



Clearer vision from **above**

Advanced Airborne Geophysics

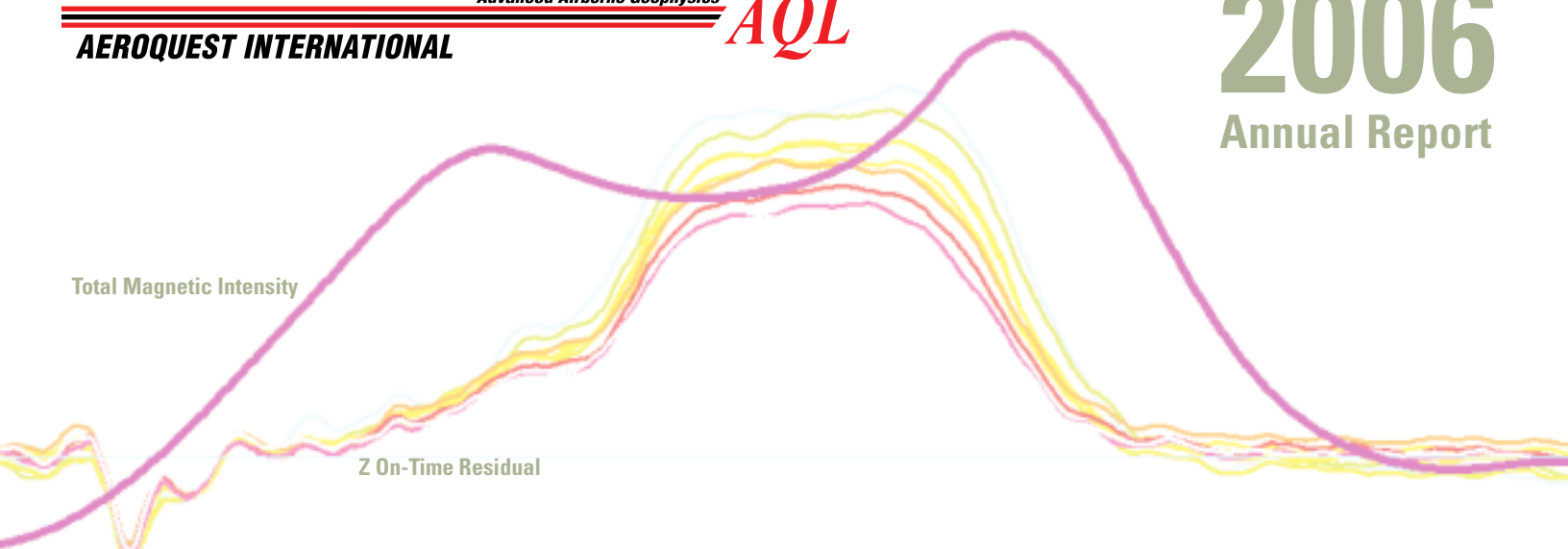
AQL

AEROQUEST INTERNATIONAL

2006
Annual Report

Total Magnetic Intensity

Z On-Time Residual



AEROQUEST INTERNATIONAL LIMITED

| | |
|---|-----------|
| Message to Our Shareholders | 1 |
| Management's Discussion and Analysis | 4 |
| Auditors' Report | 19 |
| Financial Statements | 20 |
| Summary of Significant Accounting Policies | 23 |
| Corporate Information | 32 |

2006 COMPLETED AND CONTRACTED SURVEYS

● completed ● contracted



MESSAGE TO OUR SHAREHOLDERS

Dear Shareholder,

This is my first letter to you as the CEO of Aeroquest International Limited, having joined the Company mid-year 2006, and it also marks the close of Aeroquest's first full year of operations as a public company.

It has been a year of ups and downs for Aeroquest. On the positive side, we experienced double-digit revenue growth for the 5th year in a row and made important strides in expanding our fleet, diversifying our revenue stream, and implementing our international expansion. On the negative side, the company lost money in 2006. In fact, we recorded a net loss of \$1.2 million on sales of \$9.1 million. This financial performance is unacceptable to us as managers, as I am sure it is unacceptable to you as shareholders. There are four factors that all contributed to the Company's loss in 2006. I'd like to address each of them, describe what happened, and explain why it will not happen again.

OUR SALES AND GROSS MARGINS DID NOT MEET OUR INTERNAL EXPECTATIONS.

Prior to 2006, Aeroquest had been growing at a rate of about 100% per year for the previous four years. In a high growth environment like this, it is often necessary or desirable to add costs in anticipation of expected continued revenue growth. In our case, costs were added early in the year and sales did not grow to the level expected. In addition, our gross margin, at 37%, was lower than the 43% gross margin of 2005 and lower than our own expectations. We have addressed this by making profitable revenue growth our top priority, by

refocusing our sales efforts and by expanding our international efforts.

OUR FIXED COSTS WERE TOO HIGH RELATIVE TO OUR SALES LEVEL.

The factors described above left us with a general and administrative cost structure that was too high for the level of business we were generating. We addressed this by capping the growth of these expenses and by focusing on building sales to the level that can support the level of spending.

WE INCURRED A HIGH LEVEL OF DISCRETIONARY EXPENDITURES.

We incurred some development expenses in the year that were large in relation to our revenue.

For example, during the first half of 2006, development expenses ran at approximately 12% of revenue. In the second half of 2006, we cut them back to 6% of revenue. Going forward, we expect that development expenses will be sized in relation to the Company's ability to sustain them comfortably from internally generated funds.

WE INCURRED A NUMBER OF ONE-TIME CHARGES IN THE YEAR ASSOCIATED WITH RESTRUCTURING THE COMPANY FOR PROFITABILITY

These costs, while necessary to help set the Company on the right track going forward, totalled \$411 thousand and accounted for fully 25% of our pre-tax loss.

Our focus on growing sales and sizing our spending relative to our sales has paid off. While the results of these efforts were not entirely visible in the Company's 2006 financial results, they are evident in 2007 where in the first quarter we have grown revenue by over 51% relative to the same period last year and over 57% relative to last quarter. I am also pleased to report that the Company is on course for a profitable 2007.

Implementing our Strategy

Our strategy implementation has two dimensions; technological and operational.

The technological dimension deals with our ability to design and build best-in-class airborne survey systems.

Our AeroTEM™ time-domain electro-magnetic (TEM) tool is just such a system. AeroTEM is a high resolution exploration tool that allows us to pinpoint anomalies at depths of up to 500 metres to within approximately 5 metres on the surface. This resolution is sufficient to allow some clients to do direct drilling from AeroTEM data, completely eliminating the time consuming and sometimes costly step of doing follow-up, ground-based surveys.

As we continue to improve our AeroTEM systems, we will focus on three things:

1 We will improve the power of these systems. In a very rough sense, greater power leads to greater depths of penetration. It's not quite this simple, but it's not too far off, either.

2 We will ensure that we do not sacrifice the elements of our systems that make them unique. At this point, there are two unique elements to our systems:

- We take measurements during the time that we are transmitting a signal (the "on-time") and actually use this data in our geophysical interpretations, and
- We measure the horizontal component of the magnetic field (we call it the X-component), and use that data, as well, in our geophysical interpretations.

3 We will continue to add unique elements to these systems. For example, in 2006 we added a Cesium magnetometer to the tail assembly of our AeroTEM II systems. This "mag-on-bird", as we call it, is a substantial improvement over the traditional

method of locating a magnetometer on the tow cable, some 20 metres above the TEM structure. Not only is the mag-on-bird closer to the ground, resulting in better resolution, but it is more stable as well, resulting in higher signal quality. In 2007, our improvements efforts will involve experimenting with the capacity to imbed horizontal magnetic gradient capability into our AeroTEM systems and experimenting with the possibility of making what is known as "B-field" measurements. Measuring the B-field means taking direct measurements of the magnetic field, rather than it's time derivative as we do today. B-field measurements are particularly useful in the search for high conductance targets, such as those found at Voisey's Bay in the province of Newfoundland and Labrador.

