AEROQUEST INTERNATIONAL LIMITED

MANAGEMENT'S DISCUSSION & ANALYSIS

For the period ending October 31, 2005

Management's Discussion and Analysis (MD&A) is intended to help readers understand the dynamics of our business and the key factors underlying our financial results. It explains trends in our financial condition and results of our operations for the quarter and year-to-date ended October 31, 2005 compared with our operating results for the corresponding periods ended October 31, 2004. It also compares our balance sheet as at October 31, 2005 to our balance sheet as at April 30, 2005. This MD&A should be read in conjunction with our unaudited interim consolidated financial statements for July 31, 2005 and audited consolidated financial statements and MD&A for April 30, 2005.

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

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

FORWARD-LOOKING STATEMENTS

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

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

NON GAAP FINANCIAL MEASURES

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

EBITDA

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

OVERVIEW

AEROQUEST'S BUSINESS

We are a world leader in the development and operation of innovative and proprietary airborne geophysical surveying platforms servicing the mineral exploration, oil and gas, and environmental industries. We operate a number of proprietary time-domain, sometimes called transient, electromagnetic (TEM) systems on platforms ranging from 5 metres to 12 metres in diameter, delivered under the trade-name AeroTEM. We also supply geophysical surveying platforms based on total field magnetics, magnetic gradient and impulse frequency domain electromagnetics (HEM).

Second Quarter 2006 Operating Results

Overview

In the second quarter of 2006, we made a number of changes to our management and organization, and began to reposition ourselves in the airborne survey market. Our results were below our expectations and below the level of the second quarter of last year. However, our activity level, which had been disappointing to us during the June to September time frame, had recovered somewhat by the end of the quarter. We completed 11 contracts in the second quarter as compared to nine in the previous quarter. In addition, we ended the second quarter with a healthy level of contracts in progress, as well as a reasonable backlog for the third quarter, especially in light of the fact that the third quarter is usually a slower time period in that it includes both the holiday season and freeze-up, when activity tends to wait for both ground and lakes to freeze.

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

Shortly after the end of the quarter, on the 7th of November, one of our systems was driven into the ground during a survey, destroying the system. This is the second incident this year that has resulted in the loss of a system. Our assets are insured for incidents such as these and we expect to have at least one replacement system in service by the end of the third quarter. While it is the nature of our business that our equipment is subject to certain risks, we have completed a review of each incident to identify ways to minimize the prospect of a repeat of such incidents.

Key Operating Metrics

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

Revenue

In the second quarter of 2006, our total revenue was $1,867 thousand, down $995 thousand, or 35 per cent compared to the same quarter last year. Revenue in our business is a function of changes in the number of systems we have available to fly and the average utilization of those systems. In the second quarter, we were able to utilize 5 systems, of which 4 were AeroTEM, for at least a portion of the quarter.

AeroTEM is a best-in-class system

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

Our goal is to continue to focus on adding AeroTEM systems as appropriate, focusing on incorporating our latest advances in electronics and in platform design into each new system, as well as increasing the utilization rate of the existing fleet.

Revenue & Gross Profit

(in thousands of Canadian dollars)	Three Months Ended 31-Oct-05	Three Months Ended 31-Oct-04	Year-to-Date 31-Oct-05	Year-to-Date 31-Oct-04	Change from prior year		Change from prior YTD	
Revenue	**1,867**	2,862	4,665	4,416	(995)	(35%)	249	6%
Cost of sales	**1,147**	1,423	3,208	2,326	(276)	(19%)	882	38%
Gross profit	**720**	1,439	1,457	2,090	(719)	(50%)	(633)	(30%)
Gross profit margin %	**38.6%**	50.3%	31.2%	47.3%		(11.7%)		(16.1%)

Cost of sales was $1,147 thousand in the second quarter of 2006, or approximately 61 per cent of revenue. This compares to $1,423 thousand in the same quarter last year representing 50 per cent of revenue in that quarter. The growth in cost of sales was as a result of the following factors:

- We have used larger, more expensive helicopters in 2006 as we roll out our AeroTEM III and IV systems. These systems are 10M and 12M in diameter, respectively, and provide important improvements in both depth-of-penetration and signal-to-noise ratio as compared to the AeroTEM II systems, which are 5M in diameter. Future versions of both AeroTEM III and IV systems will incorporate lighter air-frames that will allow us to fly using smaller, less expensive helicopters;
- We flew more surveys of a lower average line kilometre per survey than in pervious periods. This results in slightly lower efficiency as measured by revenue per line kilometre as mobilization and demobilization costs, which are generally billed at little or no margin, are a higher percentage of revenue; and
- We flew surveys in more diverse areas in the last quarter than in the same period last year. This resulted in fewer flying days and more days spent ferrying the systems from one location to another.

We see opportunities to improve all of these factors as we go forward into the second half of this year and the next year.

The increase in cost of sales as a percentage of revenue translated into a reduced gross profit and a lower gross profit margin percentage. Gross profit was $720 thousand compared to $1,439 thousand in the same quarter last year, a decrease of $719 thousand or 50 per cent. Our focus in the second half of 2006 is to increase gross margin, both in absolute terms and as a percentage of revenue to a level closer to that of 2005.

