

## INVESTMENT OPINION

We met with a representative of ADCC in China last week who mentioned that approvals for AeroMechanical in China are being fast-tracked. We recommend AeroMechanical Services Ltd. as a BUY with a target price of \$3.00, based on 30 times our fiscal 2010 estimated EBITDA of \$7.9 million.

## ANALYSIS

Shanghai Airlines will acquire two AFIRS for its Boeing 767s, which would be a new order: Shanghai Airlines has been mandated to transport troops in support of the Olympic torch relay in China. Two of Shanghai Airline's seven Boeing 767s will be used to transport the troops and the company has asked to have AeroMechanical's AFIRS installed prior to it commencing operations. China's ADCC (Aviation Data Communications Company) has committed to accelerate all necessary approvals for installations to be completed in June on those two Boeing 767s. This is much sooner than expected because ADCC had previously indicated that installations would begin in late July once air force approvals had been received for use of the Iridium Satellite network. Shanghai Airlines operates 55 aircraft, including 38 Boeing 737s and 12 Boeing 757s. AeroMechanical had not sold any AFIRS for Boeing 767s because only orders for 737s and A320s were placed. Although the two Boeing 767s are expected to be a special case, we fully expect that general installations will begin in July and several will be completed in time for the Olympics, which begin on August 8. China believes that AeroMechanical's AFIRS is a key component of maintaining a safe airline industry. The majority of the country's 1,200 commercial aircraft (and growing at 150 per year) eventually will be required to have AFIRS installed. In addition, long-term plans call for all general aviation

aircraft, which number about 600 and growing, may be required to have AFIRS. Five different government agencies are involved in the certification and all, but the air force, have already granted approvals. We were told by the ADCC

representative that no new competing product will be approved in the short term and if a new product were to go through the approval process, it would take approximately 10 years to get the go ahead. Orders from China currently represent over 50% of its units, but we believe this will decline to less than 10% over time as the company increases its customer base outside China. China provides a stable long-term base for future growth.

AeroMechanical will hold its AGM in Calgary on Thursday, May 22.

Valuation: We remain a BUY on the stock and believe that the current share price level presents a good buying opportunity. Our target price is \$3.00 based on 30 times our fiscal 2010 EBITDA of \$7.9 million.

## CHINA BACKGROUNDER

In China, AeroMechanical deals with a government agency called SkyBlue, not with the airlines directly. There are three government layers involved: First: The main aviation authority in China is CAAC (China Civil Aviation Authority). CAAC is the equivalent of Transport Canada or the FAA in the U.S. Second: CAAC owns ADCC (Aviation Data Communications Company), which is the agency responsible for air traffic control and all communications involving the airline industry. Third: ADCC owns Beijing SkyBlue Aviation Technology Co., which is the purchasing arm of all hardware involved in aviation. SkyBlue is the company that buys AFIRS from AeroMechanical on an exclusive basis and re-sells them to the individual airlines. SkyBlue is the main customer as far as AeroMechanical is concerned, because it is SkyBlue that will pay AeroMechanical whether the airlines have paid SkyBlue or not. Three Chinese airlines have signed onto the AFIRS program: China Eastern (213 aircraft), China Southern (293 aircraft), and Shanghai Airlines (55 aircraft). Others like Air China (217 aircraft) and Hainan Airlines (57 aircraft), we believe, are close to signing on as well. There are approximately 1,200 registered commercial aircraft in China, growing at 150 aircraft per year. The majority will be

equipped with AFIRS. In addition, there are approximately 600 general aviation aircraft engaged in forest fighting, aerial imaging, surveying, and VIP transports. Many of these aircraft will also have AFIRS eventually. The intent is to have AFIRS mandated on all aircraft in China. This cannot be done at this time because AFIRS is not certified for some of the aircraft that currently fly or will fly in China, such as the Boeing 777, Airbus A340/330, and the Boeing 787.