

**HSE Integrated Ltd.**  
**Management Discussion and Analysis (“MD&A”)**  
**For the years ended December 31, 2007 and 2006**

The following management discussion and analysis is dated March 28, 2008, and is a review of the financial results of HSE Integrated Ltd. (“HSE”, “We”, “Our”, or the “Company”) for the fiscal years ended December 31, 2007 and 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 March 28, 2008. Unless otherwise stated, dollar figures presented are expressed in thousands of Canadian dollars and per-share figures in dollars per weighted-average common share. The following MD&A contains forward-looking information and statements. We refer you to the end of the MD&A for the disclaimer on forward looking statements.

**Selected Financial Information**

	Year ended Dec. 31, 2007	Year over year % change	Year ended Dec. 31, 2006	Year over year % change	Year ended Dec. 31, 2005
Revenue	\$97,342	-3.2%	\$100,539	70.2%	\$59,075
Operating and materials	80,829	6.8%	75,655	65.0%	45,848
Operating margin	16,513	-33.6%	24,884	88.1%	13,227
Operating margin %	17.0%	-7.8%	24.8%	2.4%	22.4%
Selling, general & administrative	9,524	-0.5%	9,572	70.0%	5,631
Net earnings (loss)	(27,302)	-888.9%	3,461	88.8%	1,833
- per share basic	(0.73)	-830.0%	0.10	42.9%	0.07
- per share diluted	(0.73)	-830.0%	0.10	42.9%	0.07
EBITDA <sup>(1)</sup>	6,989	-54.4%	15,312	101.6%	7,596
EBITDA %	7.2%	-8.0%	15.2%	2.3%	12.9%
Total assets	73,372	-31.4%	106,938	108.5%	51,281
Total long-term liabilities	\$22,196	-4.9%	\$23,327	490.1%	\$3,953

See Non-GAAP Measures for <sup>(1)</sup>

**Financial Review**

**Revenue**

HSE operates in a single industry segment, which involves providing a variety of asset, worker and community safety protection services including: on-site safety supervision; gas detection; fixed and mobile air quality monitoring; breathing equipment rentals and services; fixed and mobile firefighting and fire protection services and equipment; worker decontamination (shower) services; on-site medical services; worker safety training; and safety management and consulting services.

For the years ended December 31, 2007 and 2006 the Company had no customers representing more than 10% of revenue.

The Company currently provides services to its customers in the following main business areas: Oilfield Services (“Oilfield”), Industrial Services (“Industrial”), and Environment Monitoring Services (“Environment”). Oilfield is the provision of the Company’s services within the conventional upstream, or “wellhead”, sector of the oil and gas industry. Industrial represents services delivered to non-conventional upstream oil and gas development and production, oil and gas processing and refining plants and

facilities, diverse non-petroleum resource and manufacturing industries, worker safety training, and safety management and consulting services. Environment focuses on air-quality monitoring to detect airborne contaminants which may affect the health of workers, the public, livestock, and wildlife.

The revenue for these services is shown below:

	<b>Year ended Dec. 31, 2007</b>	Year ended Dec. 31, 2006	Year over year % change
Oilfield	<b>\$43,473</b>	\$66,794	-34.9%
Industrial	<b>41,618</b>	23,459	77.4%
Environment	<b>12,251</b>	10,286	19.1%
<b>Total Revenue</b>	<b>\$97,342</b>	\$100,539	-3.2%
As a % of Revenue:			
Oilfield	<b>44.7%</b>	66.5%	
Industrial	<b>42.7%</b>	23.3%	
Environment	<b>12.6%</b>	10.2%	
<b>Total Revenue</b>	<b>100.0%</b>	100.0%	

The success of the Company's revenue diversification strategy continues to be demonstrated as significant declines in Oilfield revenues were largely offset by growth in Industrial and Environment revenues.

Oilfield revenues experienced large declines when compared to the prior year because of reduced overall activity levels within the conventional upstream, or "wellhead", sector of the oil and gas industry: oil and natural gas well drilling, completion and work-over (repair and maintenance) activity. The primary area of decline relates to natural gas. Industry sources have indicated that, when compared to the same period in the prior year, new conventional oil and gas well drilling activity levels in the Western Canadian Sedimentary Basin ("WCSB") have declined, as have well workover and stimulation activities on existing wells. Although HSE has been able to largely maintain its pricing levels with its customers, additional capacity added by competitors, in conjunction with an overall reduction in demand, has also contributed to the Company's lower revenue levels for this sector.

The Company continues its business diversification strategy, and reports a 77% (\$18.2 million) increase in Industrial revenues when compared to the prior year.

