

HSE Integrated Ltd. Management Discussion and Analysis For the Three and Six Months Ended June 30, 2006

The following discussion and analysis is a review of the financial results of HSE Integrated Ltd.'s ("HSE" or the "Company") for the three and six months ended June 30, 2006. This should be read in conjunction with the documents filed on SEDAR at www.sedar.com. Unless otherwise disclosed, the financial information presented in this discussion has been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and takes into consideration information available to management up to July 31, 2006. Unless otherwise stated, dollar figures presented are expressed in thousands of Canadian dollars and per-share figures in dollars per weighted-average common share.

Selected Financial Information

	Three Months Ended June 30, 2006	Three Months Ended June 30, 2005	Six Months Ended June 30, 2006	Six Months Ended June 30, 2005
Revenue	\$ 19,924	\$ 9,410	\$ 47,388	\$ 26,716
Operating and materials	16,826	8,828	36,561	20,078
Gross margin	3,098	582	10,827	6,638
Gross margin %	15.5%	6.2%	22.8%	24.8%
Selling, general & administrative expense	1,958	1,426	4,141	2,765
Net income (loss)	(1,073)	(1,483)	1,280	1,106
- per share basic	(.03)	(.06)	.04	.05
- per share diluted	(.03)	(.06)	.04	.05
EBITDA ⁽¹⁾	\$ 1,140	\$ (844)	\$ 6,686	\$ 3,873

See Non GAAP Measures for ⁽¹⁾

Overview

The Company's operating results for the second quarter and year-to-date ended June 30, 2006 reflects increases in both revenue and profitability. EBITDA (See Non-GAAP Measures) in the quarter increased \$1,985 or 235% to \$1,140 from a shortfall of \$(844) for the same period in 2005. On a year-to-date basis, EBITDA has increased by \$2,814 or 73% to \$6,686 in comparison to the prior year. The increase in EBITDA for both the quarter and first six months of 2006 is mainly due to significant increases in revenue (quarter: 112%, year-to-date: 77%) as a result of acquisitions, greater capacity and diversification of the Company's business into counter-cyclical industrial safety services. On a year to date basis, EBITDA as a percentage of revenue was 14.1% (2005 – 14.5%). This EBITDA margin was achieved despite a significant reduction this year in the level of higher margin well control operations, as compared to the same period in the prior year.

The Company continues to increase its operating capacity, both in its core Oilfield safety services business and in the Industrial safety sector. The Company completed the acquisitions of Sentry Fire Equipment Ltd. ("Sentry") and Front-Line Safety Limited ("Frontline") early in the quarter. These acquisitions will increase HSE's presence in Central Canada, Atlantic Canada, and the offshore drilling and production sector of Canada's East Coast.

The Company has maintained its strong balance sheet with a cash balance of \$8,926 at June 30, 2006. Working capital (current assets less current liabilities) was almost \$21 million at June 30, 2006, and long-term debt has declined from \$15.2 million at the end of the first quarter, to \$14.6 million at the end of the second quarter. HSE used treasury shares to pay for a portion of the acquisitions made this year, reducing the amount of cash and debt required. As well, the Company completed private placements in

February, 2006 (gross proceeds of \$1.375 million), and in April, 2006 (gross proceeds of \$11.7 million) in order to minimize the amount of debt required for capital expenditures and acquisitions.

Financial Review

Revenue

HSE earns its revenue by providing a variety of asset and worker safety-protection services including: on-site safety supervision; gas detection; air-quality monitoring; breathing equipment rentals and services; firefighting and fire protection; worker shower decontamination services; on-site medical services; and safety training.

Revenue for the quarter increased 112% from \$9,410 in 2005 to \$19,924 in 2006. On a year-to-date basis, revenue increased 77% to \$47,388 in 2006 versus \$26,716 for the same period in the prior year.

The acquisitions of Sentry and Frontline in April 2006 contributed approximately \$0.7 million to second-quarter revenue. It is estimated that of the \$47.4 million year-to-date revenue, approximately \$12 million represents the revenue received as a result of the acquisitions made in the first half of 2006. Revenue excluding acquisitions for the first half of 2006 increased 23% over the same period in 2005.

