
Amortization of intangible assets	<b>885</b>	892	(7)
<b>Operating profit/(loss)</b>	<b>(2,008)</b>	195	(2,203)
Operating profit as a % of revenue	<b>(18%)</b>	1.7%	

### 3.7 NET INCOME

Net loss for Q1-F09 was \$1.5 million, or \$0.04 per share compared to net income of \$0.1 million, or \$0.00 per share in Q1-F08.

Our provision for recovery of income taxes for Q1-F09 was \$0.4 million generating an apparent tax rate of 38.8% in the quarter. While this rate is an increase from the 30.4% in Q1-F08, it represents a reflection of the blend of statutory tax rates in Canada, Australia and USA, and the fact that most of our amortization expense is not deductible for tax purposes.

## NET INCOME

(in thousands of Canadian dollars)	Three months ended		
	31-Dec-08	31-Dec-07	Change
<b>Operating profit</b>	<b>\$ (2,008)</b>	\$ 195	\$ (2,203)
Interest expense (income)	<b>(56)</b>	12	(68)
Provision for income taxes	<b>(438)</b>	63	(501)
<b>Net income</b>	<b>\$ (1,514)</b>	\$ 120	\$ (1,634)
Earnings per share - basic	<b>\$ (0.04)</b>	\$ -	\$ (0.04)
Apparent tax rate	<b>38.8%</b>	30.4%	

## 4 Comparative Selected Financial Information

(Financials in 000's except /share data)	(3Mo) Q1-Dec 08	(3Mo) Q4-Sep 08	(3Mo) Q3-Jun 08	(3Mo) Q2-Mar 08	(3Mo) Q1-Dec 07	(2mo) Q2-Sep 07	(3 Mo) Q1-Jul 07	(3Mo) Q4-Apr 07	(3Mo) Q3-Jan 07
Revenue	\$ 11,298	\$ 16,017	\$ 14,537	\$ 13,295	\$ 11,197	\$ 9,944	\$ 9,355	\$ 5,937	\$ 4,098
Operating profit	\$ (2,008)	\$ 2,024	\$ 590	\$ 1,613	\$ 195	\$ 1,444	\$ 1,658	\$ 782	\$ 412
Net income	\$ (1,514)	\$ 1,603	\$ 304	\$ 815	\$ 121	\$ 1,046	\$ 938	\$ 321	\$ 210
Weighted average common shares	33,597	33,785	34,662	32,553	27,603	22,702	21,538	15,787	15,838
Earnings per share (basic)	\$ (0.04)	\$ 0.05	\$ 0.01	\$ 0.03	\$ 0.00	\$ 0.05	\$ 0.04	\$ 0.02	\$ 0.01
Earnings per share (diluted)	\$ (0.04)	\$ 0.05	\$ 0.01	\$ 0.03	\$ 0.00	\$ 0.04	\$ 0.04	\$ 0.02	\$ 0.01
Operating cash flow/share	\$ 0.03	\$ 0.05	\$ 0.06	\$ 0.09	\$ 0.06	\$ 0.08	\$ 0.08	\$ 0.05	\$ 0.03
Systems available for use at period end *	27	28	27	23	19	21	20	9	9
Fixed-wing systems	10	11	11	9	8	10	10		
Helicopter systems	17	17	16	14	11	11	10	9	9
AeroTEM systems included in above	13	13	11	8	8	8	7	6	6
Line kilometres flown during period									
Helicopter systems	59,150	74,100	73,200	59,000	47,700	38,000	51,100	44,800	25,600
Fixed-wing systems	316,000	520,000	457,700	362,000	408,900	351,000	158,000		
Contract back-log (CAD\$ thousands)									
Helicopter systems	\$ 2,700	\$ 6,900	\$ 5,100	\$ 5,900	\$ 8,000	\$ 8,400	\$ 12,000	\$ 8,300	\$ 3,500
Fixed-wing systems	\$ 9,700	\$ 9,200	\$ 11,900	\$ 11,400	\$ 11,000	\$ 7,900	\$ 11,000	\$ -	\$ -
Other	\$ 1,600	\$ 1,900	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Total Backlog	\$ 14,000	\$ 18,000	\$ 17,000	\$ 17,300	\$ 19,000	\$ 16,300	\$ 23,000	\$ 8,300	\$ 3,500