The operational dimension addresses what we will do to optimize the amount of money we can make from the systems that we design and build.

There are four keys points to our operational strategy. They are listed here in the approximate order that we have addressed or will consider them:

1 Increase the number of survey systems, with a focus on AeroTEM.

We have been building our fleet for the past two years. As I write this, we have nine operational systems, six of which are AeroTEM. In 2007 we expect to introduce at least three new AeroTEM systems as well as a number of geophysical survey systems based on other survey methods.

2 Expand internationally.

As F2006 drew to a close we began flying our first truly international surveys. We have targeted Russia, Mexico, Africa and Brazil as areas of high interest to us. Not only are many of these areas highly prospective from an exploration standpoint, but, excepting Russia, they are in climates that allow us to fly either all year round, or to fly during

the Canadian winter months – a traditionally slow season for us.

3 Expand into non-TEM survey methods.

Many of our clients would like us to offer survey capabilities beyond just time-domain electro-magnetics. To date, we have responded to this opportunity by activating one frequency-domain system, known as the Impulse™ system, as well as two tri-directional magnetic gradiometers. To support these and the AeroTEM systems, we have also purchased two Gamma-ray spectrometer systems. Taken together, these systems give Aeroquest the capability to address virtually all of the major mineral commodities from an exploration standpoint, as well as precious metals and certain gems and oil and gas.

How We Make Money

Our revenue equation is quite straightforward. Prospective revenue is the product of the effective number of systems we have and the revenue potential per system per year. We are very focused on increasing these two measurables in the coming year. I have talked about our plans with respect to adding systems, and in the year upcoming we will also be focused on improving the revenue from each system. We will do this by selling more surveys for each system and by working on increasing the revenue per line kilometer of each of our systems.

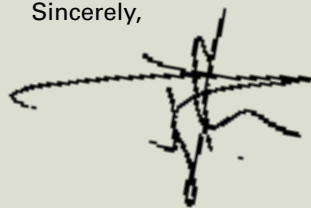
Our gross margin is only slightly more complicated. As helicopter costs are such a large percentage of our Cost of Sales, gross margin is essentially determined by the relationship between revenue and helicopter costs. In order to improve our gross margin, we will focus on pricing at a level that accurately reflects our expected helicopter costs and we will work toward establishing relationships with helicopter suppliers that provide us with lower costs.

4 Expand into other applications of TEM survey methods.

We have identified three new markets that we would like to pursue; oil and gas, unexploded ordinance (UXO) and groundwater exploration. In F2006, we made some strides testing the technical feasibility of our systems in oil and gas and UXO and, while the results were quite positive, much work remains to be done in the areas of selecting the appropriate partner or partners, building a supporting infrastructure, getting the necessary qualifying certifications and positioning us to be able to respond to the appropriate Requests for Proposals. In 2007 we will refine and begin implementing our strategy to penetrate these new markets.

A wise person once told me to make sure that I was always on either the “learning curve” or the “earning curve”, and to carefully manage the amount of time I spent on each. Aeroquest, for better or worse, has spent much of the past twelve months on the learning curve. We’ve learned how to sell, how to manage the logistics of having multiple systems located at far flung points on the earth, and we have learned what it takes to be a successful public company. The challenge we have established for ourselves in 2007 is to move to the earning curve – and we expect to demonstrate success immediately. Thank you for your patience and continued support.

Sincerely,



Roy T. Graydon
CEO

MANAGEMENT'S DISCUSSION & ANALYSIS

FOR THE PERIOD ENDING APRIL 30, 2006

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

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

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

FORWARD-LOOKING STATEMENTS

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

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

NON-GAAP FINANCIAL MEASURES

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

EBITDA

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

OVERVIEW

AEROQUEST'S BUSINESS

We are a world leader in the development and operation of innovative and proprietary airborne geophysical surveying platforms servicing the mineral exploration, oil and gas, and environmental industries. We operate a number of proprietary time-domain (sometimes called transient) electromagnetic (TEM) systems on

platforms ranging from five metres to 12 metres in diameter, delivered under the tradename AeroTEM. We also supply geophysical surveying platforms based on frequency domain electromagnetics (under the Impulse trade name), total field magnetics, magnetic gradient and radiometrics.

Summary of Quarterly Results

| (in thousands 000's) | Q1-05 | Q2-05 | Q3-05 | Q4-05 | Q1-06 | Q2-06 | Q3-06 | Q4-06 |
|----------------------|--------|--------|--------|--------|--------|--------|--------|--------|
| Sales | 1,546 | 2,836 | 940 | 2,585 | 2,798 | 1,867 | 1,764 | 2,683 |
| EBITDA | 163 | 826 | (317) | (394) | (248) | (265) | 124 | 95 |
| Net Income | 26 | 565 | (337) | (797) | (329) | (524) | (78) | (252) |
| Avg. Common Shares | 10,400 | 10,400 | 15,829 | 15,837 | 15,840 | 15,840 | 15,840 | 15,840 |
| EPS | 0.00 | 0.05 | (0.02) | (0.05) | (0.02) | (0.03) | (0.00) | (0.02) |

2006 OPERATING RESULTS

OVERVIEW

This year marked our company's first full year as a public company. It was a year of learning for us as we worked on, and by year-end had completed, the transition from being a single product company selling in a single market to one offering multiple systems and multiple platforms to clients around the world.

We repositioned our company for profitability in the second half of the year and are very pleased with our progress during that period of time. Our revenue continues to grow, our gross margin has

stabilized and we were cash flow positive, as measured by operating cash flow, in the last two quarters of the year. We completed 63 contracts during the year and flew over 65,300 line kms. We are particularly pleased with the level of contracted backlog in the business, which has grown from insignificant levels early in the year, to the point at year end, where we had a backlog of 22 different contracts on three continents, totalling \$2.6 million. Since year-end this backlog has grown to over 40 contracts and over \$5.8 million.

Key Operating Metrics

| | 2006 | | | | 2005 | |
|---|--------|--------|--------|--------|--------|-------|
| | Q4 | Q3 | Q2 | Q1 | Q4 | Q3 |
| Systems available for use at period-end | 7 | 7 | 7 | 8 | 7 | 5 |
| AeroTEM systems | 4 | 4 | 4 | 5 | 4 | 3 |
| Line kilometres flown during period | 16,900 | 12,950 | 18,700 | 16,800 | 24,600 | 5,400 |
| Contracts completed | 24 | 15 | 15 | 9 | 10 | 6 |
| Contracts in backlog at period end | 22 | 7 | 6 | 0 | 2 | 2 |

SYSTEMS

We operate seven systems on four different platforms. Our most popular and most innovative platform is AeroTEM. It is based on time-domain electromagnetics (TEM). TEM systems are referred to as active systems in that we energize the earth (using pulsed electric fields) and then measure the earth's response to that energy stimulus. TEM systems are used to identify bodies that are capable of conducting electricity because they measure a property of the earth called conductance. The term "time-domain" distinguishes it from "frequency-domain" and refers to the fact that we measure the response of the earth at various points in time both while we are stimulating the earth (the "on-time") and when our transmitter is shut off (the "off-time").

All the AeroTEM systems are based on rigid air-frame designs. These rigid systems are the foundation that allows us to take reliable measurements of three different components of the earth's response. We measure the vertical component of the earth's response during the on-time and we can measure both the vertical and horizontal components of the off-time response. We refer to these as Z-on, Z-off and X-off, respectively. Recent advances to

our AeroTEM systems include the addition of magnetic sensors to the airframe to measure the vertical component of the ambient magnetic field while we are flying the EM survey.