In 2006, HSE was reorganized to provide increased focus to its customers in the following areas: Oilfield Services (Oilfield), Industrial Services (Industrial), and Environment Monitoring Services (Environment). The composition of revenue for the first six months of 2006 was: Oilfield – 70%; Industrial – 20%; Environmental – 10%. Oilfield revenue increased by 61% on a year-to-date basis primarily due to the increased capacity provided by the acquisition of Key Safety Services Inc. (“Key”) in January 2006, and through the growth of existing capacity in place prior to the end of 2005. Industrial and Environmental revenue increased by 235% on a year-to-date basis for two reasons; firstly, due to the growth of existing capacity and an increased marketing focus towards the end of 2005, and secondly through the acquisition of Sentry, Frontline and Key Monitoring Solutions Corp. (“KMS”), (acquired January 2006). The growth of Industrial and Environment revenue reflects the Company’s strategy of diversification from Oilfield. The oilfield services market is largely dependent on the level of drilling, completion and well-servicing activities of the upstream oil and gas sector, and is subject to seasonal activity cycles.

Operating and Materials Expense

Operating and materials expense consists of costs directly attributable to the provision of safety and related services to customers. These include: wages and benefits for field employees and contractors; equipment rentals and leases; transportation; fuel; consumables; equipment repairs and maintenance; and field-office administration including field sales.

Operating and materials expense for the three months ended June 30, 2006 totaled \$16,826 (YTD – \$36,561) or 84.5% (YTD – 77.2%) of revenue as compared to \$8,828 (YTD - \$20,078) or 93.8% (YTD – 75.2%) of revenue for the comparable periods in 2005.

The second-quarter reduction in operating and materials expense as a percentage of revenue is due to several factors. These include the higher utilization rate that accompanies the eventual integration of assets from acquired companies, and the continual improvement of fleet-management techniques. With its increased size and the establishment of corporate purchasing practices, HSE is also realizing improved savings on procurement. With the increased focus on growing the Industrial safety services proportion of the total business mix, the Company was able to realize higher utilization rates of its Industrial personnel and assets at a time when that sector traditionally experiences higher levels of activity. This increase in Industrial safety activity takes place during the traditional seasonal downturn in the Oilfield sector.

On a year-to-date basis, operating and materials expense as a percentage of revenue has increased slightly. This variance is primarily due to a significant portion of revenue in the first quarter of 2005 being derived from one large and several small well-control operations. These operations generated higher margins compared to regular safety services during this prior period. There has been only a minimal contribution of revenue from this type of activity to date in 2006.

Selling, General and Administrative Expense

Sales, general and administrative (“SG&A”) expense consists of costs not directly attributable to the provision of services for customers. These include costs generally associated with the following: corporate head-office functions and services; administrative personnel; corporate sales and marketing costs; liability insurance; professional fees; and investor relations expenses. Many of these costs are relatively fixed in nature and do not vary directly with activity.

SG&A for the three months ended June 30, 2006 amounted to \$1,958 (YTD – \$4,141) or 9.8% of revenue (YTD – 8.7%), versus \$1,426 (YTD – \$2,765) or 15.2% (YTD – 10.3%) of revenue for the comparable periods in 2005.

The decreased rate as a percentage of revenue for both the quarter and for the first half of the year in comparison to the similar periods in the prior year, are due to the expansion of HSE's revenue base both internally and through acquisitions at a greater rate than required increases in SG&A. The absolute increase in SG&A costs in comparison to the prior year is a result of higher business development and corporate costs necessary to support the increased size of the Company.

Amortization

Amortization for the second quarter of 2006 was \$1,870 (YTD – \$3,298). This compares to \$928 (YTD – \$1,716) for the same period in 2005. The increase in amortization expense reflects the impact of the significantly larger asset base of the Company at the end of the quarter. The cost base of property and equipment has increased by 97% from June 30, 2005 to June 30, 2006, of which 70% of the growth came from acquisitions.

Interest Expense

In the first six months, interest and bank charges increased from \$252 in 2005 to \$647 in 2006. The change was caused by term debt loans used to fund the Key and KMS acquisitions, draws on the operating line as a result of higher activity levels in the first quarter, interest on capital leases, and higher interest rates. The Company repaid its obligations under the operating credit facility by June 30, 2006.