\* excluding gamma ray spectrometers

## 5 Liquidity and Capital Resources

Our cash balances, have declined by \$1.2 million from \$15.4 million at September 30, 2008 to \$14.2 million at December 31, 2008. As well, our current liabilities have increase slightly from \$10.6 million to \$10.8 million in the same period. Cash and short-term investments are currently invested in liquid Canadian dollar, Australian dollar or U.S. dollar denominated bank guaranteed securities with maturities no greater than ninety days.

### 5.1 OPERATING ACTIVITIES

Before changes in non-cash working capital, operating cash flow was flat at \$0.0 million in Q1-F09, a decrease of \$1.6 million from Q1-F08. Operating cash flow is tracking lower as a result of the reduced net income and lower non-cash operating expenses (notably stock based compensation).

Changes in non-cash working capital generated \$1.1 million in Q1-F09, as compared to generating \$3.6 million in Q1-F08. The difference in non-cash working capital is primarily a result of receivable balances increasing by \$0.1 million in Q1-F09 compared with receivable collections of \$2.2 million in Q1-F08.

### 5.2 INVESTING ACTIVITIES

Investment activities in Q1-F09 consumed \$2.1 million of cash, substantially all of which was for the acquisition of capital assets. In Q1-F08, investment activities consumed \$3.3 million of cash, \$1.2 million for capital assets and \$2.0 million related to the acquisition of Geophex on December 31, 2007.

### 5.3 FINANCING ACTIVITIES

Included in financing activities is the repurchase of 75,000 common shares under our Normal Course Issuer Bid for a total cost of \$0.1 million. Payments under our capital leases consumed \$0.1 million of cash compared with \$0.2 million of cash in the first quarter last year.

Also included in the financing activities in the first quarter last year was \$0.6 million of cash generated from the issuance of common shares.

### 5.4 CAPITAL RESOURCES

We have separate credit facilities and associated financial covenants in place for our Canadian and Australian operations. At December 31, 2008, no amounts had been drawn on either facility.

We believe that cash flow from operations and unused operating facilities will be sufficient to fund our working capital, capital expenditure requirements and debt service costs (if applicable) for the near future.

### 5.5 SUMMARY FINANCIAL POSITION

At December 31, 2008, we had current assets of \$24.9 million and current liabilities of \$10.8 million. Net working capital was \$14.0 million, a decrease of \$2.3 million from September 30, 2008 and an increase of \$13.7 million from December 31, 2007. The increase in net working capital from the Q1-F08 is primarily the result of the equity issue closing in Feb 2008 raising gross proceeds of \$20 million. Offsetting this increase in cash was expenses related to the equity issue of \$2.0 million, the repayment of outstanding promissory notes of \$5.3 million due from the acquisition of UTS and Geophex in 2007, and repurchase of shares under the Normal Course Issuer Bid of \$3.3 million throughout the last fiscal year and into the first quarter of this year (see note 10 below).

#### CASH & WORKING CAPITAL CHANGES

(in thousands of Canadian dollars)	31-Dec-08	30-Sep-08	31-Dec-07	Change from year-end	Change from 31-Dec-07
<b>Cash</b>	<b>\$14,202</b>	\$15,373	7,434	(\$1,171) (8%)	\$6,768 91%
Non-cash current assets	<b>10,688</b>	11,584	8,619	(896) (8%)	2,069 24%
<b>Current assets</b>	<b>24,890</b>	26,957	16,053	(2,067) (8%)	8,837 55%
Less: Current liabilities	<b>10,839</b>	10,626	15,731	213 2%	(4,892) (31%)
<b>Net working capital</b>	<b>\$14,051</b>	\$16,331	\$322	(\$2,280) (14%)	\$13,729 4264%
Current ratio	<b>2.3</b>	2.5	1.0	(9%)	125%