The rise in Industrial revenues is from the delivery of increased levels of safety services to oil and gas processing facilities, thermal heavy oil recovery, and oilsands extraction and construction projects in Alberta; safety services, fire suppression, gas detection and breathing air equipment rental services to diverse industrial and commercial markets in British Columbia, Alberta, and Ontario; safety services for the refining, mining, offshore drilling and production and other industries in Atlantic Canada; and worker safety training and safety consulting services in all markets.

A significant portion of the increase in Industrial revenues came from the delivery of the full range of HSE's services to operations and facilities in the oilsands producing and development areas of Northeast Alberta. This geographic area experienced growth rates of 290% over the prior year, and by the end of 2007 represented over 17% of total revenue (2006 – 4%).

A large portion of the increase in Industrial revenues also came from providing safety services to support major plant and facility maintenance and repair projects. In the second and third quarter of 2007, the Company secured and executed a greater number of simultaneous, large scale projects of this type than in any prior year. The customers for these large scale safety services were very diverse; clients included oilsands facilities, refineries, cement plants, high volume sour gas processing facilities, chemical factories,

and fertilizer facilities.

Services delivered in Central and Atlantic Canada, and the North Eastern United States is characterized as Industrial revenue. Revenue from these areas has increased on a year to year basis by 29%, to almost \$13 million. This is due both to the acquisitions completed in April 2006, and through increased marketing efforts in existing markets.

Greater marketing efforts have also increased worker training demand, resulting in increased classroom capacity and course offerings across Canada.

As a result of the additional air quality monitoring capacity added in the prior year, Environment revenues increased in the year by 19% as compared to the same period in 2006. The Company has experienced client and sectoral diversification in this business group.

In the third quarter of 2007, the Company acquired Prairie Wide Safety Ltd. ("PWS") of Weyburn, Saskatchewan. PWS serves the hydrocarbon producing region of southeast Saskatchewan by providing complete oilfield and industrial safety services to drilling, completion, well servicing and field processing operations. The revenue included in the third and fourth quarters associated with this acquisition was \$0.9 million and was accretive to earnings.

### **Operating and Materials Expense and Operating Margin**

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; field service centre property costs; transportation; fuel; consumables; equipment repairs and maintenance; and field office administration including field sales.

Operating and materials expense for the year ended December 31, 2007 totaled \$80.8 million or 83.0% of revenue as compared to \$75.7 million or 75.2% of revenue in 2006. Operating margin for the year has declined from \$24.9 million (24.8% of revenue) in 2006, to \$16.5 million (17.0% of revenue) in 2007.

The reduction in operating margins is primarily due to both a lower level of overall revenue, and a reduction of the level of Oilfield revenues which contain a greater proportion of higher-margin equipment rental revenue (such as fire trucks and large mobile decontamination units) which are mainly utilized in the completion and stimulation of newly drilled natural gas and crude oil wells, or major workovers or re-completions of existing oil and gas wells. Lower overall equipment utilization, resulting in lower revenue, was partially offset by the re-deployment of personnel to the Industrial market, a key element of the Company's client and regional diversification strategy.

Included in the year is an addition to the provision for doubtful accounts of \$0.8 million (a majority of which was recorded in the fourth quarter) as recognition of the potentially challenging environment, particularly for small natural gas producers, faced by some of the Company's Alberta customers.

### **Selling, General and Administrative Expense**

Selling, general and administrative ("SG&A") expense consists of costs not directly attributable to the delivery of services to 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.

SG&A for the year ended December 31, 2007 amounted to \$9.5 million, which is relatively unchanged from the prior year. Included in the year are costs (\$0.2 million) related to the Company's initial listing on the Toronto Stock Exchange.

## **EBITDA and Net Earnings (Loss)**

Despite relatively stable revenue levels as compared to the prior year, EBITDA (see “Non-GAAP Measures”) in the year has declined to \$7.0 million, from \$15.3 million in the prior year. This was primarily caused by reduced rental revenue due to reduced utilization of higher margin safety equipment associated with the Oilfield services component.

The Company has experienced reduced activity on the Oilfield side of the business mainly due to weaker economic fundamentals faced by customers involved in that industry. As a result, Management conducted a review for possible impairment of property and equipment, goodwill, and intangible assets, the outcomes of which are described below.

A review for impairment of property and equipment was conducted at December 31, 2007. This analysis consisted of comparing the carrying value of the property and equipment at year end to the sum of the undiscounted future cash flows expected to result from its use and eventual disposition. Based upon this review, Management concluded that an impairment did not exist at year end, and therefore no write-down of property and equipment was required.