Operating Costs

Overall, second quarter operating costs were $1,221 thousand, up from $705 thousand in the same quarter last year. The year-over-year increase of $516 thousand in operating costs is primarily due to an increase in personnel committed to sourcing and delivering surveys as well as increases in research and development expenses to allow us to improve upon our existing product line.

Operating costs as a percentage of revenue have risen significantly over the past year as we have put in place an infrastructure to allow us to expand both geographically and in product scope, addressing opportunities in the unexploded ordinance (UXO) market, the groundwater survey market and the oil and gas market. We expect that these additional costs will result in increased revenues in the second half of 2006 and beyond.

Notwithstanding this optimism, we have implemented a cost reduction program targeted at reducing non-revenue producing activity and discretionary expenditures over the remainder of this year. This cost reduction exercise should reduce our operating costs by over $100 thousand per quarter for the remainder of this year.

Operating Costs

(in thousands of Canadian dollars)	Three Months Ended **31-Oct-05**	31-Oct-04	Year-to-Date 31-Oct-05	31-Oct-04	Change from prior year		Change from prior YTD	
Research & development expense	**266**	109	567	186	157	144%	381	204%
General & adminstrative expense	**719**	493	1,366	896	226	46%	471	53%
Depreciation & amortization expense	**236**	103	481	238	133	129%	244	103%
Stock option expense	**-**	-	37	-	-		37	
Total operating costs	**1,221**	705	2,451	1,319	516	73%	1,131	86%
% of Revenue	**65.4%**	24.6%	52.5%	29.9%		40.8%		22.7%

OPERATING PROFIT (LOSS)

EBITDA

Primarily as a result of the previously mentioned decrease in gross profit, and increase in operating costs, EBITDA for the second quarter 2006 was a loss of $238 thousand, a decrease of $1,076 thousand or 128 per cent over the same quarter last year. Over the year-to-date period, EBITDA is down by $1,494 thousand, of 148 per cent. The steps outlined above that will lead to higher revenue; higher gross margins and lower operating costs will result in improvements to this profitability measure over the second half of this year.

EBITDA & Operating Profit (Loss)

(in thousands of Canadian dollars)	Three Months Ended **31-Oct-05**	31-Oct-04	Year-to-Date 31-Oct-05	31-Oct-04	Change from prior year		Change from prior YTD	
Operating profit (loss)	**(474)**	735	(967)	771	(1,209)	(165%)	(1,738)	(225%)
Depreciation & amortization	**236**	103	481	238	133	129%	244	103%
EBITDA	**(238)**	838	(485)	1,009	(1,076)	(128%)	(1,494)	(148%)
Writedown of discontinued project	**73**	-	73	-	73		73	
Contract cancellation costs	**268**	-	268	-	268		268	
EBITDA after unusual items	**(580)**	838	**(827)**	1,009	(1,344)	(160%)	(1,762)	(175%)

As a consequence of the above factors, our operating loss was $474 thousand in the second quarter, a reduction of $1,209 thousand, or 165 per cent from the operating profit of $735 thousand in the same quarter last year.

Depreciation and amortization charges totaled $236 thousand, a 129 per cent increase from the same quarter last year. Depreciation and amortization has generally been rising as we build and deploy more AeroTEM systems. We expect this growth to continue.

In the second quarter, we took special charges totaling $341 thousand related to the costs incurred in implementing the first part of our cost reduction initiative, including a payment of $247,000 to a contractor who was also a director in contract termination costs. We do not expect any further unusual charges in respect of this initiative.

NET INCOME (LOSS)

As a consequence of the above factors, we recorded a net loss in the quarter of $524 thousand, or ($0.03) per share, compared with net income of $565 thousand or $0.05 per share in the same quarter last year.

Net Income (Loss)

(in thousands of Canadian dollars)	Three Months Ended **31-Oct-05**	Three Months Ended 31-Oct-04	Year-to-Date 31-Oct-05	Year-to-Date 31-Oct-04	Change from prior year		Change from prior YTD	
Operating profit (loss)	**(474)**	735	(967)	771	(1,209)	(165%)	(1,738)	(225%)
Writedown of development costs	**73**	-	73	-	73		73	
Contract cancellation costs	**268**	-	268	-	268		268	
Provision for income taxes (recovery)	**(292)**	169	(456)	180	(461)	(273%)	(636)	(354%)
Net income (loss)	**(524)**	565	(852)	591	(1,089)	(193%)	(1,443)	(244%)
Earnings per share - basic	**$ (0.03)**	$ 0.05	$ (0.05)	$ 0.06	$ (0.25)	(8.0%)	$ (0.33)	(11.0%)

<u>CASH FLOW</u>

CASH FLOW FROM OPERATING ACTIVITIES

Operating activities provided $206 thousand of cash in the second quarter and provided $358 thousand in the same quarter last year, which was a decrease of $152 thousand. This decrease was due to a number of factors, the largest of which related to operating losses, offset by positive changes in non-cash working capital.

