



**AEROQUEST INTERNATIONAL LIMITED  
INTERIM MANAGEMENT'S DISCUSSION & ANALYSIS (MD&A)**

For the three and nine months ended June 30, 2010.

# AEROQUEST INTERNATIONAL LIMITED



## MANAGEMENT'S DISCUSSION & ANALYSIS FOR THE PERIOD ENDING JUNE 30, 2010

*Issued on August 5, 2010*

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 and nine months ended June 30, 2010 ("Q3-F2010" and "YTD-F2010" respectively) compared with our operating results for the three and nine months ended June 30, 2009 ("Q3-F2009" and "YTD-F2009"). It also compares our balance sheet as at June 30, 2010 to our September 30, 2009 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., Optimal Geomatics Inc., Aeroquest (UK) Limited and AeroKaz LLP (collectively, "the Company"), with all material 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 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 the Company or persons acting on behalf of the Company 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 10 to the consolidated financial statements for the year.

## 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, and gain or loss on foreign exchange.

## 2 Our Business, Strategy & Outlook

### 2.1 AEROQUEST'S BUSINESS

We are a world leader in the development and operation of innovative and proprietary airborne geoscience survey platforms serving the mineral and petroleum exploration industries, and the environmental and infrastructure industries. We operate a large fleet of airborne geophysics and geomatics survey systems utilizing two separate delivery platforms; rotary and fixed wing aircraft. Our geophysics survey technologies include time-domain and frequency-domain electro-magnetics (including our proprietary AeroTEM, time-domain electromagnetic technology), gravity, magnetic, and radiometric systems. Our geomatics survey technologies include LiDAR and ortho-rectified digital and film photography. Our combination of geoscience technologies and airborne platforms give us one of the broadest arrays of product and service offerings in our industry in the world today. We are active on virtually all continents assisting our clients in investigating features at or near the earth's surface and to depths of several kilometers beneath the earth's surface.