The unique features of our systems allow us to produce very high resolution data with a high signal-to-noise ratio, to do conductance discrimination and to retrieve information on position, orientation, depth and thickness of conductors.

We currently offer three types of AeroTEM systems that we designate AeroTEM II, III and IV.

AEROTEM II

The AeroTEM II system is based on a platform that is approximately five metres in diameter. The power level of this system (a peak dipole moment of approximately 40,000 Amp-m²) has allowed it to see conductors as deep as 400 metres, although it is more typically used in the search for targets that are up to 250 metres in depth. The AeroTEM II system, because of its size and base frequency (150 Hz) has been shown to be quite useful in the search for gold and platinum group elements (PGEs),

as well as for kimberlites, the host rock of diamonds. The AeroTEM II system is particularly adept at surveying in rugged or mountainous terrain where its smaller diameter and modest weight allow it to be quite manoeuvrable. During 2006 one AeroTEM II system crashed while on ferry, leaving us, at year-end, with three AeroTEM II systems in operation, and one in the process of being recommissioned.

AEROTEM III

The AeroTEM III system is based on a platform that is approximately 9 metres in diameter. The power level of this system is higher – from 120,000 to up to 275,000 Amp-m². The AeroTEM III system has been used to search for targets at mid-level depths – up to 400 metres, and is also well suited to work in the oil and gas sector where near surface rocks are often conductive. The range of base frequencies of this system (90 Hz and 150 Hz) also makes it suitable for base metal exploration, and particularly for nickel. During 2006, one AeroTEM III system was accidentally driven into the ground and destroyed. We have constructed a new AeroTEM III system and expect to commission it in the first quarter of 2007.

AEROTEM IV

The AeroTEM IV system is based on a platform that is approximately 12 metres in diameter. The power level of this system can range from 140,000 up to 400,000 Amp-m². The AeroTEM IV system is well suited to the search for deeper targets, up to 600 metres, and in areas where the rocks are more conductive. At year-end we had one AeroTEM IV system in operation and two others under construction.

Our goal is to continue to focus on adding AeroTEM systems as appropriate, focusing on incorporating our latest advances in electronics and in platform design into each new system, as well as increasing the utilization rate of the existing fleet. We expect to commission new AeroTEM systems at a rate of approximately one per quarter for the next several quarters. These systems will vary from 6 metres to approximately 15 metres in diameter and all will have more powerful transmitters and will be capable of operating at a range of base frequencies. Our newest system, AeroTEM V, expected in the second half of 2007 will be a system almost 15 metres in diameter that will have a power level up to 700,000 Amp-m². We expect these systems to continue to offer exceptionally high resolution and better depths of investigation than any system we have in use today.

IMPULSE

The Impulse system is a frequency-domain EM system. It works by transmitting a primary electromagnetic field at discrete frequencies and then measuring the secondary electromagnetic response from the sub-surface at the same frequencies. By transmitting discrete frequencies at two different orientations (one vertical and one horizontal) it is possible to estimate the orientation, position and conductance of the body creating the response. At year-end we had one Impulse system in operation.

MAGNETIC GRADIOMETER

We own and operate a tri-directional magnetic gradiometer. This is a passive system, as opposed to both AeroTEM and Impulse, which are active systems. The gradiometer takes four measurements of

the earth's magnetic field every 0.1 seconds from sensors that are spatially separated by 3m. These four measurements can be used to calculate the rate of change of the earth's magnetic field in three orthogonal directions. At year-end we had one tri-directional magnetic gradiometer system in operation and had begun the construction of a second.

RADIOMETRICS

We also own and operate a gamma ray spectrometer. This passive system measures the rate of spontaneous radiological decay from rocks up to 60 cm below the earth's surface. In most survey applications, the spectrometer is combined with another of our systems to produce several measurements simultaneously. The most popular combination is gradiometer and spectrometer. At year-end we had one radiometrics system in operation and had made commitments to purchase a second.

Revenue & Gross Profit

| (in thousands of Canadian dollars) | Three Months Ended | | Year-to-Date | | Change from prior year | | Change from prior YTD | |
|------------------------------------|--------------------|-----------|--------------|-----------|------------------------|------|-----------------------|------|
| | 30-Apr-06 | 30-Apr-05 | 30-Apr-06 | 30-Apr-05 | | | | |
| Revenue | 2,683 | 2,585 | 9,112 | 7,907 | 98 | 4% | 1,205 | 15% |
| Cost of sales | 1,730 | 1,607 | 5,764 | 4,539 | 123 | 8% | 1,225 | 27% |
| Gross profit | 953 | 978 | 3,348 | 3,368 | (25) | (3%) | (20) | (1%) |
| Gross profit margin % | 36% | 38% | 37% | 43% | | (2%) | | (6%) |

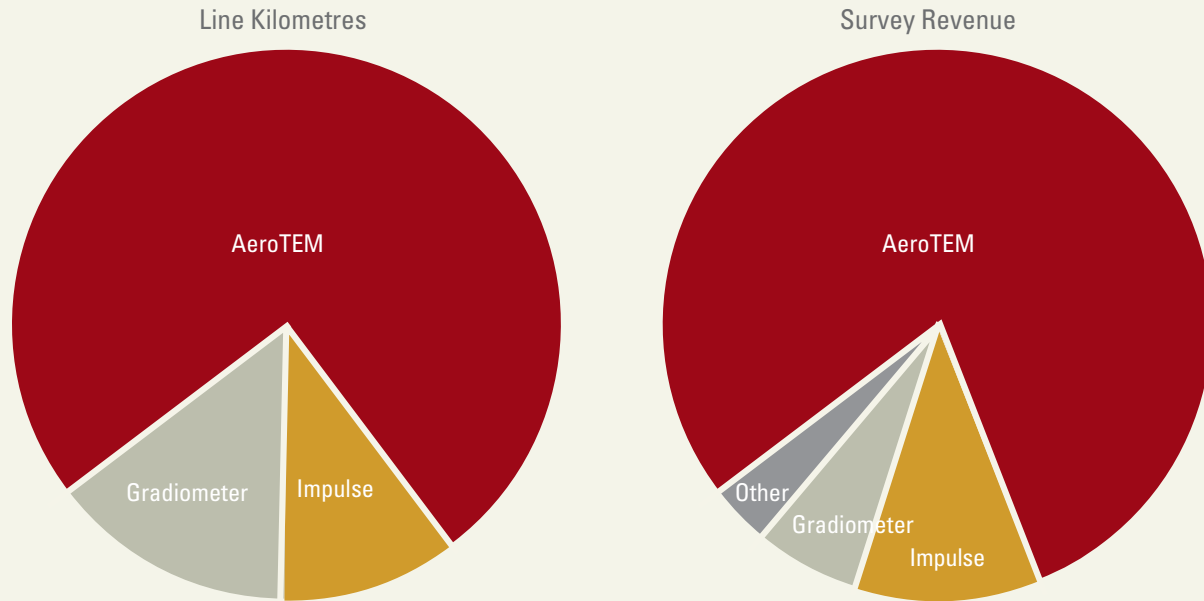
REVENUE

Our revenue in the fourth quarter of 2006 was \$2,683 thousand, a modest increase of \$98 thousand, or 4 percent from the level of \$2,585 thousand in the same period in 2005. In 2006, our total revenue was \$9,112 thousand, up \$1,205 thousand, or 15 per cent compared to the same last year. Our revenue is characterized by a relatively small number of contracts, so the presence or absence of one or two contracts can have a meaningful impact on our sales level in a given period.

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 2006 in general, we flew a larger number of contracts of shorter average duration than we did in similar periods in 2005. Cost of sales was \$1,730 thousand in the fourth quarter of 2006, and \$5,764 thousand for the full year, or approximately 63 per cent of revenue. This compares to \$1,607 thousand in the same quarter last year and \$4,539 thousand for the full year, representing 57 per cent of revenue in that year.