Before changes in non-cash working capital, operating cash flow used $214 thousand in the second quarter of 2006 a change of ($883) thousand from the second quarter of 2005. Operating cash flow declined due to the decline in operating profit discussed above.

Cash Flow from Operating Activities

(in tousands of Canadian dollars)	Three Months Ended **31-Oct-05**	Three Months Ended 31-Oct-04	Year-to-Date 31-Oct-05	Year-to-Date 31-Oct-04	Change from prior year		Change from prior YTD	
Net income (loss)	**(524)**	565	(852)	591	(1,089)	(193%)	(1,443)	(244%)
Depreciation & amortization	**236**	103	481	238	133	129%	244	103%
Stock option expense	**-**	-	37	-	-		37	
Writedown of development costs	**73**	-	73	-	73		73	
Operating cash flow	**(214)**	669	(261)	829	(883)	(132%)	(1,090)	(131%)
Change in non-cash working capital	**420**	(311)	50	(55)	731	(235%)	106	(191%)
Cash flow from operating activities	**206**	358	(210)	774	(152)	(42%)	(984)	(127%)

CASH FLOW FROM INVESTING ACTIVITIES

Overall, investment activities in the second quarter used $321 thousand of cash. This compares to the second quarter of last year when investing activities produced cash of $157 thousand.

Cash Flow from Investing Activities

(in thousands of Canadian dollars)	Three Months Ended **31-Oct-05**	Three Months Ended 31-Oct-04	Year-to-Date 31-Oct-05	Year-to-Date 31-Oct-04	Change from prior year		Change from prior YTD	
Acquisition of capital assets	**(339)**	(581)	(680)	(1,046)	242	(42%)	366	(35%)
Sales of marketable securities	**-**	700	-	787	(700)	(100%)	(787)	(100%)
Change in loan receivable	**18**	34	3	-	(17)	(48%)	3	
Decline in value of long term investment	**-**	4	-	4	(4)	(100%)	(4)	(100%)
Cash flow from investing activities	**18**	738	3	791	(720)	(98%)	(788)	(100%)

Acquisition of capital assets consumed $339 thousand, or 18 per cent of revenue, as compared to $581 thousand, or 20 per cent of revenue in the same quarter last year. Capital investments were made primarily to expand the fleet of AeroTEM systems.

CASH FLOW FROM FINANCING ACTIVITIES

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

Cash Flow from Financing Activities

(in thousands of Canadian dollars)	Three Months Ended **31-Oct-05**	Three Months Ended 31-Oct-04	Year-to-Date 31-Oct-05	Year-to-Date 31-Oct-04	Change from prior year		Change from prior YTD	
Repayment of long term debt	**(2)**	(6)	(5)	(13)	4	(60%)	8	(62%)
Issuance of Common Shares	**0**	3,321	0	3,321	(3,321)	(100%)	(3,321)	(100%)
Other items	**0**	115	0	84	(115)	(100%)	(84)	(100%)
Cash flow from financing activities	**(2)**	3,430	(4)	3,392	(3,432)	(100%)	(3,397)	(100%)

LIQUIDITY AND CAPITAL RESOURCES

Our liquidity, as measured by cash balances, has declined by $892 thousand from the start of the year. A large portion of this change is due to investments in capital assets, which have used $680 thousand over the two quarters. The remaining $212 thousand was used to fund net operating losses.

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

FINANCIAL POSITION

At October 31, 2005, we had current assets of $4,782 thousand and current liabilities of $1,785 thousand. Net working capital was $2,997 thousand, a decrease from the $3,937 thousand at April 30, 2005. This $940 thousand change from the prior year-end is primarily due to the afore-mentioned factors, including investments in capital assets and funding operating losses, as well as net changes in non-cash working capital.

Cash & Working Capital Changes

(in thousands of Canadian dollars)	**31-Oct-05**	30-Apr-05	Change from prior year end	
Cash	**2,142**	3,034	(892.0)	(29%)
Non-cash current assets	**2,640**	2,653	(13.0)	(0%)
Current liabilities	**1,785**	1,750	35.0	2%
Net working capital	**2,997**	**3,937**	(940.0)	(24%)
Current ratio	**2.7**	3.2	(0.6)	(18%)

Transactions with Related Parties

During the period, we paid $115 thousand to companies owned by certain directors for management consulting services. These transactions are in the normal course of operations and are measured at the exchange value (the amount of consideration established and agreed to by the related parties), which approximates the arm's length equivalent value for services performed. In addition, we paid a total of $247,000 to a former director in termination costs associated with a contract.

Share Capital

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

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

	Number of options	**Exercise price**	**Expiry date**
Fully vested & exercisable options held by directors, officers, employees and consultants under the Company's Stock Option Plan	1,175,000	$ 2.00	October 31, 2009
	75,000	$ 2.00	January 31, 2010
	60,000	$ 2.00	February 28, 2010
	130,000	$ 2.00	June 30, 2010
Total vested & exerciseable under Stock Option Plan	1,440,000	$ 2.00	
Unvested options	25,000	$ 2.00	January 31, 2010
Held by Brokers	300,000	$ 2.00	October 28, 2006
Total	1,765,000	$ 2.00	