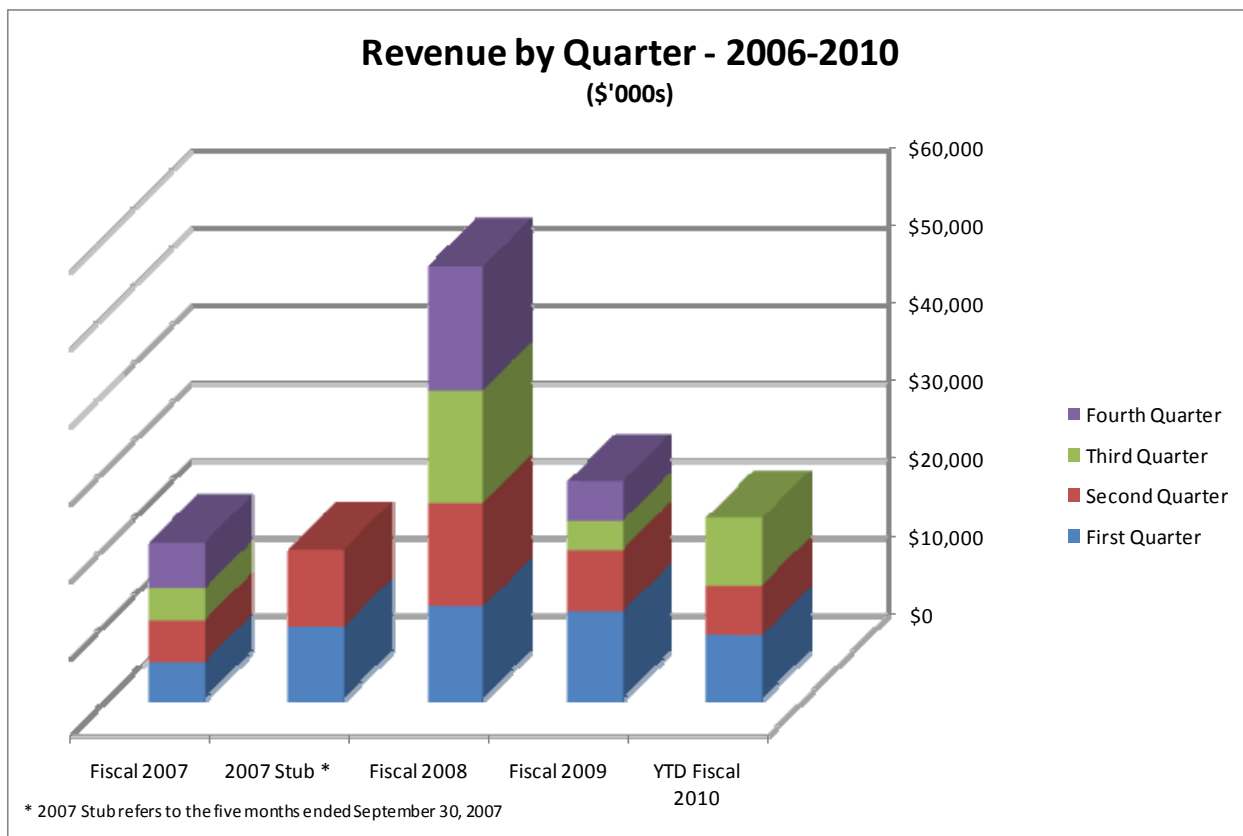
### 2.2 SELECTED COMPARATIVE QUARTERLY FINANCIAL INFORMATION

(Financials in 000's except /share data)	Fiscal 2010			Fiscal 2009				Fiscal 2008
	Q3-Jun 10	Q2-Mar 10	Q1-Dec 09	Q4-Sep 09	Q3-Jun 09	Q2-Mar 09	Q1-Dec 08	Q4-Sep 08
Revenue	\$ 8,646	\$ 6,487	\$ 8,174	\$ 5,099	\$ 3,651	\$ 7,963	\$ 11,298	\$ 16,017
Operating profit/(loss)	\$ (2,480)	\$ (3,122)	\$ (3,193)	\$ (6,362)	\$ (4,601)	\$ (1,698)	\$ (2,008)	\$ 2,024
Net income	\$ (1,794)	\$ (2,268)	\$ (2,266)	\$ (4,657)	\$ (3,498)	\$ (953)	\$ (1,514)	\$ 1,603
Weighted average common shares	36,986	36,944	36,776	33,725	33,627	33,613	33,597	33,785
Earnings per share (basic)	\$ (0.05)	\$ (0.06)	\$ (0.06)	\$ (0.14)	\$ (0.11)	\$ (0.03)	\$ (0.04)	\$ 0.05
Earnings per share (diluted)	\$ (0.05)	\$ (0.06)	\$ (0.07)	\$ (0.13)	\$ (0.11)	\$ (0.03)	\$ (0.04)	\$ 0.05
Operating cash flow/share	\$ 0.07	\$ (0.02)	\$ (0.04)	\$ (0.05)	\$ (0.06)	\$ 0.02	\$ 0.03	\$ 0.05
Total assets	\$ 49,040	\$ 50,971	\$ 56,162	\$ 57,740	\$ 60,240	\$ 64,624	\$ 68,660	\$ 69,540
Long term liabilities	\$ 19	\$ 54	\$ 136	\$ 224	\$ 252	\$ 316	\$ 486	\$ 470
Systems available for use at period end *	26	28	28	29	27	28	27	28
Fixed-wing systems	9	9	9	10	10	11	10	11
Helicopter systems	15	17	17	17	17	17	17	17
AeroTEM systems included in above	11	13	13	13	13	13	13	13
Geomatics systems	2	2	2	2	-	-	-	-
Line kilometres flown during period								
Helicopter systems	27,500	20,100	22,700	5,400	2,700	11,400	59,150	74,100
Fixed-wing systems	286,000	88,000	267,000	351,000	144,000	189,000	316,000	520,000
Contract back-log (CAD\$ thousands)								
Helicopter systems	\$ 2,700	\$ 1,700	\$ 2,000	\$ 1,100	\$ 100	\$ 1,000	\$ 2,700	\$ 6,900
Fixed-wing systems	\$ 8,200	\$ 3,800	\$ 1,600	\$ 2,700	\$ 5,600	\$ 5,600	\$ 9,700	\$ 9,200
Geomatics	\$ 3,600	\$ 4,700	\$ 7,400	\$ 6,700	\$ -	\$ -	\$ -	\$ -
Other	\$ 300	\$ 340	\$ 400	\$ 400	\$ 900	\$ 1,400	\$ 1,600	\$ 1,900
Total Backlog	\$ 14,800	\$ 10,540	\$ 11,400	\$ 10,900	\$ 6,600	\$ 8,000	\$ 14,000	\$ 18,000

\* excluding gamma ray spectrometers

We are finally beginning to see the effect of a recovering economy in our operating results. Greenfield exploration activity has begun to improve, notably in Africa and South East Asia. As a result, our Q3-F2010 revenue increased by \$4.9 million to \$8.6 million from \$3.7 million in Q3-F2009. Gross profit in Q3-F2010 was \$1.8 million, an increase of \$1.4 million from the \$0.4 million reported in Q3-F2009. Q3-F2010 net loss was \$1.8 million compared with Q3-F2009 loss of \$3.5 million. The reduction in net loss is due to several factors working at once, including improved year-over-year revenue in airborne geophysics, improved gross margin when compared to Q3-F2009 due to the fixed cost component of cost of sales applied to a lower revenue base in 2009 and foreign currency income compared with losses in the prior year.

Our cost reduction initiatives that began in our last fiscal year have resulted in a significant reduction in run-rate general and administrative expenses on a year over year basis. In particular, headcount reductions totaling 60 per cent of our staff took place in January, March and July of 2009 resulting in an annualized \$3.5 million reduction to our payroll burden. Other reductions to senior management salaries will also help to reduce our run rate operating costs. We have also reduced the ongoing general and administrative cost structure in our Optimal Geomatics subsidiary (now renamed Aeroquest Optimal) through a combination of headcount reductions, cost mitigation and sales of non-core assets. These issues are discussed in more detail throughout this MD&A.