2006 Survey Activity Breakdown



Cost of sales was increased by approximately \$1,225 thousand compared to 2005, resulting from the requirement to use larger, more expensive helicopters to operate the large diameter systems and as a consequence of doing, on average, smaller surveys in 2006 than in 2005.

The increase in revenue was not enough to offset the increase in cost of sales. As a result, gross profit for the year was \$3,348 thousand, a decline of \$20 thousand from the prior year. Gross profit margin declined from 43 percent in 2005 to 37 percent in 2006 for the reasons mentioned above. Our expectation is to return our gross margin to the range of 40 to 45 per cent of revenue in 2007.

2006 Survey Activity Breakdown

| | Three Months Ended | | Year-to-Date | | Change from prior year | | Change from prior YTD | |
|-------------------------------------|--------------------|-----------|--------------|-----------|------------------------|--------|-----------------------|--------|
| | 30-Apr-06 | 30-Apr-05 | 30-Apr-06 | 30-Apr-05 | | | | |
| (in thousands of Canadian dollars) | | | | | | | | |
| Research & development expense | 44 | 286 | 793 | 645 | (242) | (85%) | 148 | 23% |
| General & administrative expense | 789 | 302 | 2,788 | 1,661 | 487 | 161% | 1,127 | 68% |
| Depreciation & amortization expense | 242 | 252 | 954 | 611 | (10) | (4%) | 343 | 56% |
| Stock option expense | 25 | 776 | 62 | 776 | (751) | (97%) | (714) | (92%) |
| Write down of long term investment | - | 8 | - | 8 | (8) | (100%) | (8) | (100%) |
| Total operating costs | 1,100 | 1,624 | 4,597 | 3,701 | (524) | (32%) | 896 | 24% |
| % of Revenue | 41% | 63% | 50% | 47% | | (22%) | | 4% |

OPERATING COSTS

Overall, fourth quarter operating costs were \$1,100 thousand, down by \$524 thousand, or 32 percent from \$1,624 thousand in the same quarter last year. This decrease is attributable to the fact that last year's fourth quarter included a \$776 thousand expense for stock options that was reduced by \$751 thousand to \$25 thousand in the fourth quarter of this year. Year-over-year, operating costs increased by \$896 thousand 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, offset by the above-mentioned decrease in stock option expense.

Research and development expense was \$44 thousand for the quarter, down \$242 thousand, or 85 percent from the same period last year. However, research and development costs were \$793 thousand on a year-to-date basis, up by 23 per cent from the level of \$645 thousand last year. In the fourth quarter, we scaled back the level of discretionary expenditures, including

research and development expenses, as a part of our efforts to reduce non-revenue producing or supporting activity.

General and administrative expenses totalled \$789 thousand in the quarter, up from \$302 thousand in the same quarter last year. On a year-to-date basis, general and administrative costs are \$2,788 thousand, up 68 percent, or \$1,127 thousand from the level in the same period last year. General and administrative costs have risen over the past year as we have put in place an infrastructure to allow us to expand both geographically and in product scope, addressing opportunities in the oil and gas market, the UXO market and the groundwater survey market. We expect that these additional costs will result in increased revenues in 2007 and beyond.

Depreciation and amortization charges totalled \$242 thousand in the quarter, a 4 per cent decline from the same quarter last year, and \$954 thousand for the year a 56 per cent increase, year-over-year. Depreciation and amortization has generally

Operating Profit (Loss) & EBITDA

| | Three Months Ended | | Year-to-Date | | Change from prior year | | Change from prior YTD | |
|------------------------------------|--------------------|-----------|--------------|-----------|------------------------|-------|-----------------------|--------|
| | 30-Apr-06 | 30-Apr-05 | 30-Apr-06 | 30-Apr-05 | | | | |
| (in thousands of Canadian dollars) | | | | | | | | |
| Operating profit (loss) | (147) | (646) | (1,249) | (333) | 499 | 77% | (916) | (275%) |
| Depreciation & amortization | 242 | 252 | 954 | 611 | (10) | (4%) | 343 | 56% |
| EBITDA | 95 | (394) | (295) | 278 | 489 | 124% | (573) | (206%) |
| Write down of discontinued project | 69 | - | 142 | - | 69 | | 142 | |
| Contract cancellation costs | - | - | 268 | - | - | | 268 | |
| Other costs (income) | (12) | (20) | (47) | (67) | 8 | (40%) | 20 | (30%) |
| EBITDA after unusual items | 38 | (374) | (658) | 345 | 412 | 110% | (1,003) | (291%) |
| EBITDA as a % of Revenue | 4% | (15%) | (3%) | 4% | | | | |

been rising as we build and deploy more AeroTEM systems. We expect the rate of growth of this expense will slow over the next several quarters.

OPERATING PROFIT (LOSS)

Our operating loss was \$147 thousand in the fourth quarter, an improvement of \$499 thousand, or 77 per cent, from the operating loss of \$646 thousand in the same quarter last year. Consequently, we recorded EBITDA of \$95 thousand in the fourth quarter, as compared to a loss of \$394 thousand in the same period last year. Most of the \$489 thousand improvement in EBITDA in the fourth quarter came from the difference in stock option expense between the quarters.

Our EBITDA for the year was a loss of \$295 thousand, a drop of \$573 thousand from last year's EBITDA of \$278 thousand. However, the cost reductions and profitability improvements made during the second half of the year have overcome this negative variance with the result that the

Company's operations are more profitable today than they were at this time last year. The Company does not expect to repeat its performance in the early part of 2007.

NET INCOME (LOSS)

We recorded a provision for income taxes in the quarter of \$48 thousand and a year to date recovery of \$429 thousand which reflects a year-to-date adjustment in the fourth quarter limiting the current taxes recoverable to total taxes paid in prior years of \$480 thousand. As a consequence, we recorded a net loss in the quarter of \$252 thousand, or \$(0.02) per share, compared with a net loss of \$797 thousand or \$(0.05) per share in the same quarter last year. It is our objective to become a profitable enterprise within the next quarter.

For the reasons articulated above the full year loss was \$1,183 thousand, or \$(0.07) per share. This compared to a loss of \$543 thousand or \$(0.04) per share in 2005.

Net Income (Loss)

| | Three Months Ended | | Year-to-Date | | | | | |
|---------------------------------------|--------------------|-----------|--------------|-----------|------------------------|-------|-----------------------|--------|
| | 30-Apr-06 | 30-Apr-05 | 30-Apr-06 | 30-Apr-05 | Change from prior year | | Change from prior YTD | |
| (in thousands of Canadian dollars) | | | | | | | | |
| Operating profit (loss) | (147) | (646) | (1,249) | (333) | 499 | 77% | (916) | (275%) |
| Write down of development costs | 69 | - | 142 | - | 69 | | 142 | |
| Contract cancellation costs | - | - | 268 | - | - | | 268 | |
| Other costs (income) | (12) | (20) | (47) | (67) | 8 | (40%) | 20 | (30%) |
| Provision for income taxes (recovery) | 48 | 171 | (429) | 277 | (123) | (72%) | (706) | (255%) |
| Net income (loss) | (252) | (797) | (1,183) | (543) | 545 | 68% | (640) | (118%) |
| Earnings per share - basic | \$ (0.02) | \$ (0.05) | \$ (0.07) | \$ (0.04) | \$ 0.03 | 68% | \$ (0.03) | (80%) |

CASH FLOW

CASH FLOW FROM OPERATING ACTIVITIES

Operating cash flow before changes in non-cash working capital provided \$57 thousand in the fourth quarter of 2006, a reduction of \$167 thousand from the fourth quarter of 2005. Operating cash flow decreased in part because of the Company's increase in infrastructure costs and reduced operating margins. Year over year, operating cash flow decreased by \$962 thousand for the same reasons.