Summary of Quarterly Results

	2006		2005				2004		
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2
Revenue	\$19,924	\$27,465	\$17,280	\$15,080	\$9,410	\$17,306	\$9,086	\$4,719	\$2,681
Net Income (loss)	(1,073)	2,353	(59)	786	(1,482)	2,588	360	(227)	(289)
EBITDA	1,140	5,548	1,501	2,224	(845)	4,717	1,120	109	(193)
Income (loss) per share - basic and diluted	\$(0.03)	\$ 0.07	\$ 0.0	\$ 0.02	\$ (0.06)	\$0.11	\$ 0.02	\$(0.02)	\$(0.03)

HSE's business has a seasonal component. For a description of this seasonality, please refer to the Company's 2005 Annual Report.

The Company is actively developing its Industrial safety services business so that in the future, the quarterly revenue fluctuations will be less significant. Considerable progress was made in this area through two acquisitions completed in April 2006 – Sentry and Frontline. The acquisitions of Sentry and Frontline will further stabilize quarterly revenues in the future because of the specialized nature of their businesses. Sentry provides year-round plant safety equipment and services to refineries and petrochemical facilities, not just during seasonal major maintenance activity. Frontline provides offshore safety services that are not subject to seasonal activity fluctuations.

Liquidity and Capital Resources

The Company's principal sources of capital are cash flows from operations, borrowings under an established credit facility with its senior lenders, and equity financing.

The Company, through the conduct of its operations, has undertaken certain contractual obligations as noted in the following table:

Commitments outstanding by fiscal years ended December 31

(\$'000)	2006	2007	2008	2009	2010	2011	Total
Capital lease obligations	507	1,032	1,015	868	40	9	3,471
Operating leases	2,000	3,672	3,124	2,506	1,405	392	13,099
Long-term debt	2,148	4,308	4,324	4,004	3,951	-	18,735
Total contractual obligations	4,655	9,012	8,463	7,378	5,396	401	35,305

Cash provided by operations

Cash provided by operations in the second quarter was \$4,580, much of which represented the collection of outstanding receivables from the high levels of revenue generated from the first quarter. On a year-to-date basis, cash provided from operations was \$1,555. The primary reason for the negative change in the year-to-date non-cash working capital results from an extended accounts receivable cycle. The Company has dedicated increased focus in improving its administrative practices in this area, with the goal of reducing the impact on cash flow that this represents. At June 30, 2006, HSE believes that only a minimal amount of accounts receivable would be deemed uncollectible.

Cash provided by financing

In comparison to the end of 2005, the Company for the first six months of 2006:

- repaid the outstanding amount owing on the operating line of credit from the prior year;
- increased long-term debt by \$17,174;
- issued shares for proceeds of \$13,480 (net of costs) through private placements.

As at June 30, 2006, all companies within the consolidated HSE group were in full compliance with their debt covenants.

Cash used in investing

On a year-to-date basis, the Company has invested \$1,150, primarily in field safety equipment. Close to the end of the first quarter, the Company announced plans for an \$8.0-million capital expenditure program through to the end of the first quarter of 2007. This capital program is allocating \$4.0 million to upgrading the existing capital asset fleet, and an additional \$4.0 million is slated for incremental operating capacity. Based upon current pricing, utilization rates and levels of business activity, the Company estimates that this capital when completely invested will generate annual revenues in excess of \$20 million. There were nominal expenditures in relation to this program in the first half of 2006. HSE expects to spend against this capital program over the latter half of 2006 and the first quarter of 2007.

The investment in acquisitions for the year was \$20,686, as a result of the Key, KMS, Sentry and Frontline acquisitions. Of the net assets purchased through acquisitions in 2006, \$12,205 is related to the purchase of vehicles, property and equipment, which has contributed to the increase in the operating capacity of the Company.

Liquidity

The Company operates using a relatively conservative capital structure limiting the amount of debt outstanding to reasonable levels reflecting the historic cyclical nature of its industry. As at June 30, 2006, HSE had \$17.8 million of total non revolving term debt outstanding, with \$8 million of un-drawn operating facility and approximately \$5 million of undrawn revolving term loan.

The Company's credit facilities provide a \$20-million non-revolving term loan amortizing equally over five years, a revolving \$5-million term loan amortizing equally over five years, and an operating line of \$10 million (seasonally reduced to \$8 million) margined to accounts receivable. In February, 2006 the Company completed a private placement of 550,000 common shares at \$2.50 per share for gross proceeds of \$1.375 million; in April, 2006, HSE completed a private placement of 3,300,000 common shares at \$3.55 per share for gross proceeds of \$11.7 million.