## 2.3 BUSINESS STRATEGY

Our strategy is to become the preferred supplier of airborne geoscience survey technologies and services in the world. Our strategy has three components:

1. **Establish ourselves internationally** – Ours is a global industry with global opportunities; if we want to be the one that people turn to in order to get help in capitalizing on these opportunities, then we have to be ready and able to go anywhere. To date, we have successfully surveyed in over 50 countries around the globe and have completed surveys and positioned systems on every continent where commercial natural resource exploration activities occur.
2. **Find new applications for our technologies** – We will continue to develop various new markets where we can take advantage of the technologies we understand like in the Energy, Environmental Services and Infrastructure industries.
3. **Explore other, complementary, technologies** – Specifically, we are looking for new technologies that are either complimentary with our existing technologies, or complimentary with our existing service delivery model. Aerial geomatics technologies are examples of such complementary technologies. Aerial geomatics is similar to geophysics surveying except that the objects of interest in geomatics are at the earth's surface, whereas the objects of interest in geophysics are usually buried beneath the earth's surface. At the end of our fiscal 2009 year, we negotiated and closed the purchase of Optimal Geomatics Inc., giving us capabilities in two important remote sensing technologies; LiDAR and aerial photography.

## 2.4 OUTLOOK

Global spending in both mineral and petroleum exploration remains slow and we expect it to remain below the levels of 2007 and 2008 for fiscal 2010, albeit at higher levels than in 2009. Commodity prices are at levels that would normally stimulate exploration so we remain optimistic about the medium and long terms, but in the short term the exploration opportunities remain lower than normal as our customers manage their cash positions and continue to adopt a 'wait and see' attitude. We have downsized our business to reflect this reality and are working to maintain breakeven or better positions in each of our regional offices.

The outlook for the aerial geomatics segment remains positive in the long run as government organizations (especially in the United States) are required to replace aging and develop new infrastructure. The pace of new contract awards has slowed somewhat in the short term, a function of the existing uncertainties in general, but we expect that this is only temporary.

Notwithstanding the cautious optimism for the future, we remain focused on closely managing our costs. In the last fifteen months, we have aggressively reduced our cost structure including global workforce reductions of approximately 50 per cent of our geophysics survey staff, and the closure of one regional office in fiscal 2009. These decisions were not made lightly but were required to properly size our

operations to the forecasted business in the near future. This process of closely managing our cost structure continued into fiscal 2010. With the acquisition of Aeroquest Optimal, we are now presented with an opportunity to integrate back office operations, eliminate one set of public company costs and rationalize the cost structures between the geophysics and geomatics operations. We will continue to focus on operational efficiencies and carefully managing our cash as economic conditions improve.

We continue to look for other businesses that may be combined with our own to enhance our product offerings, geographical presence and range of technologies. We continue to believe that this market will present us with corporate acquisition opportunities that allow us to compress our strategic plan; allowing us to accomplish more in a shorter time frame.

Looking forward beyond one year, our objective is to use our short term tactics to position ourselves to react quickly once the recovery in our core markets takes hold. We continue to believe that the current market pressures that exist in the minerals and oil & gas markets are short term and ongoing depressed exploration expenditures are not realistic in the medium or long term.

### **3 Third Quarter Operating Results**

#### **3.1 OVERVIEW AND HIGHLIGHTS**

With the acquisition of Optimal Geomatics Inc. on September 30, 2009, we began to report our revenues, cost of sales and margins in the following three business segments:

- Airborne Geophysics –Aeroquest Surveys and UTS/Aeroquest (the former UTS Geophysics) businesses;
- Aerial Geomatics – comprising Aeroquest Optimal (the former Optimal Geomatics business); and
- Contract R&D – Aeroquest Sensortech (the former Geophex Ltd. business).

The Airborne Geophysics segment is further split into fixed wing and helicopter modes to distinguish between the two modes of airborne exploration.

In the third quarter we finally saw signs of economic recovery trickling down to greenfield exploration activities, especially in the emerging markets of Africa and South-East Asia. In Q3-F2010, we recorded an increase in consolidated revenue of 137 per cent over Q3-F2009. In the Airborne Geophysics segment, helicopter services increased by 565 per cent to \$2.2 million and fixed wing services increased by 24 per cent to \$3.6 million from their respective levels in Q3-F2009. The Aerial Geomatics segment contributed \$2.3 million in Q3-F2010. The Contract R&D segment contributed \$0.6 million in revenue for the quarter, an increase of 39 per cent to the level reported in Q3-F2009. A more detailed discussion on these variances is provided below.

Our cash balances decreased slightly to \$5.7 million at the end of Q3-F2010 from \$6.1 million at the end of our last fiscal year (September 30, 2009). However, cash balances did increase in Q3-F2010 by \$2.1 million from the \$3.6 million reported in Q2-F2010. Cash flow from operations in Q3-F2010 was positive \$2.6 million. As discussed below, cash flow from operations before changes in working capital was negative \$0.2 million and changes in non-cash working capital generated \$2.7 million of cash in the quarter. Capital expenditures for the quarter were \$0.4 million compared to \$0.6 million in Q3-F2009, reflecting

our efforts to minimize cash outflows. We expect capital expenditures to remain modest for the balance of fiscal 2010.