Changes in non-cash working capital further reduced cash flow by \$76 thousand in the fourth quarter of 2006 and provided additional cash of \$248 thousand from the same period in 2005. The reduction of \$324 thousand was a result of an increased investment in Accounts receivable in the month of April 2006. Year over year changes in non-cash working capital of \$1,412 thousand were primarily due to the fact that the investment in Accounts receivable in 2005 was not repeated in 2006.

Cash Flow from Operating Activities

| (in thousands of Canadian dollars) | Three Months Ended | | Year-to-Date | | Change from prior year | | Change from prior YTD | |
|------------------------------------|--------------------|-----------|--------------|-----------|------------------------|--------|-----------------------|--------|
| | 30-Apr-06 | 30-Apr-05 | 30-Apr-06 | 30-Apr-05 | | | | |
| Net income (loss) | (252) | (797) | (1,183) | (543) | 545 | 68% | (640) | (118%) |
| Depreciation & amortization | 242 | 252 | 954 | 611 | (10) | (4%) | 343 | 56% |
| Stock option expense | 25 | 776 | 62 | 776 | (751) | (97%) | (714) | (92%) |
| Write down of long term investment | - | 8 | - | 8 | (8) | (100%) | (8) | (100%) |
| Future income taxes (recovery) | 47 | (15) | 47 | (15) | 62 | (413%) | 62 | (413%) |
| Gain on disposal of capital assets | (5) | - | (5) | - | (5) | | (5) | |
| Operating cash flow | 57 | 224 | (125) | 837 | (167) | (75%) | (962) | (115%) |
| Change in non-cash working capital | (76) | 248 | 295 | (1,117) | (324) | (131%) | 1,412 | 126% |
| Net income (loss) | (19) | 472 | 170 | (280) | (491) | (104%) | 450 | 161% |

CASH FLOW FROM INVESTING ACTIVITIES

Overall, investment activities in the fourth quarter generated \$1 thousand of cash. This compares to the fourth quarter of last year when investing activities used cash of \$859 thousand. For the full year, cash flow from investing activities used \$688 thousand, an increase of \$215 thousand from the level of \$473 thousand in 2005. Comparisons with the same period last year are heavily influenced by sales of marketable securities last year that were not repeated this year.

Acquisition of capital assets consumed \$382 thousand, or 14 per cent of revenue, as compared to \$875 thousand, or 34 per cent of revenue in the same quarter last year. For the full year, we invested a total of \$1,074 thousand in capital assets, as compared to \$2,442 thousand in 2005. The reduction in investing activity reflects the fact that we built fewer systems in 2006. We are targeting to keep ongoing capital expenditures at approximately

Cash Flow from Investing Activities

| | Three Months Ended | | Year-to-Date | | | | | |
|--|--------------------|-----------|--------------|-----------|------------------------|--------|-----------------------|--------|
| | 30-Apr-06 | 30-Apr-05 | 30-Apr-06 | 30-Apr-05 | Change from prior year | | Change from prior YTD | |
| (in thousands of Canadian dollars) | | | | | | | | |
| Acquisition of capital assets | (382) | (875) | (1,074) | (2,442) | 493 | 56% | 1,368 | 56% |
| Sales of marketable securities | - | - | - | 1,984 | - | - | (1,984) | (100%) |
| Change in loan receivable | - | 16 | 3 | (15) | (16) | (100%) | 18 | 121% |
| Insurance proceeds on equipment | 383 | - | 383 | - | 383 | - | 383 | - |
| Cash flow from investing activities | 1 | (859) | (688) | (473) | 860 | 100% | (215) | (45%) |
| Capital expenditures as a % of revenue | 14% | 34% | 12% | 31% | | | | |

10 per cent of revenue and should be able to approximately double the size of our fleet in 2007. Capital investments were, and will be, made primarily to expand the fleet of AeroTEM systems.

CASH FLOW FROM FINANCING ACTIVITIES

In the fourth quarter and the past full year, financing activities were not significant. In past periods financing activity was dominated by the reverse takeover and subsequent issue of common shares in the second quarter of 2005.

Our liquidity, as measured by cash balances, has declined by \$523 thousand from the start of the year. A large portion of this change was due to investments in capital assets, which have consumed a net amount of \$691 thousand over the year. These investments are expected to translate into increased revenue which will allow us to improve our cash position going forward.

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.

Cash Flow from Financing Activities

| | Three Months Ended | | Year-to-Date | | | | | |
|-------------------------------------|--------------------|-----------|--------------|-----------|------------------------|--------|-----------------------|--------|
| | 30-Apr-06 | 30-Apr-05 | 30-Apr-06 | 30-Apr-05 | Change from prior year | | Change from prior YTD | |
| (in thousands of Canadian dollars) | | | | | | | | |
| Repayment of long term debt | - | (5) | (6) | (25) | 5 | (100%) | 19 | (76%) |
| Issuance of Common Shares | - | (277) | - | 3,321 | 277 | (100%) | (3,321) | (100%) |
| Cash flow from financing activities | - | (282) | (6) | 3,296 | 282 | (100%) | (3,302) | (100%) |

LIQUIDITY AND CAPITAL RESOURCES

FINANCIAL POSITION

At April 30, 2006, we had current assets of \$5,183 thousand and current liabilities of \$2,387 thousand. Net working capital was \$2,796 thousand, a decrease from the \$3,723 thousand at April 30, 2005. This \$927 thousand change from the prior year-end is primarily due to investments in capital assets and the historical requirement to fund operating losses.

TRANSACTIONS WITH RELATED PARTIES

During the year, we paid \$423 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.

Cash Flow from Operating Activities

| (in thousands of Canadian dollars) | 30-Apr-06 | 30-Apr-05 | Change from prior year end | |
|------------------------------------|-----------|-----------|----------------------------|-------|
| Cash | 2,511 | 3,034 | (523) | (17%) |
| Non-cash current assets | 2,672 | 2,517 | 155 | 6% |
| Current assets | 5,183 | 5,551 | (368) | (7%) |
| Less: Current liabilities | 2,387 | 1,828 | 559 | 31% |
| Net working capital | 2,796 | 3,723 | (927) | (25%) |
| Current ratio | 2.2 | 3.0 | (0.9) | (28%) |



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:

Summary of Stock Options

| | 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 | 202,500 | \$0.50 | October 28, 2009 |
| | 55,000 | \$2.00 | October 28, 2009 |
| | 30,000 | \$0.50 | March 1, 2010 |
| | 45,000 | \$2.00 | June 30, 2010 |
| | 35,000 | \$0.50 | June 30, 2010 |
| | 280,000 | \$0.50 | February 9, 2011 |
| | 50,000 | \$0.50 | March 28, 2011 |
| Total vested & exercisable under Stock Option Plan | 697,500 | \$0.71 | |
| Fully vested & exercisable options held by Brokers | 300,000 | \$2.00 | October 28, 2006 |
| Total | 997,500 | \$1.10 | |

INTERNAL CONTROL SYSTEMS

To ensure the integrity and objectivity of our data, we maintain a system of internal controls comprising of written policies, procedures and a program of internal reviews that provides reasonable assurance that transactions are recorded and executed in accordance with their authorization, that assets are properly safeguarded and that reliable financial records are maintained.

During the year ended April 30, 2006 there were no significant changes to the systems of internal control within our company.

CRITICAL ACCOUNTING POLICIES**Nature of Business**

Aeroquest International Limited (formerly PICorp. Capital Ltd.) was incorporated by Certificate of Incorporation issued pursuant to the provisions of the General Corporation Law of the State of Delaware on September 21, 2001. On April 29, 2004, the Company was continued under the

ABCA and on October 27, 2004 continued under the OBCA in conjunction with the Qualifying Transaction. The Company is a public company trading on the TSX Venture Exchange.