Impairment tests were performed on intangible assets and goodwill at December 31, 2007. The results of the tests indicated that the carrying amount of goodwill and certain intangible assets exceeded their fair value. Accordingly, a write-down of \$25.0 million and \$0.5 million was incurred for goodwill and intangible assets (short term non-compete agreements), respectively.

Total amortization for the year was \$8.1 million. This was comprised of \$6.8 million in property and equipment amortization, and \$1.2 million in intangible asset amortization. Property and equipment amortization has increased by \$0.4 million when compared to the prior year due to previous investments in property and equipment and from similar assets acquired through acquisitions. As well, the recognition of intangible assets on acquisitions made in the prior year has also contributed to the increase in amortization.

Stock-based compensation for the year was \$1.1 million (2006 - \$1.0 million), and has slightly increased due to additional grants of stock options to employees of the Company.

Interest on long term debt and other interest and bank charges decreased slightly from \$1.4 million in 2006 to \$1.3 million for 2007. Interest from increased obligations under capital leases was offset by interest reductions resulting from lower levels of bank debt.

For 2007, the loss on disposal of property and equipment was \$0.9 million with proceeds on sale of \$1.1 million. Asset divestitures consisted mainly of retirement of vehicles replaced through the Company's capital expenditure program.

HSE had a \$2.7 million income tax recovery versus an expense of \$1.5 million for the comparable period in 2006. The reduction can be attributed to lower earnings, and a \$1.1 million future tax rate reduction resulting from the Federal government's announcement of reductions to future corporate income tax rates which were substantively enacted in the fourth quarter.

The net loss for the year was \$27.3 million, which represents a decline compared to the net earnings of \$3.5 million in 2006. The decrease in net earnings is primarily due to a goodwill and intangible asset impairment charge of \$25.5 million, and to a lesser extent to lower levels of EBITDA, offset by the recovery of prior year income tax.

## Fourth Quarter Results

In the fourth quarter of 2007, the Company achieved revenues of \$26.5 million, which were largely similar to the revenue levels in the fourth quarter of 2006. Softer activity levels in the Oilfield safety service side of the business were largely offset by higher revenue levels from Industrial and Environment. There was a 40% decline in EBITDA to \$2.6 million in the fourth quarter of 2007, when compared to the same period in the prior year. The decline in EBITDA was primarily caused by a reduction in the utilization of higher margin equipment rentals to customers, an increase in the provision for doubtful accounts (\$0.4 million), and one time costs, the majority of which was severance, associated with overhead cost reduction initiatives (\$0.4 million). There was a net loss of \$9.2 million in the fourth quarter of 2007, versus net earnings of \$1.0 million for the same period in 2006. A large majority of the loss was related to write-downs of goodwill and intangible assets.

## 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 lender, and equity financing.

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

Years ended December 31,	2008	2009	2010	2011	2012	Total
Capital lease obligations	\$1,488	1,145	303	111	6	\$3,053
Vehicle operating leases	1,717	1,389	1,300	692	18	5,116
Property & other leases	2,513	2,093	1,641	833	417	7,497
Long-term debt	216	1,153	13,871	20	-	15,260
Total contractual obligations	\$5,934	5,780	17,115	1,656	441	\$30,926

## Cash Provided by (Used in) Operations

Cash provided by operations in the year was \$1.5 million as compared to \$8.5 million for the same period in the prior year. The primary causes for the change are lower levels of earnings, and greater aging in accounts receivable. Management has increased the provision for doubtful accounts to \$1.2 million (approximately 5% of outstanding accounts receivables) as recognition of the potentially challenging environment faced by some of the Company's smaller customers primarily in the petroleum industry in Alberta.

## Cash Provided by (Used in) Financing and Investing

During 2007, the Company made payments of \$1.9 million for its capital leases, and \$2 million towards repayment of long-term debt (\$0.3 million of which was debt reduction on the acquisition of PWS). The cash consideration related to the PWS acquisition was \$1.9 million, and proceeds from disposal of property and equipment were \$1.1 million.

Purchases of property and equipment for the year amounted to \$4.1 million, the majority of which consists of revenue generating safety services rental equipment, and the fabrication costs related to fire and shower units.

## Liquidity

In the quarter ended June 30, 2007, HSE entered into an agreement with its current lender (a Canadian Chartered Bank) for credit facilities that provide the Company with increased financial flexibility to pursue strategic opportunities as they arise. The credit facilities include a \$25 million three-year interest-only revolving facility and a \$7.5 million operating facility. Depending upon certain financial ratios, the facilities

bear interest at the bank's prime rate (or U.S. base rate) plus up to 2.25%, or at bankers' acceptance rates with a stamping fee of 1.50 to 3.75%. An additional standby fee ranging between 0.20 to 0.60% per annum is also required on the unused portion of the credit facilities. The revolving facility matures on June 25, 2010, with an ability to extend the term at the lender's option. The operating facility is renewable annually and is margined to accounts receivable. The operating facility is subject to covenants that are typical for this type of facility. The credit facilities are collateralized under a general security agreement.