## **6 Risks and Uncertainties**

### **6.1 Foreign currency exchange risk**

We record transactions and prepare our financial statements in Canadian dollars. For Q1-F09, we maintained operations in Canada, Australia, and the United States with business conducted in other countries. International operations are considered financially and operationally self-sustaining. Accordingly, our assets and liabilities of our foreign subsidiaries are translated into Canadian dollars at period end exchange rates. Revenue and expense items of our foreign subsidiaries are translated into Canadian dollars at monthly exchange rates.

Significant portions our expenditures are denominated in these currencies and therefore, a natural hedge exists for much of this exposure. However, a net exposure exists for Australian and United States dollars cash flows that can affect earnings as the Canadian dollar exchange rate changes in relation to these currencies.

Other comprehensive income includes a currency translation adjustment related to our net investment in self-sustaining subsidiaries.

While our foreign exchange policy does permit active hedging of any portion of our net foreign currency cash flow beyond the natural hedges identified and discussed above, no active hedges were employed in the quarter. As a result, we do not employ any derivative products.

### **6.2 INTEREST RATE RISK**

Since we did not have any interest bearing debt in the first quarter, interest rate volatility did not have a direct impact on our operations.

### **6.3 OTHER LITIGATION**

On August 19, 2008 we announced that we had been served with a Statement of Claim by Geotech Ltd., Geotech Airborne Limited and Geo Equipment Manufacturing Ltd. (the "Geotech Claim") filed in the Ontario Superior Court of Justice. The Geotech Claim includes \$50 million in general damages and \$1 million in punitive damages from Aeroquest, three of its subsidiaries and another party for an alleged breach of contractual undertakings and misappropriation of certain confidential information. The claim relates to the activities of a former employee of Geotech Ltd. during the course of his employment with Aeroquest and certain undertakings given by the employee and Aeroquest in connection therewith. On September 22, 2008, we filed a Statement of Defence and Counterclaim indicating, among other things, that the Claim was completely without merit and Geotech's sole reason for filing the claim was to damage the business, operations and reputation of Aeroquest. We have counterclaimed for a total of \$21 million for abuse of process and damages. Both the Geotech Claim and Defence and Counterclaim remain unresolved as of December 31, 2008.

We are of the view that the Geotech Claim is completely without merit and thus no amount has been recognized in our financial statements related to this claim.

In addition to the above, we are involved in various claims and litigation arising in the normal course of business. While the outcome of these matters is uncertain and there can be no assurance that such matters will be resolved in our favour, we do not currently believe that the outcome of adverse decisions in any pending or threatened proceedings related to those or other matters or amount which may be required to pay by reason thereof would have a material adverse impact on our financial position, results of operations or liquidity.

## **7 Off-Balance Sheet Arrangements**

We have not entered into any off balance sheet arrangements, other than previously disclosed, that have, or are reasonably likely to have, an impact on the current or future results of operations or the financial condition of our company.

## **8 Transactions with Related Parties**

For the three months ended December 31, 2008 and 2007 we did not make any payments to companies or any other parties related to our officers or directors .

## **9 Cancellation of Proposed Spectrem Air Transaction**

On September 24, 2008 we announced that we had signed a non-binding letter of intent with Spectrem Air Limited (“Spectrem”) a member of the Anglo American group of companies, one of the world’s largest mining and natural resource groups, to create a long-term outsourcing arrangement whereby Spectrem would outsource substantially all of its current airborne geophysical surveying business to Aeroquest. Details of the letter of intent were outlined in the press release dated that same day, and in our year-end MD&A and audited financial statements.

Due to the extraordinary market conditions that have occurred since the signing of the letter of intent, including reductions in commodity prices and corresponding anticipated reductions in exploration spending, both parties have agreed that the economic assumptions driving the transaction have fundamentally changed. As a result, we announced on February 4, 2009 that the parties have mutually agreed to terminate the letter of intent.