### 3.2 AIRBORNE FLEET SUMMARY

Beginning in the fall of 2008, we slowed the pace of expansion in anticipation of the slowing economy. In this most recent quarter, there were no new additions to the geophysics survey fleet. However, we took two of our older AeroTEM II systems off-line permanently in the quarter. These older systems are smaller diameter and of lower power. While they remain ideal systems for certain exploration targets, we do not believe that we need four of them going forward. Accordingly, we retired the two oldest systems. As an aside, we name all of our AeroTEM systems using the Military alphabet (Alpha, Bravo, Charlie, Delta, Echo, Foxtrot,,,) according to the order in which they were constructed. The two systems we retired were Bravo and Charlie – the second and third AeroTEM systems ever built. Both these systems have been in service since about 2004.

In addition, we decided in the quarter to replace the Cessna 206 aircraft that was damaged in early fiscal 2010 (and reported on in our first quarter). A new aircraft has been acquired and as at quarter-end was being outfitted for survey as a multi-sensor magnetic survey system. We expect that this new system will begin surveying in the fourth quarter of fiscal 2010 and will be added to the fleet summary at that time.

Our active fleet is now comprised of 26 systems; 15 helicopter based and 11 fixed wing based. This includes two systems acquired in connection with the acquisition of Aeroquest Optimal, one LiDAR system and an aerial digital camera.

#### AIRBORNE FLEET SUMMARY

	Helicopter	Fixed wing	Total
<b>Geophysics</b>			
<b>AeroTEM</b>	11		11
<b>Impulse/GEM-2A</b>	2		2
<b>Magnetics</b>			
<b>single sensor</b>	1	4	5
<b>multi-sensor</b>	1	3	4
<b>Gravity</b>			
<b>(+ multi-sensor mag)</b>		2	2
<b>Geomatics</b>		2	2
<b>Total</b>	15	11	26

### 3.3 REVENUE BY GEOGRAPHIC SEGMENT

While the decline in global exploration spending in mining and petroleum has impacted our volume of business, we continue to be active around the globe. As of June 30, 2010, we had positioned helicopter systems in North and South America, Europe, Africa and Australasia. During the same period, we operated fixed wing units in Australia & the South Pacific, Africa and North America.

Changes in the revenue mix between Canada, Australia and the United States reflect normal variations in quarterly activity as we commence and then complete various survey projects around the world. Of the 25 per cent of revenue in the quarter that is outside of Canada, Australia and the United States, no country represents more than 10 per cent of revenue. With the acquisition of Aeroquest Optimal, we began reporting our revenue from the United States as a separate segment as the overwhelming percentage of Aeroquest Optimal's business is currently in the United States.

## REVENUE BY GEOGRAPHIC SEGMENT

### Three Months Ended June 30, 2010

(thousands of Canadian dollars)	Canada	Australia	USA	RoW	Total	
<b>Airborne Geophysics</b>						
Fixed Wing services	\$ 222	\$ 1,632	\$ 15	\$ 1,717	\$ 3,586	41%
Rotary Wing services	1,789			364	2,153	25%
<b>Total Geophysics</b>	<b>2,011</b>	<b>1,632</b>	<b>15</b>	<b>2,081</b>	<b>5,739</b>	<b>66%</b>
<b>Aerial Geomatics</b>	<b>199</b>		<b>2,117</b>		<b>2,316</b>	<b>27%</b>
<b>Contract R&amp;D</b>			<b>519</b>	<b>72</b>	<b>591</b>	<b>7%</b>
<b>Total Revenue - Aeroquest Group</b>	<b>\$ 2,210</b>	<b>\$ 1,632</b>	<b>\$ 2,651</b>	<b>\$ 2,153</b>	<b>\$ 8,646</b>	<b>100%</b>
	25.6%	18.9%	30.7%	24.9%	100%	

### Nine Months Ended June 30, 2010

(thousands of Canadian dollars)	Canada	Australia	USA	RoW	Total	
<b>Airborne Geophysics</b>						
Fixed Wing services	\$ 3,507	\$ 3,572	\$ 244	\$ 2,794	\$ 10,117	43%
Rotary Wing services	2,372	364	-	2,304	5,040	22%
<b>Total Geophysics</b>	<b>5,879</b>	<b>3,936</b>	<b>244</b>	<b>5,098</b>	<b>15,157</b>	<b>65%</b>
<b>Aerial Geomatics</b>	<b>199</b>	<b>-</b>	<b>6,759</b>	<b>-</b>	<b>6,958</b>	<b>30%</b>
<b>Contract R&amp;D</b>	<b>-</b>	<b>-</b>	<b>1,120</b>	<b>72</b>	<b>1,192</b>	<b>5%</b>
<b>Total Revenue - Aeroquest Group</b>	<b>\$ 6,078</b>	<b>\$ 3,936</b>	<b>\$ 8,123</b>	<b>\$ 5,170</b>	<b>\$ 23,307</b>	<b>100%</b>
	26.1%	16.9%	34.9%	22.2%	100%	