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

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Aeroquest Limited and Aeroquest (UK) Limited. All significant inter-company transactions and balances have been eliminated on consolidation.

Use of Estimates

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

Revenue Recognition

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

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

Financial Instruments

Unless otherwise noted, it is management's opinion that the Company is not exposed to significant interest, currency or credit risks arising from its financial instruments. The fair values of these financial instruments approximate their carrying values, unless otherwise noted.

Foreign Currency Translation

Foreign currency accounts are translated into Canadian dollars as follows:

- At the transaction date, each asset, liability, revenue and expense is translated into Canadian dollars by the use of the exchange rate in effect at that date.
- At the year end date, monetary assets and liabilities are translated into Canadian dollars by using the exchange rate in effect at that date.

The resulting foreign exchange gains and losses are included in income in the current period.

Cash and Cash Equivalents

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

Long-term Investments

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

Intellectual Property

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

Capital Assets

Capital assets are stated at cost less accumulated amortization. Cost is net of related investment tax credits and

government grants. Amortization based on the estimated useful life of the asset is calculated as follows:

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

Long-Lived Assets

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

tax rates and laws expected to be in effect when the differences are realized.

Stock-Based Compensation

Aeroquest International has adopted the recommendations of the CICA with respect to stock based compensation and other stock based payments. These standards require that direct awards of stock, liabilities incurred or other compensation arrangements that are based on the price of common stock, be measured at fair value at each reporting date, with the change in fair value reported in the statement of operations.

Research and Development

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

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

Income Taxes

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



AEROQUEST INTERNATIONAL LIMITED

CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED APRIL 30, 2006 AND 2005

Contents

| | |
|-------------------------|-----------|
| Auditors' Report | 19 |
|-------------------------|-----------|

Consolidated Financial Statements

| | |
|---|----|
| Consolidated Balance Sheets | 20 |
| Consolidated Statements of Operations and Retained Earnings (Deficit) | 21 |
| Consolidated Statements of Cash Flows | 22 |
| Summary of Significant Accounting Policies | 23 |
| Notes to Consolidated Financial Statements | 25 |

AUDITORS' REPORT

To the Shareholders of Aeroquest International Limited

We have audited the consolidated balance sheets of Aeroquest International Limited as at April 30, 2006 and 2005 and the consolidated statements of operations and retained earnings (deficit) and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at April 30, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

(signed) "BDO Dunwoody LLP"

Chartered Accountants
Toronto, Ontario
June 9, 2006

Consolidated Balance Sheets

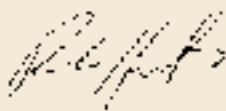
| As at April 30 | 2006 | 2005 |
|---|---------------------|---------------------|
| Assets | | |
| Current | | |
| Cash and cash equivalents | \$ 2,510,679 | \$ 3,034,338 |
| Accounts receivable | 1,907,319 | 1,939,571 |
| Income taxes receivable | 480,000 | — |
| Prepaid expenses | 58,681 | — |
| Contracts in process | 165,749 | 513,433 |
| Loan receivable (Note 2) | 60,528 | 63,713 |
| | \$ 5,182,956 | \$ 5,551,055 |
| Long-term investments (Note 3) | \$ 126,001 | \$ 16,001 |
| Capital assets (Note 4) | 2,607,618 | 2,740,931 |
| Intellectual property (Note 5) | 93,757 | 218,767 |
| Future income taxes (Note 8) | 62,792 | 110,000 |
| | \$ 8,073,124 | \$ 8,636,754 |
| Liabilities and Shareholders' Equity | | |
| Current | | |
| Accounts payable and accrued liabilities | \$ 1,584,042 | \$ 1,026,808 |
| Income tax payable | — | 78,553 |
| Deferred revenue | 802,925 | 717,249 |
| Current portion of long-term debt (Note 6) | — | 5,580 |
| | \$ 2,386,967 | \$ 1,828,190 |
| Shareholders' Equity | | |
| Share capital (Note 7) | \$ 5,836,176 | \$ 5,836,176 |
| Contributed surplus (Note 7d) | 986,771 | 925,950 |
| Retained earnings (deficit) | (1,136,790) | 46,438 |
| | \$ 5,686,157 | \$ 6,808,564 |
| | \$ 8,073,124 | \$ 8,636,754 |

The accompanying summary of significant accounting policies and notes are an integral part of these financial statements.

On behalf of the Board:



Roy Graydon
Director



Roland Horst
Director

Consolidated Statements of Operations and Retained Earnings (Deficit)

| For the years ended April 30 | 2006 | 2005 |
|--|----------------|--------------|
| Sales | \$ 9,112,291 | \$ 7,907,357 |
| Cost of sales | 5,764,336 | 4,539,237 |
| Gross margin | 3,347,955 | 3,368,120 |
| Expenses and other items | | |
| Development expenses | 792,933 | 644,652 |
| General and administrative expenses | 2,787,891 | 1,661,461 |
| Amortization expense | 954,216 | 610,704 |
| Stock option expense | 61,510 | 775,950 |
| Write down of long-term investment | — | 8,003 |
| | 4,596,550 | 3,700,770 |
| Operating loss | (1,248,595) | (332,650) |
| Write down of discontinued development projects | 142,424 | — |
| Contract cancellation costs | 268,250 | — |
| Other costs (income) | (47,110) | (66,823) |
| | 363,564 | (66,823) |
| Loss before income taxes | (1,612,159) | (265,827) |
| Income taxes (recovery) (Note 8) | | |
| Current | (476,139) | 291,899 |
| Future | 47,208 | (15,000) |
| | (428,931) | 276,899 |
| Net loss for the year | (1,183,228) | (542,726) |
| Retained earnings, beginning of year, as previously reported | 111,438 | 589,164 |
| Prior period adjustment (Note 15) | (65,000) | — |
| Retained earnings, beginning of year, as restated | 46,438 | 589,164 |
| Retained earnings (deficit), end of year | \$ (1,136,790) | \$ 46,438 |
| Loss per share: | | |
| Basic and fully diluted (Note 12) | \$ (0.07) | \$ (0.04) |

The accompanying summary of significant accounting policies and notes are an integral part of these financial statements.

Consolidated Statements of Cash Flows

| For the years ended April 30 | 2006 | 2005 |
|--|---------------------|---------------------|
| Cash provided by (used in) | | |
| Operating activities | | |
| Net loss for the year | \$ (1,183,228) | \$ (542,726) |
| Adjustments required to reconcile net loss with net cash from operating activities | | |
| Amortization | 954,216 | 610,704 |
| Write down of long-term investment | – | 8,003 |
| Stock option expense | 61,510 | 775,950 |
| Future income taxes (recovery) | 47,208 | (15,000) |
| Gain on disposal of capital assets | (5,253) | – |
| Operating cash flow before changes in non-cash working capital | (125,547) | 836,931 |
| Accounts receivable | (77,748) | (1,531,645) |
| Prepaid expenses | (58,681) | 102,130 |
| Contracts in process | 347,684 | (314,683) |
| Accounts payable and accrued liabilities | 557,234 | 349,262 |
| Income taxes | (558,553) | (92,889) |
| Deferred revenue | 85,676 | 370,407 |
| Cash flow from operating activities | 170,065 | (280,487) |
| Investing activities | | |
| Loan receivable | 3,185 | (14,463) |
| Increase in capital assets | (1,074,226) | (2,442,412) |
| Sale of marketable securities | – | 1,983,961 |
| Insurance proceeds on capital assets | 382,897 | – |
| Cash flow from investing activities | (688,144) | (472,914) |
| Financing activities | | |
| Repayment of long-term debt | (5,580) | (24,603) |
| Net proceeds from common share issue | – | 3,321,219 |
| Cash flow from financing activities | (5,580) | 3,296,616 |
| Net change in cash and cash equivalents during the year | (523,659) | 2,543,215 |
| Cash and cash equivalents, beginning of year | 3,034,338 | 491,123 |
| Cash and cash equivalents, end of year | \$ 2,510,679 | \$ 3,034,338 |

Supplementary information (Note 13)

The accompanying summary of significant accounting policies and notes are an integral part of these financial statements.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

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

Principles of Consolidation The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Aeroquest Limited and Aeroquest (UK) Limited. All significant inter company transactions and balances have been eliminated on consolidation.