However, our relationship with Spectrem remains strong and we will continue to cooperate on business initiatives going forward as well as ongoing technology development around our AeroTEM™ technology.

## 10 Share Capital

At December 31, 2008, we had 33,613,309 Common Shares issued and outstanding and as at the same date the Common Share stock options held by directors, officers, employees, consultants, and brokers were as follows:

	Number of options	Exercise price	Expiry date
Issued options held by directors, officers and consultants under the Company Stock Option Plan	32,500	\$ 0.50	October 28, 2009
	10,000	\$ 2.00	October 28, 2009
	5,000	\$ 0.50	March 1, 2010
	15,000	\$ 2.00	June 30, 2010
	27,500	\$ 0.50	June 30, 2010
	250,000	\$ 0.50	February 9, 2011
	50,000	\$ 0.50	March 28, 2011
	427,500	\$ 0.60	June 30, 2011
	10,000	\$ 0.75	October 3, 2011
	15,000	\$ 0.75	October 13, 2011
	227,000	\$ 2.34	September 30, 2012
	30,000	\$ 3.15	January 15, 2013
	50,000	\$ 1.70	July 16, 2013
Total outstanding	1,149,500	\$ 1.06	
Total exercisable	936,167	\$ 0.78	

We have a Restricted Stock Unit (RSU) plan under which the Board of Directors of our Company may grant RSU units of our Company to qualified directors, officers, employees, and persons providing ongoing services to our Company. The strike price of these units will not be less than the market price of the common shares at the time of the grant. The units vest over a three year period with one third vesting in each of the three years on the anniversary date of the grant. At December 31, 2008 there were 323,332 RSU's outstanding. No RSU's were granted in the quarter. However, 173,335 previously granted RSU's vested in the quarter and were converted to Common Shares (representing one third of the existing RSU's granted in 2006 and 2007).

On December 13, 2007, we received approval from the TSX Venture Exchange for a normal course issuer bid whereby we were given the right to purchase up to 1,374,660 of our common shares on the open market for cancellation terminating on December 16, 2008.

On July 24, 2008, we delisted from the TSX-Venture Exchange and commenced trading on the Toronto Stock Exchange (TSX). Concurrent with the graduation to the TSX, the TSX approved an amendment to the Normal Course Issuer Bid of December 13, 2007 which increased the number of shares that can be acquired pursuant to the bid to 1,653,336 common shares (an increase of 278,676 common shares).

In the current quarter, we purchased 75,000 shares for cancellation for a total consideration of \$0.1 million. The share capital value and outstanding shares have been adjusted to reflect this cancellation. The Normal Course Issuer Bid expired in December, 2008 as was not renewed.

## 11 Internal Controls and Disclosure Controls & Procedures

We maintain a system of internal controls over financial reporting designed to safeguard assets and ensure that financial information is reliable. We also undertake ongoing evaluations of the effectiveness of our internal controls over financial reporting and, where appropriate, implement enhancements. We also file annual and quarterly certifications in accordance with National (formerly Multilateral) Instrument 52-109 certifying that our CEO and CFO have reviewed our financial statements and MD&A to ensure that they do not contain an untrue fact or omit a material fact, and that they present fairly the financial position, results of operation and cash flows of our company.

We also maintain a system of disclosure controls and procedures designed to ensure the reliability, completeness and timeliness of the information we disclose in all of our public disclosure documents, including this MD&A. These controls are designed to ensure that information required to be disclosed by Aeroquest is recorded, processed, summarized and reported on a timely basis, as required by law, and is accumulated and communicated to Aeroquest's senior management and board of directors to allow timely decisions on required disclosure. In addition, our Audit Committee and Board of Directors provide an oversight role with respect to all public disclosure and review all financial statements, press releases, and MD&A, including this one. Our annual and quarterly certifications also confirm that disclosure controls exist, that we have evaluated their effectiveness, and that we have reported to you our conclusions about their effectiveness, especially during the period covered by this MD&A.