## 3.4 CONSOLIDATED RESULTS

### OPERATING STATEMENTS

(in thousands of Canadian dollars)	Three Months		Change		Nine Months		Change	
	Q3-F10	Q3-F09	\$	%	Jun '10	Jun '09	\$	%
<b>Revenue</b>								
Airborne Geophysics								
Fixed Wing	<b>3,586</b>	2,901	685	24%	<b>8,385</b>	12,712	(4,327)	-34.0%
Helicopter	<b>2,153</b>	324	1,829	565%	<b>6,772</b>	8,797	(2,025)	-23.0%
<b>Total Airborne Geophysics</b>	<b>5,739</b>	3,225	2,514	78%	<b>15,157</b>	21,509	(6,352)	-29.5%
Aerial Geomatics	<b>2,316</b>	-	2,316	N/A	<b>6,958</b>	-	6,958	N/A
Contract R&D	<b>591</b>	426	165	39%	<b>1,192</b>	1,404	(212)	-15.1%
	<b>8,646</b>	3,651	4,995	137%	<b>23,307</b>	22,913	394	1.7%
<b>Cost of sales</b>								
Airborne Geophysics								
Fixed Wing	<b>2,739</b>	2,354	385	16%	<b>6,882</b>	8,658	(1,776)	-20.5%
Helicopter	<b>1,944</b>	680	1,264	186%	<b>5,830</b>	7,093	(1,263)	-17.8%
<b>Total Airborne Geophysics</b>	<b>4,683</b>	3,034	1,649	54%	<b>12,712</b>	15,751	(3,039)	-19.3%
Aerial Geomatics	<b>1,895</b>	-	1,895	N/A	<b>5,695</b>	-	5,695	N/A
Contract R&D	<b>225</b>	183	42	23%	<b>444</b>	547	(103)	-18.8%
	<b>6,803</b>	3,217	3,586	111%	<b>18,851</b>	16,298	2,553	15.7%
<b>Gross profit</b>	<b>1,843</b>	434	1,409	325%	<b>4,456</b>	6,615	(2,159)	-32.6%
<b>Gross margin</b>								
Airborne Geophysics								
Fixed Wing	<b>23.6%</b>	18.9%			<b>17.9%</b>	31.9%		
Helicopter	<b>9.7%</b>	-109.9%			<b>13.9%</b>	19.4%		
<b>Total Airborne Geophysics</b>	<b>18.4%</b>	5.9%			<b>16.1%</b>	26.8%		
Aerial Geomatics	<b>18.2%</b>	0.0%			<b>18.2%</b>	0.0%		
Contract R&D	<b>61.9%</b>	57.0%			<b>62.8%</b>	61.0%		
<b>Gross profit margin %</b>	<b>21.3%</b>	11.9%			<b>19.1%</b>	28.9%		

(in thousands of Canadian dollars)	Three Months		Change		Nine Months		Change	
	Q3-F10	Q3-F09	\$	%	Jun '10	Jun '09	\$	%
General & administrative expense	2,660	2,295	365	15.9%	7,751	9,728	(1,977)	-20.3%
Foreign exchange (gain) loss	(121)	690	(811)	-117.5%	60	(540)	600	-111.1%
<b>Total cash operating costs</b>	<b>2,539</b>	<b>2,985</b>	<b>(446)</b>	<b>-14.9%</b>	<b>7,811</b>	<b>9,188</b>	<b>(1,377)</b>	<b>-15.0%</b>
<i>% of revenue</i>	<i>22.5%</i>	<i>26.7%</i>			<i>69.1%</i>	<i>82.1%</i>		
Stock-based compensation expense	85	108	(23)	-21.3%	255	348	(93)	-26.7%
EBITDA	(781)	(2,659)	1,878	-70.6%	(3,610)	(2,921)	(689)	23.6%
<i>EBITDA as a % of revenue</i>	<i>-1.4%</i>	<i>-20.0%</i>			<i>-6.6%</i>	<i>-22.0%</i>		
Depreciation of capital assets	871	1,155	(284)	-24.6%	2,626	2,968	(342)	-11.5%
Amortization of intangible assets	828	785	43	5.5%	2,560	2,418	142	5.9%
<b>Operating profit/(loss)</b>	<b>(2,480)</b>	<b>(4,599)</b>	<b>2,119</b>	<b>-46.1%</b>	<b>(8,796)</b>	<b>(8,307)</b>	<b>(489)</b>	<b>5.9%</b>
<i>Operating profit as a % of revenue</i>	<i>-38.2%</i>	<i>-57.8%</i>			<i>-60.0%</i>	<i>-43.1%</i>		
Interest and other expense (income)	(51)	(4)	(47)	1175.0%	(285)	(146)	(139)	95.2%
Provision for income taxes	(635)	(1,097)	462	-42.1%	(2,183)	(2,195)	12	-0.5%
<b>Net income</b>	<b>\$ (1,794)</b>	<b>\$ (3,498)</b>	<b>\$ 1,704</b>	<b>-48.7%</b>	<b>\$ (6,328)</b>	<b>\$ (5,966)</b>	<b>\$ (362)</b>	<b>6.1%</b>
Earnings per share - basic	\$ (0.05)	\$ (0.10)	\$ 0.05		\$ (0.17)	\$ (0.17)	\$ -	