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

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

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

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

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

Foreign Currency Translation Foreign currency accounts are translated into Canadian dollars as follows:

- At the transaction date, each asset, liability, revenue and expense is translated into Canadian dollars by the use of the exchange rate in effect at that date.
- At the year end date, monetary assets and liabilities are translated into Canadian dollars by using the exchange rate in effect at that date.

The resulting foreign exchange gains and losses are included in income in the current period.

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

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

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

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

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

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

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

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

Stock-based Compensation The Company has adopted the recommendations of the CICA with respect to stock-based compensation and other stock-based payments. These standards require that direct awards of stock, liabilities incurred or other compensation arrangements that are based on the price of common stock, be measured at fair value at each reporting date, with the change in fair value reported in the statement of operations.

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1 | Reverse Takeover

On October 28, 2004, Aeroquest Limited and its principal shareholders entered into a reverse takeover of PICorp. Capital Ltd. (previously Phoenix International, Inc.) ("PICorp") wherein all of the issued and outstanding shares of Aeroquest Limited were sold, by way of share exchange, to PICorp (the "RTO"). Holders of issued and outstanding common shares of Aeroquest Limited received one share of PICorp for each Aeroquest Limited share held.

Pursuant and prior to the RTO, PICorp consolidated its common shares on a three-for-one basis such that 3,166,665 shares were consolidated to 1,055,555 shares.

Prior to the RTO, the entire principal amount of Aeroquest Limited's convertible debentures, issued on May 31, 2004 with interest accruing at 10% commencing six months from the date of the original transfer of funds, were converted into common shares at rates of \$.90 to \$1.00. At the time of closing, Aeroquest Limited had 12,773,607 shares outstanding, including 2,373,607 shares issued upon conversion of the debentures.

Upon completion of the RTO, there were 13,829,162 common shares outstanding of PICorp, which was renamed Aeroquest International Limited.

The RTO has been accounted for in accordance with EIC-10 as a capital transaction resulting from the recapitalization of PICorp. The consolidated balance sheet combines the assets and liabilities of PICorp as an acquisition under the purchase method. The net assets acquired at fair value at October 28, 2004 are as follows:

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

2 | Loan Receivable

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

3 | Long-term Investments

| | 2006 | 2005 |
|-----------------------|-----------|-----------|
| Convertible debenture | \$110,000 | \$- |
| Public company shares | 16,001 | 16,001 |
| | \$126,001 | \$ 16,001 |

The convertible debenture is non-interest bearing to the maturity date and bears interest at 15% p.a. accrued daily, compounded monthly beyond the maturity date to the date of payment. Once final approval has been received for a listing for trading on the CNQ, the issuer has agreed to pay 40% of the principal balance concurrently with the closing of the first issuance of securities. The balance of 60% is to be repaid in three payments of 20% each, every 90 days thereafter, with any remaining amounts to be paid in full by the maturity date. This debenture is convertible in whole or in part at any time up to and including the maturity date at the conversion price of \$0.05 or for 2,200,000 common shares. The maturity date is 12 months after the closing of the first issuance of securities to the public. Aeroquest Limited also holds 2,200,000 warrants to purchase 2,200,000 common shares at \$0.07 per share expiring on May 11, 2007.

The Company owns shares in several Canadian public companies. The market value of these shares at April 30, 2006 was \$142,000 (\$50,000 in 2005).

4 | Capital Assets

| | 2006 | | | 2005 |
|------------------------------------|-------------|---------------------|----------------|----------------|
| | Cost | Accum. Amortization | Net Book Value | Net Book Value |
| Airborne and geophysical equipment | \$3,128,228 | \$1,392,717 | \$1,735,511 | \$1,959,266 |
| Automotive equipment | 427,069 | 203,640 | 223,429 | 245,415 |
| Data processing equipment | 256,283 | 142,763 | 113,520 | 109,406 |
| Leasehold improvements | 87,993 | 55,375 | 32,618 | 61,949 |
| Office equipment | 135,645 | 40,243 | 95,402 | 58,037 |
| | 4,035,218 | 1,834,738 | 2,200,480 | 2,434,073 |
| Equipment in process | 407,138 | — | 407,138 | 306,858 |
| | \$4,442,356 | \$1,834,738 | \$2,607,618 | \$2,740,931 |

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

5 | Intellectual Property

| | 2006 | 2005 |
|--------------------------|------------|------------|
| Intellectual property | \$ 375,032 | \$ 375,032 |
| Accumulated amortization | (281,275) | (156,265) |
| | \$ 93,757 | \$ 218,767 |

6 | Long-term Debt

| | 2006 | 2005 |
|---|------|----------|
| Finance contract payable 5.9%, due December 4, 2005, monthly payments of \$825 principal and interest | \$ – | \$ 5,580 |
| Less: current portion | – | 5,580 |
| | \$ – | \$ – |

7 | Share Capital
(a) Authorized:

Unlimited number of voting common shares.

(b) Issued and outstanding:

| | No. of Common Shares | Share capital |
|---|----------------------|---------------|
| PICorp Capital Ltd. – balance at May 1, 2003 | 3,166,665 | \$ 280,040 |
| Consolidation of common shares on a 3 for 1 basis | (2,111,110) | – |
| Prereverse takeover issued common shares of PICorp | 1,055,555 | \$ 280,040 |
| Aeroquest Limited – balance at May 1, 2003 | 100 | \$ 100 |
| Shares issued for stock dividends | 4,863,310 | 5 |
| Stock options granted | – | 123,260 |
| Shares issued on stock options granted | 1,369,565 | 138 |
| Shares issued in exchange for intellectual property | 4,167,025 | 375,032 |
| Prereverse takeover issued common shares of Aeroquest Limited | 10,400,000 | \$ 498,535 |
| Opening share capital (comprised of the number of issued and outstanding common shares of PICorp and the stated capital of Aeroquest Limited) | 1,055,555 | \$ 43,307 |
| Common shares issued on the RTO (Note 1) | 10,400,000 | 498,535 |
| Debentures converted to Aeroquest International Limited shares, net of issue costs (Note 6) | 2,373,607 | 2,071,423 |
| Shares issued upon exercise of options in Aeroquest International Limited | 11,111 | 5,000 |
| Public offering of Aeroquest International Limited shares | 2,000,000 | 4,000,000 |
| Costs relating to share issue net of income tax effect | – | (782,089) |
| Issued from the date of the RTO | 15,840,273 | \$ 5,836,176 |

Shares held in escrow at April 30 amounted to 2,464,166 (2006) and 7,392,501 (2005).

7 | Share Capital (continued)**(c) Stock Options:**

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

In addition, the Company granted 300,000 options to certain brokers at the time of the RTO as partial consideration for services rendered in respect of the RTO.