In 2008, the Canadian Securities Authorities announced changes to NI 52-109 that will impact our reporting effective for fiscal quarters ending after December 15, 2008. Changes that have an impact include the following new requirements that we:

- evaluate the effectiveness of Internal Controls over Financial Reporting ('ICFR');
- use a control framework in the design of their ICFR and such framework must be disclosed; and
- disclose all material weaknesses, their financial impact (actual or potential), and plans or actions to remediate such weaknesses.

In the quarter, we engaged external advisors to assess the impact of these changes on our current evaluation of ICFR and disclosure control and procedures. As a result, our Chief Executive Officer and Chief Financial Officer evaluated the effectiveness of our disclosure controls and procedures and internal control over financial reporting, and determined that they were effective as of December 31, 2008.

## **12 Critical Accounting Policies and Estimates**

Here and in our Consolidated Financial Statements (including the Notes) we have identified the accounting policies and estimates that are critical to the understanding of our business and the results of our operations.

### **12.1 ACCOUNTING POLICY CHANGES**

On October 1, 2007, we adopted new Canadian accounting standards for financial instruments disclosures and presentation, sections 3862 and 3863, that require the Company to increase disclosure on the nature, extent and risk arising from the financial instruments and how the entity manages those risks.

Also on October 1, 2007, we adopted new Canadian accounting standards for capital management that specifies the disclosure of an entity's objectives, policies and procedures for managing capital, quantitative data about what it manages as capital, any externally imposed capital requirements and the consequences of non-compliance.

On October 1, 2008, we adopted new Canadian accounting recommendations for goodwill and intangible assets. The new recommendations provide guidance on when expenditures qualify for recognition as intangible assets. Our results of operations were not materially affected by the new recommendations.

### **12.2 FOREIGN ACCOUNTING STANDARDS**

The results of operations of our subsidiary UTS Geophysics Pty Ltd. are prepared in accordance with Australian equivalents to International Reporting Standards (AIFRS) and then adjusted to Canadian GAAP standards for consolidation.

### **12.3 USE OF ESTIMATES**

In the preparation of our financial statements we are required to make some estimates of the fair value of certain transactions, or the likely impact of certain events on our results of operations. The following is a summary of the areas that require the most significant use of estimates:

#### *BAD DEBT EXPENSE*

We are required, each reporting period, to make an estimate of the likelihood that we will collect all of the accounts receivable owed to us. This requires that we exercise some judgment about the timing and likelihood of payment on accounts that have become past due and record a provision for those accounts where there is significant risk of collection. We review all outstanding accounts receivable on at least a monthly basis to establish whether or not any action is required.

#### *FOREIGN CURRENCY TRANSLATION*

We record revenue in Canadian, Australian, and United States dollars, as well as in Euros and, at times,

other currencies. Changes in the exchange rates between currencies may create a change in the revenue, or profit on a survey between the time we record revenue and the time we disburse for costs. In addition, we translate all amounts into Canadian dollars for the purposes of financial reporting.

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 monthly average exchange rate.
- At the period 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.

### *GOODWILL AND INTANGIBLE ASSETS*

Goodwill represents the difference between the price paid and the fair value attributed to tangible and intangible assets upon the acquisition of businesses. Goodwill is not amortized but tested for impairment annually or more frequently if changes in circumstances indicate a potential impairment. The impairment test first consists of a comparison of the fair value of the reporting unit to which goodwill is assigned with its carrying amount. When the carrying amount of a reporting unit exceeds its fair value, the fair value of the reporting unit's goodwill is compared with its carrying amount to measure the amount of the impairment loss, if any. Any impairment loss is charged to earnings in the period in which the loss is incurred. The Corporation uses the discounted cash flow method to determine the fair value of reporting units.

Intangible assets are amortized over the useful life of the underlying asset. No amortization is recorded where the asset has an infinite life or is not determinable. Any intangible assets not subject to amortization are tested annually for any impairment. 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 undiscounted 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.