In Q3-F2010, consolidated revenue was \$8.6 million, up \$5.0 million or 137 per cent over Q3-F2009. In Airborne Geophysics, revenue from helicopter services was \$2.2 million, up \$1.8 million or 565 per cent over Q3-F2009 while revenue from fixed wing services was \$3.6 million, up \$0.7 million or 24 per cent over Q3-F2009. Revenue from helicopter services improved due to increased helicopter survey work in Canada as well as the execution of a large helicopter survey in S.E. Asia. Fixed wing survey services showed a marked improvement – especially in our Australian operations, which recorded record levels of new fixed wing contracts through April to June of 2010.

Revenue from Aerial Geomatics was \$2.3 million, representing the newly acquired Aeroquest Optimal business. Revenue from Contract R&D was \$0.6 million in Q3-F2010, an increase of \$0.2 million or 39% over the revenue reported in Q3-F2009.

Cost of sales was \$6.8 million in Q3-F2010, or 79 per cent of revenue, compared to \$3.2 million or 88 per cent of consolidated revenue in Q3-F2009. Gross margin in Q3-F2010 increased by 9 percentage points to 21 per cent, compared with 12 per cent in Q3-F2009, primarily the result of the much lower business volumes in the prior year impacting the fixed cost component of cost of sales and thus reducing margins.

Aerial Geomatics gross profit in the quarter was 18 per cent, which remains below our expectations. A large part of the lower margin was due to a higher than normal percentage of revenue that was subcontracted to third parties. In these cases, no markup is permitted on this revenue when it is part of a contract with the United States government or its agencies.

In Airborne Geophysics, gross margin in helicopter services was 10 per cent in Q3-F2010, as compared to negative 110 per cent in the Q3-F2009. This margin improvement is primarily attributable to the performance in Q3-F2009 where negative margins resulted from fixed costs in helicopter cost of sales allocated to lower revenues. Due to the cost reduction initiatives undertaken later in fiscal 2009, the fixed cost component of helicopter cost of sales has reduced thus improving margins. However, these margin levels are still well below our expectations and the levels we experienced during the peak exploration years in 2007 and 2008.

Gross margin in Airborne Geophysics fixed wing services was \$2.7 million, or 24 per cent of revenue in the current quarter as compared to 19 per cent in Q3-F2009. Note that with the improved fixed wing backlog levels at the end of Q3-F2010 (and thereafter), we expect fixed wing margins to continue to improve in the fourth quarter and thereafter.

### **3.5 CASH OPERATING COSTS**

Cash operating costs in Q3-F2010 totaled \$2.5 million, a decline of \$0.5 million, or 15 per cent from the \$3.0 million reported in Q3-F2009. This decrease is primarily due to:

- Foreign exchange income of \$0.1 million in Q3-F2010 compared with a foreign exchange loss of \$0.7 million in Q3-F2009 resulting in an overall reduction of \$0.8 million

Offset by:

- Aeroquest Optimal cash operating costs of \$0.6 million that were not reflected in Q3-F2010.

### **3.6 OPERATING PROFIT AND EBITDA**

EBITDA in Q3-F2010 was negative \$0.8 million, an improvement of \$1.9 million over the negative EBITDA of \$2.7 million reported in Q3-F2009.

Depreciation and amortization charges totaled \$1.7 million in Q3-F2010 compared with \$1.9 million of depreciation and amortization reported in Q3-F2009. The increase in depreciation & amortization on capital assets acquired in the Optimal Geomatics transaction was offset by reduced depreciation in other areas of the business as assets become fully depreciated.

As a result, operating loss in Q3-F2010 was \$2.5 million compared with an operating loss of \$4.6 million in Q3-F2009.

### **3.7 NET LOSS**

Net loss for Q3-F2010 was \$1.8 million, or \$0.05 per share compared to net loss of \$3.5 million, or \$0.10 per share in Q3-F2009.

Our provision for recovery of income taxes for Q3-F2010 was \$0.6 million generating an apparent tax rate of 24 per cent in the quarter, a decrease over the 26 per cent apparent tax rate reported in Q3-F2009.

## **4 Liquidity and Capital Resources**

Our cash balances declined by \$0.4 million from \$6.1 million at September 30, 2009 to \$5.7 million at June 30, 2010. However, cash balances did increase by \$2.1 million from March 31, 2010 when cash was at \$3.6 million. Most of this change in liquidity was the result of cash flow from operations generating \$2.6 million of cash in Q3-F2010.

Much of the improvement in cash flow in operations was from changes in working capital primarily due to income tax refunds received in the quarter of \$2.4 million. We have also generated another \$1.5 million in income taxes recoverable during the first nine months of 2010.