The following table summarizes options granted under the Stock Option Plan for the year ended April 30, 2006.

| | Number of options | Avg. exercise price |
|--|-------------------|---------------------|
| Outstanding, beginning of year | 1,635,000 | \$ 2.00 |
| Granted | 460,000 | .50 |
| Cancelled | (1,097,500) | 2.00 |
| Outstanding and exercisable, end of year | 997,500 | \$ 1.10 |

The following table summarizes information about stock options outstanding at April 30, 2006.

| Exercise Price | Number outstanding, April 30, 2006 | Weighted average remaining contractual life (years) | Weighted average exercise price |
|--------------------|------------------------------------|---|---------------------------------|
| \$ 0.50 to \$ 2.00 | 997,500 | 3.09 | \$ 1.10 |

The fair value of stock options granted during the 2006 fiscal year was estimated using the BlackScholes option pricing model on the date of the grant with the following weighted average assumptions

| | |
|---------------------------------|-------------------|
| Stock price at grant date | \$ 0.36 - \$ 1.35 |
| Exercise price | \$ 0.50 - \$ 2.00 |
| Expected life of options | 3 years |
| Expected stock price volatility | 40% |
| Expected dividend yield | - |
| Risk-free interest rate | 3.0% - 4.0% |

(d.) Contributed Surplus

| | 2006 | 2005 |
|--|-----------|-----------|
| Contributed surplus, beginning of year | \$925,950 | \$- |
| Stock option expense | 61,510 | 925,950 |
| Adjustment on consolidation | (689) | - |
| Contributed surplus, end of year | \$986,771 | \$925,950 |

8 | Income Taxes

| Income Taxes | 2006 | 2005 |
|--|----------------|--------------|
| Net loss before income taxes | \$ (1,612,159) | \$ (265,827) |
| Statutory income tax rate | 36.12% | 36.12% |
| Computed income tax payable (recovery) | (582,312) | (96,017) |
| Non-deductible expenses | 32,170 | 287,267 |
| Non-deductible amortization | 45,154 | 54,588 |
| Rate difference before RTO | 28,849 | 50,813 |
| Actual recovery of prior year taxes | — | — |
| Other | — | (4,752) |
| Recognition of future tax assets | 47,208 | (15,000) |
| Income taxes | \$ (428,931) | \$ 276,899 |

The tax effects of temporary differences that give rise to significant portion of the future tax assets at April 30, 2006 and 2005 are presented below:

| Future Taxes | 2006 | 2005 |
|-----------------------|-----------|-----------|
| Capital assets | \$- | \$16,000 |
| Share issuance costs | 45,000 | 95,000 |
| Loss carry-forward | 17,792 | - |
| Net future tax assets | 62,792 | 111,000 |
| Other | — | (1,000) |
| | \$ 62,792 | \$110,000 |

9 | Related Party Transactions

During the year, the Company paid \$423,000 (\$460,000 in 2005) 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.

10 | Commitments

The Company has operating leases for its two premises. The lease for one location is for \$4,958 per month, under a lease expiring in February, 2007. The other lease calls for payments of \$3,437 per month until April 2007 and \$3,646 per month thereafter until April, 2010.

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

| | |
|------|-------------------|
| 2007 | \$ 88,354 |
| 2008 | 43,750 |
| 2009 | 43,750 |
| 2010 | 43,750 |
| | <u>\$ 219,604</u> |

11 | Segmented Information

The Company has no distinct reportable business segments.

In 2006, no one customer represented more than 10% of revenue. In 2005, two customers represented 35% of revenue.

Included in revenue is an amount of \$309,462 (\$469,882 in 2005) for the sale of equipment.

12 | Earnings (Loss) per Share

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

| | 2006 | 2005 |
|---|----------------|--------------|
| Numerator: | | |
| Net loss for the year | \$ (1,183,228) | \$ (542,726) |
| Denominator: | | |
| Average common shares outstanding | 15,840,273 | 13,116,433 |
| Fully diluted common shares outstanding | 16,837,773 | 13,868,100 |
| Basic and fully diluted loss per share | \$ (0.07) | \$ (0.04) |

The weighted average number of shares used in computing the earnings per share for 2006 was calculated based on the average number of shares outstanding for the year. The weighted average number of shares used in computing the earnings per share for 2005 was calculated based on the number of shares outstanding for the period from the beginning of the fiscal year to the date of the reverse takeover, deemed to be the number of shares issued by Aeroquest International Limited (formerly PICorp.) (the legal parent) to the shareholders of Aeroquest Limited (the legal subsidiary) and for the period from the date of the reverse takeover to the end of the fiscal year based on the number of shares issued by the Company.

As the Company experienced a loss for 2006 and 2005, all potential common shares outstanding from dilutive securities are considered antidilutive and are excluded from the calculation of loss per share.

13 | Supplementary Cash Flow Information

| | 2006 | 2005 |
|--|-----------|-----------|
| (a) Interest paid | \$ 20,158 | \$ 3,164 |
| (b) Interest received | 47,110 | 66,823 |
| (c) Income tax paid | 93,674 | 583,784 |
| Non Cash Transactions: | | |
| (a) Debentures converted to common shares net of debenture issue cost (Note 7 (b)) | – | 2,071,423 |
| (b) Accounts receivable converted to convertible debenture (Note 3) | 110,000 | – |

14 | Credit Facility

The Company has operating facilities totalling \$250,000 available for its use, bearing interest at prime plus 0.75%, and secured by a general security agreement. As at April 30, 2006 no amounts have been drawn on this facility.

15 | Prior Period Adjustments

(i) A stock option expense in the amount of \$150,000 (300,000 options @ \$0.50) was recorded in 2005 with an offset to contributed surplus. These options were granted to the broker for services related to the public offering and as such should have been recorded as a reduction of share capital. An adjustment has been made in 2006 and applied retroactively restating stock option expense and share capital by an amount of \$150,000.

(ii) An under provision for income taxes was made in 2005 in the amount of \$215,000 and corrected in 2006 with an adjustment to the income tax expense. This adjustment has been applied retroactively restating income tax expense and income tax payable in the amount of \$215,000 for 2005.

| Effect on Income statement of prior period adjustments | |
|--|-----------|
| Stock option adjustment (i) | (150,000) |
| Income tax provision adjustment (ii) | 215,000 |
| Net cost of prior period adjustments as a reduction to retained earnings | \$ 65,000 |

16 | Comparative Figures

The comparative figures have been reclassified to conform to the financial statement presentation of the current year.

CORPORATE INFORMATION

Officers

Wally Boyko
Chairman

Roy T. Graydon
CEO

Steve Balch
President

Wilfred J. Edge
CFO

Directors

Steve Balch
President,
Aeroquest International Limited
Director

John Barker
Director

Wally Boyko
Chairman,
Aeroquest International Limited
Director

Roy T. Graydon
CEO,
Aeroquest International Limited
Director

Roland Horst
Director

Norman Paterson
Director

Gordon West
Director

Head Office

AEROQUEST INTERNATIONAL LIMITED

845 Main Street East, Unit 4
Milton, Ontario
Canada L9T 3Z3

T: (905) 693-9129

F: (905) 693-9128

W: www.aeroquestsurveys.com

Legal Counsel

MINDEN GROSS GRAFSTEIN & GREENSTEIN LLP

111 Richmond Street W., Suite 700
Toronto, Ontario
Canada M5H 2H5

T: (416) 369-4112

F: (416) 864-9223

Auditors

BDO DUNWOODY

4255 Sherwoodtowne Blvd.
Mississauga, Ontario
Canada L4Z 1Y5

T: (905) 270-7700

F: (905) 270-7915

Transfer Agent

COMPUTERSHARE INVESTOR SERVICES INC.

9th Floor, 100 University Avenue
Toronto, Ontario
Canada M5J 2Y1

T: (800) 564-6253

F: (888) 453-0330

Clearer **vision**
from **above**



AEROQUEST INTERNATIONAL LIMITED

845 Main Street East, Unit 4
Milton, Ontario
Canada L9T 3Z3

T: (905) 693-9129

F: (905) 693-9128

W: www.aeroquestsurveys.com