The Company is planning an \$8.0-million capital expenditure program in the second half of 2006 and early 2007, and anticipates other acquisitions in the future. At this time HSE believes that operating cash flows, bank credit facilities and equity financing will be available to finance its capital expenditure and acquisition program.

Off Balance Sheet Arrangements

The Company does not have off-balance sheet arrangements other than typical operating leases for equipment entered into in the normal course of business.

Related-Party Transactions

During the quarter ended June 30, 2006, the Company had the following transactions with related parties. These transactions are measured at exchange amounts, which approximate an arm's length equivalent,

A company controlled by a director of HSE subcontracted the provision of certain goods and services from HSE. During the quarter, HSE billed this company \$290 in respect of the goods and services provided. These products and services were sold at rates agreed to as part of the acquisition of the assets of the company. A total of \$425 remained in accounts receivable at June 30, 2006, in respect of this and prior period billings. During the quarter, HSE purchased consumables at a cost of \$7 from this company. There was no amount payable at June 30, 2006.

During the quarter, the Company paid rent for shop facilities in the amount of \$62 to a company controlled by an officer and director of the company. Included in accounts receivable is \$54 which is due from the same officer and director.

Acquisitions

- a) On January 10, 2006, the Company completed the acquisition of Key Safety Services Inc. (“Key”) and Key Monitoring Solutions Corp. (“KMS”) (collectively the “Key Group”) in a business combination accounted for as a purchase. Key performs oilfield safety services in Western Canada. KMS provides air-quality monitoring services for hydrocarbon drilling, completion and well servicing activities, and for industrial operations. The results of operations are included in the accounts from the date of acquisition. Consideration for the acquisition was comprised of 2.4 million common shares of the Company valued at \$2.64 per share, \$8,250 cash, \$3,390 in promissory notes issued to the vendors, the assumption of debt and acquisition costs. The purchase price allocation is preliminary and certain items, such as fair value of assets and liabilities as of the acquisition date, have not been finalized.
- b) On April 5, 2006 HSE completed the acquisition of Sentry Fire Equipment Ltd. (“Sentry”) in a business combination accounted for as a purchase. Sentry offers fire, gas detection and breathing-air equipment sales and service to industrial and commercial markets in southern Ontario. The results of operations will be included in the accounts from date of acquisition. Consideration for the acquisition was \$3,600 cash. The purchase price allocation has not been completed and certain items such as fair value of assets and liabilities as of the acquisition date have not been finalized.
- c) On April 21, 2006 the Company completed the acquisition of Front-Line Safety Limited. (“Frontline”) in a business combination accounted for as a purchase. Frontline performs industrial safety services for the refining, mining, offshore drilling and production and other industries in Atlantic Canada. The results of operations will be included in the accounts from date of acquisition. Consideration for the acquisition was comprised of 667 thousand common shares of the company at \$3.47 per share, \$750 of cash and additional contingent consideration to be determined upon Frontline’s operating results for the fiscal year ending August 31, 2006. The purchase price allocation has not been completed and certain items such as fair value of assets and liabilities as of the acquisition date have not been finalized.

Acquisitions Announced Subsequent to Quarter End

On July 1, 2006 the Company completed the acquisition of Bear’s Safety & Rescue Services Ltd. (“Bear’s”) of Bonnyville, Alberta in a business combination accounted for as a purchase. Bear’s provides industrial safety services to upstream oil and gas processing facilities, refineries, and petrochemical plants in northeast Alberta and has provided safety supervision to drilling operations in northern Canada and internationally. Consideration for the acquisition was \$800 cash and the issuance of 100 thousand common shares at a deemed price of \$3.29 per share. The purchase price allocation has not been completed and certain items such as fair value of assets and liabilities as of the acquisition date have not been finalized.

Critical Accounting Policies and Estimates

HSE prepares its consolidated financial statements in accordance with Canadian generally accepted accounting principles. In doing so, management is required to make various estimates and judgments in determining the reported amounts of assets and liabilities, revenues and expenses, as well as the disclosure of commitments and contingencies. Management bases its estimates and judgments on historical experience and on other various assumptions that are believed to be reasonable under the circumstances. Estimates and assumptions are reviewed periodically, and actual results may differ from those estimates under different assumptions or conditions. Management must use its judgment related to uncertainties in order to make these estimates and assumptions.