## CASH & WORKING CAPITAL CHANGES

(in thousands of Canadian dollars)	Three Months			Nine Months		
	Q3-F10	Q3-F09	Change	Jun-10	Jun-09	Change
<b>Operating activities</b>						
Net Income/(Loss)	\$ (1,794)	\$ (3,498)	\$ 1,704	\$ (6,328)	\$ (5,965)	\$ (363)
<b>Non-cash operating items</b>						
Depreciation/Amortization	1,699	1,940	(241)	5,185	5,385	(200)
Future taxes	(123)	(247)	124	(629)	(775)	146
Gain on disposal of capital assets	(18)	-	(18)	(376)	-	(376)
Stock based compensation	85	108	(23)	255	348	(93)
<b>Operating cash before change in non-cash working capital</b>	<b>(151)</b>	<b>(1,697)</b>	<b>1,546</b>	<b>(1,893)</b>	<b>(1,007)</b>	<b>(886)</b>
Change in non-cash working capital	2,702	(188)	2,890	2,277	(1,451)	3,728
<b>Cash flow from operations</b>	<b>2,551</b>	<b>(1,885)</b>	<b>4,436</b>	<b>384</b>	<b>(2,458)</b>	<b>2,842</b>
<b>Investing activities</b>						
Capital asset purchases	(368)	(551)	183	(839)	(4,678)	3,839
Proceeds from disposal of capital assets	18	-	18	510	-	510
Long term investments acquired	-	-	-	(90)	(36)	(54)
<b>Cash flow from investing</b>	<b>(350)</b>	<b>(551)</b>	<b>201</b>	<b>(419)</b>	<b>(4,714)</b>	<b>4,295</b>
<b>Financing Activities</b>						
Capital lease payments	(122)	(42)	(80)	(474)	(185)	(289)
Redemption of shares	-	-	-	-	(57)	57
Proceeds from issuance of shares	-	42	(42)	25	42	(17)
<b>Cash flow from financing</b>	<b>(122)</b>	<b>-</b>	<b>(122)</b>	<b>(449)</b>	<b>(200)</b>	<b>(249)</b>
Net change in cash for the period	2,079	(2,436)	4,515	(484)	(7,372)	6,888
Cash - beginning of period	3,583	10,437	(6,854)	6,146	15,373	(9,227)
<b>Cash - end of period</b>	<b>\$ 5,662</b>	<b>\$ 8,001</b>	<b>\$ (2,339)</b>	<b>\$ 5,662</b>	<b>\$ 8,001</b>	<b>\$ (2,339)</b>

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 three months.

### 4.1 OPERATING ACTIVITIES

Operating activities consumed approximately \$0.2 million of cash in the quarter, while changes in working capital generated \$2.7 million of cash, and capital expenditures used \$0.4 million of cash. Operating cash flow is tracking higher as a result of the improved financial position in the quarter and the impact of deposits resulting from new contracts combined with the income tax refunds noted previously. The net change in working capital is composed of a decrease in non-cash current assets of \$1.9 million combined with an increase in current liabilities of \$0.8 million

### 4.2 INVESTING ACTIVITIES

Investment activities in Q3-F2010 consumed \$0.4 million of cash representing capital expenditures made in the quarter. We expect capital expenditures to remain modest for the balance of the year (especially when compared to the prior year). Q3-F2009's capital expenditures were \$0.6 million.

### 4.3 FINANCING ACTIVITIES

The bulk of the financing activities in Q3-F2010 were the payments under our capital leases of \$0.1 million and is higher than the \$42K reported in Q3-F2009 due primarily to the capital leases acquired on the Optimal Geomatics transaction.

#### 4.4 CASH

Our cash balances increased in Q3-F2010 by \$2.1 million compared with a decline in cash of \$2.4 million in Q3-F2009. This \$4.5 million improvement is primarily the result of:

- Positive cash flow from operations of \$2.5 million in Q3-F2010 compared to negative \$1.9 million in Q3-F2009; and
- Capital expenditures in Q3-F2010 of \$0.4 million compared to \$0.6 million in Q3-F2009.

We are continuing to actively manage our working capital wherever possible to ensure that cash is appropriately invested in our business operations. In the most recent quarter, we have also seen a trend where suppliers are more willing to accept extended payment terms than in prior quarters, likely due to improved economic conditions compared with earlier in the fiscal year.

#### 4.5 CAPITAL RESOURCES

We have a credit facility in place for our Canadian operations. At June 30, 2010, no amounts have been drawn on this facility.

We believe that cash, 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.

#### 4.6 SUMMARY FINANCIAL POSITION

As of June 30, 2010, we had current assets of \$14.1 million and current liabilities of \$6.1 million. Net working capital was \$8.0 million, a decrease of \$2.6 million from September 30, 2009.