Amortization is recorded on a straight line basis over the estimated useful life of the assets. Customer relationships and technology are amortized over seven years, sales backlog is amortized over one year and any trade names are not amortized.

### *INCENTIVE COMPENSATION*

We have Incentive Plans of which all employees are members. One such Incentive Plan establishes Target and Stretch performance levels against which the performance of the Company and its senior managers are measured. Each quarter we accrue an amount equal to one quarter of the estimated Incentive Plan payout, based on the Company meeting its Target performance levels. The actual amount

paid could be different from the amounts estimated in interim periods requiring an adjustment, usually in the fourth quarter of the year.

The fair value of stock-based compensation is estimated using a Black-Scholes option pricing methodology. The principal assumptions required for the Black-Scholes methodology are assumptions about the expected life of the options, and the expected volatility and dividend policy of the underlying stock over the expected life of the options.

#### **12.4 INTERNATIONAL FINANCIAL REPORTING STANDARDS ('IFRS')**

In 2006, the Canadian Accounting Standards Board ("AcSB") published a new strategic plan that will significantly affect financial reporting requirements for Canadian public and publicly accountable companies. The AcSB strategic plan outlines the convergence of Canadian GAAP with IFRS over a five year period ended in 2011. On May 9, 2008, the Canadian Securities Administrators issued CSA Staff Notice 52-320 which provided guidance on disclosure related to each financial reporting period in the three years before the first year for which a public company prepares its financial statements in accordance with IFRS. As we will begin reporting our financials under IFRS in our September 30, 2012 fiscal year, the staff notice requires disclosure on the key elements and timing of our IFRS changeover plan beginning in this interim MD&A.

There are several phases to that we will have to complete on the path to implementing IFRS:

- The initial impact assessment and scoping phase including the identification of significant differences between existing Canadian GAAP and IFRS as relevant to the Company's specific instance;
- The key elements phase including the identification, evaluation and selection of accounting policies necessary for the changeover to IFRS. As well, this phase includes other operational elements such as information technology, internal control over financial reporting and training;
- Finally, the embedding phase that will integrate the solutions into our underlying financial systems and processes that are necessary for the Company to changeover to IFRS.

We have engaged third party consultants to assist in this process. As of December 31, 2008, we have begun the initial impact assessment phase. We are not yet in a position to quantify the result (if any) of this study but will continue to report on this process in subsequent MD&A.

## **13 OUTLOOK**

### **13.1 SHORT-TERM**

We believe that the economic slowdown that has led to depressed commodity prices will continue in the short-term. Global exploration spending in both mineral and petroleum exploration has slowed and we expect it to remain below last year's levels throughout the balance of this calendar year.

To address this slowdown, we have established the following four priorities for the balance of the 2009 fiscal year:

1. Improve efficiencies in our field operations;
2. Expand our success in select commodities, including gold, uranium and petroleum services;
3. Make meaningful and demonstrable progress in environmental services; and
4. Remain opportunistic.

Other opportunities for airborne surveys will continue to grow, especially in the environmental and unexploded ordinance (UXO) areas as we anticipate government spending in these areas will continue to grow. It is doubtful though that such growth will make up for the slowdown in the mineral and petroleum industries.

In response to the slowdown, we have taken measures to reduce our cost structure including a decision to reduce our global workforce by 20% in January, 2009 through a combination of permanent reductions and temporary layoffs. This decision was not taken lightly but was required to properly size our operations to the forecasted business in the near future. We will continue our strategy of focusing on operational efficiencies and carefully managing our cash until economic conditions improve.

### **13.2 MEDIUM TO LONG-TERM**

Looking forward, our objective is to use our short term tactics to position ourselves to react quickly once the recovery in our core markets occurs. Currently, we do not see any impediments to achieving this goal and we believe we have the financial resources to ride out the current economic storm. We believe that the current market pressures that exist in the minerals and oil & gas markets are short term and ongoing depressed commodity prices are not realistic in the medium or long term.