The accounting policies and estimates believed to require the most difficult, subjective or complex judgments and which are material to the Company’s financial reporting results are: allowance for doubtful

accounts receivable, goodwill impairment, impairment of long lived assets, depreciation and amortization of property and equipment, and future income taxes.

There were no new accounting standards or pronouncements enacted during the quarter and year to date ended June 30, 2006 that had a material affect on the Company's financial position, results of operations, or cash flows or are anticipated to have a material affect on the Company's financial position, results of operations or cash flows for the remainder of 2006.

Business Risks

A complete discussion on the business risks faced by the Company can be found in the HSE's 2005 Annual Report.

Outlook

Due to high oil prices, reasonably high gas prices and strong upstream industry cashflows, demand for the Company's Oilfield safety services remains very strong compared to historical levels. HSE has positioned itself as the leading supplier in this area and has been able to maintain the vast majority of the senior staff and customers associated with acquisitions. In addition, in the past two years the Company has enjoyed growing customer acceptance of the "safety services bundle" or the integrated safety package that the Company has developed. This development is likely to continue in the future, providing an ongoing competitive advantage to the Company.

There have been five acquisitions enhancing the Industrial safety services the Company provides: Sentry, Frontline and Bear's in 2006; Confined Space Response Services Ltd. in 2005; and Scotford Safety Inc. in 2004. These have given HSE a significant delivery footprint in the major petroleum industry refining and processing markets like Edmonton, Fort Saskatchewan, Sarnia and Dartmouth. These were all niche players that are now offering their clients the full HSE services package. As has been the case for Oilfield service, the response of customers to the Company's integrated Industrial services package has been positive and will likely continue to be so.

In the second half of 2005 HSE opened a service location in Fort McMurray, the epicenter of significant existing and planned investments to develop the vast oil sands resources of northeast Alberta. This involved a significant capital and operating investment that negatively affected overall financial performance in the fourth quarter of 2005 and the first quarter of 2006. However, the revenue from the Fort McMurray operation has been growing steadily and will likely move to a positive cash flow situation later in 2006. The Company believes it has the right combination of products and services for the oil sands developers and will continue to make the necessary investment and commitment to fully evaluate what appears to be a significant opportunity for the Company.

With the acquisition of KMS, came the recently commercialized Carmen-Reactor stand-alone air-quality and communication system. This technology monitors air quality and meteorological conditions on a continuous basis and communicates unsafe atmospheric conditions immediately to all stakeholders. This system is gaining increasing acceptance by the petroleum industry and appears to have applications in other industries.

Early in the third quarter, the Company announced its Well Control and Emergency Response service (WC&ER) and an alliance with Boot's & Coots to provide WC&ER services to their clients under their WELLSURE® well control insurance and blowout risk liability analysis products in Canada. With a large fleet of high-capacity firefighting equipment located across Alberta and northeast B.C., the Company is also ideally positioned to protect assets, housing and communities in the event of a forest fire. The Company regards servicing the safety needs of the entire forestry industry – including lumber and pulp and paper mills – as logical business growth opportunities for the future.

Forward-Looking Statements

This report contains forward-looking statements as required under OSC Form 51-102F1 concerning, among other things, the Company's prospects, expected revenues, expenses, profits, financial position, strategic direction, and growth initiatives, all of which are subject to risks, uncertainties and assumptions. These forward-looking statements are identified by their use of terms and phrases such as *expect, anticipate, estimate, believe, may, will, intend, plan* and other similar terms and phrases. These statements are based on certain assumptions and analyses made by the Company based on its experience and assessment of current conditions, known trends, expected future developments and other factors it believes are appropriate under the circumstances. Such statements are subject to numerous external variables, both known and unknown, such as changes in commodity prices for natural gas and oil, changes in drilling activity, weather conditions, industry-specific and general economic conditions and exchange rate fluctuations. If any of these risks and uncertainties materialize or if assumptions are incorrect, actual results may differ materially from those expressed or implied in the forward-looking statements.

Non GAAP Measures

This report contains the following measure which is not standardized under GAAP and therefore may not be comparable with similar measures presented by other companies:

- (1) EBITDA is defined as net income before provisions for interest, taxes, stock-based compensation, amortization and gains or losses on the disposal of property and equipment.