#### SUMMARY CASH & WORKING CAPITAL

(in thousands of Canadian dollars)	30-Jun-10	30-Sep-09	Change from prior year-end	
<b>Cash</b>	<b>\$5,662</b>	\$6,146	(\$484)	-7.9%
Non-cash current assets	<b>8,485</b>	10,696	(2,211)	-20.7%
<b>Current assets</b>	<b>14,147</b>	16,842	(2,695)	-16.0%
Less: Current liabilities	<b>6,110</b>	6,238	(128)	-2.1%
<b>Net working capital</b>	<b>\$8,037</b>	\$10,604	(\$2,567)	-24.2%
Current ratio	<b>2.3</b>	2.7		-14.2%

## **5 Risks and Uncertainties**

### **5.1 Foreign Currency Exchange Risk**

We record transactions and prepare our financial statements in Canadian dollars. For Q3-F2010, we maintained operations in Canada, Australia, and the United States with business conducted in other countries as well. International operations are considered financially and operationally self-sustaining. Accordingly, the 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 of our contract survey expenditures are denominated in the same currency as our revenue on these contract surveys 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 or the year. As a result, we do not employ any financial derivative products.

### **5.2 INTEREST RATE RISK**

We did not have any interest bearing debt in either Q3-F2010 or Q3-F2009 and had positive cash balances during these periods. Interest rate volatility had minimal impact on our operations only to the extent that the interest rate received on our cash balances was negatively affected by the overall decline in interest rates in the Canada, Australia and the United States.

### **5.3 LITIGATION**

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.

## **6 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.

## **7 Acquisition of Optimal Geomatics Inc.**

At the end of our 2009 fiscal year we completed the acquisition of Optimal Geomatics Inc. (TSX-V:OPG). Under the terms of the Arrangement Agreement, the transaction was effected by way of a Plan of Arrangement completed under the Canada Business Corporations Act. Optimal shareholders received 1 common share of Aeroquest for each 21 common shares of Optimal owned and resulted in Aeroquest issuing approximately 3.0 million common shares to Optimal shareholders.

The acquisition has been accounted for under the purchase method of accounting and has been included in the balance sheet of the Company on September 30, 2009. The details of the consideration given and the fair value of net assets acquired, in Canadian dollars, are as follows:

Net Assets Acquired at Fair Values ('000s):

Cash	\$ 529
Accounts receivable	2,269
Inventory	7
Work in progress	48
Prepays	267
Capital assets	429
Other assets	254
Accounts payable and accrued liabilities	(1,484)
Capital lease obligations	(247)
Deferred revenue	(192)
<b>Total net assets acquired, net of cash</b>	<b>\$ 1,351</b>

Consideration provided was a combination of shares of the Company along with cash expended in deal costs as follows:

Acquisition costs	\$ 594
Less: Cash acquired	(529)
Cash cost of acquisition	65
Shares of Aeroquest International (2,989,192 shares @ \$0.43)	1,285
<b>Total Purchase Price</b>	<b>\$ 1,351</b>

## 8 Share Capital

### 8.1 Stock Option Plan

At June 30, 2010, we had 36,985,938 Common Shares issued and outstanding and as at the same date the Common Share stock options held by directors, officers, and employees were as follows:

	Number of options	Exercise price	Expiry date
Issued options held by directors, officers and employees under the Company Stock Option Plan	250,000	\$ 0.50	February 9, 2011
	367,500	\$ 0.60	June 30, 2011
	3,000	\$ 0.75	October 3, 2011
	15,000	\$ 0.75	October 13, 2011
	81,000	\$ 2.34	September 30, 2012
	50,000	\$ 1.70	July 16, 2013
	323,666	\$ 0.42	January 18, 2014
	65,000	\$ 0.38	February 26, 2014
	480,000	\$ 0.45	August 4, 2014
	120,000	\$ 0.55	October 20, 2014
	515,000	\$ 0.63	May 11, 2015
Total outstanding	2,270,166	\$ 0.62	
Total exercisable	1,236,166	\$ 0.70	

## 8.2 Restricted Stock Unit Plan

At June 30, 2010 there were 243,332 RSU's outstanding. No RSU's were granted, vested or converted into Common Shares in either Q3-F2010 or Q3-F2009.

## 9 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.

NI 52-109 also contains the requirements that we, on an annual basis:

- evaluate the effectiveness of Internal Controls over Financial Reporting ('ICFR');
- evaluate the effectiveness of Disclosure Controls & Procedures ('DC&P')
- use a control framework in the design of our 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 first quarter of fiscal 2009, we engaged external advisors to assess the impact of these changes on our current evaluation of ICFR and disclosure control and procedures. 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 September 30, 2009.

## **10 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.

### **10.1 ACCOUNTING POLICY CHANGES**

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.

On October 1, 2008, we adopted new CICA Handbook Section 1000, Financial Statement Concepts which was amended to focus on the capitalization of costs that truly meet the definition of an asset and de-emphasizes the matching principle. The results of operations of the Company were not materially affected by these new pronouncements.

### **10.2 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. Our Geophex Ltd. subsidiary results are reported under United States GAAP and are adjusted to Canadian GAAP standards for consolidation.

### **10.3 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. We use a combination of the discounted cash flow method and the market value 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 until a decision is made to phase out the trade name at which point in time a fair value assessment of the name is performed.

## *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.

### **10.4 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 June 30, 2010, we have completed the initial impact assessment and have begun work on the key elements phase. However, 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.