At the end of the current quarter, the draw against the revolving facility was \$13.8 million, and there was no draw against the operating facility.

At December 31, 2007, the Company was in compliance with its financial covenants.

## **Acquisition**

On July 1, 2007 the Company acquired the outstanding shares of Prairie Wide Safety Ltd. ("PWS") of Weyburn, Saskatchewan in a business combination accounted for using the purchase method. PWS serves the hydrocarbon producing region of southeast Saskatchewan by providing complete oilfield and industrial safety services to drilling, completion, well servicing and field processing operations. The final purchase consideration will be determined based upon a predetermined formula not to exceed \$2.2 million plus the assumption of debt based upon historical results, with additional consideration contingent upon performance measures achieved in the first year after the acquisition date. The results of operations are included in the accounts from the date of acquisition. Estimated consideration and costs were comprised of 100,000 common shares of the Company valued at \$1.64 per share, \$1.9 million cash, and the assumption of debt. The purchase price allocation has not been completed, and certain items such as fair value of assets and liabilities and estimates for contingent consideration as of the acquisition date have not been finalized.

## **Outlook**

Reduced conventional oil and gas exploration, development and production activity levels in the WCSB, relative to the record activity levels experienced over the past few years, have negatively affected the Oilfield safety services component of the business, and some industry analysts have predicted that this will continue into 2008.

However, the increase in crude oil and natural gas prices in the first quarter of 2008 are causing more petroleum industry analysts to believe that the activity downturn that began in the second quarter of 2006 may have reached bottom leading to a stabilization of activity in this sector, and possibly a recovery in the second half of 2008 and into 2009.

In executing the Company's diversification strategy, marketing, equipment and manpower resources were redeployed into the Industrial component of the business which continues to diversify the Company's client base and assist in reducing the cyclical and seasonality of safety services provided to the conventional upstream oil and gas sector.

In the year, the Company was able to demonstrate its ability to successfully execute multiple, simultaneous, large scale safety service operations within diversified plant and facility operations for its customers. This had three positive outcomes for HSE. First, redeploying Oilfield safety services personnel to Industrial assignments has permitted the Company to retain largely all of its technical field services personnel. This will position HSE to fully exploit the recovery in the Oilfield sector when it emerges. Second, diversifying the assignments of the technical field services team has given these personnel valuable on-the-job training in delivering safety services to different industries. Third, this capability was achieved over the last several years by laying the groundwork of focused marketing efforts, and the development of personnel and internal processes.

By exhibiting its capabilities in activities of this magnitude, HSE, with its integrated and bundled service model, is better positioned to partner with its customers by offering a greater range of services that can be delivered throughout the year, and from which higher margins can be attained. Servicing the Industrial sector will be a permanent and growing component of the HSE business mix in the future. Continued positive client response to the HSE business model and services bundle gives management of the Company the confidence to continue to recruit and train more safety technicians and professionals and to consider opening new service locations in new markets.

In the latter half of 2007, Management performed a comprehensive review of its overhead structure and identified potential cost reductions of over \$3 million (when compared to the cost structure in 2007) that is not intended to reduce or impair service or delivery capacity. These initiatives included facilities consolidation intended to increase efficiency and reduce fixed costs, and a review of equipment, vehicles, and personnel considered not essential in adding significant value to our customers. A vast majority of the cost reduction initiatives were undertaken prior to the end of the year, with the annualized savings expected in 2008. As well, the Company also does not anticipate the need to significantly increase corporate support costs in the near term.

Based primarily on sharply lower natural gas drilling activity in 2007 and the outlook for 2008 that this trend will continue, HSE will increase its initiatives to move surplus safety equipment to client requirements in other markets where these assets can enjoy higher utilization levels and thus increase the Company's revenues without significant capital investment. Markets in which HSE has relocated equipment in 2007 include Saskatchewan, Ontario and New Brunswick. For 2008, future markets where equipment may be redeployed include British Columbia, Saskatchewan, Ontario, New Brunswick, Nova Scotia, the industrial Midwest of the United States, and one or more of the conventional oil producing areas of the western United States.

The recent Crown royalty changes announced by the province of Alberta have increased uncertainty for the Oilfield sector of the Company's business in the future. These royalty changes will decrease the amount of oil and gas development opportunities that are economic for our customers to exploit in Alberta under different commodity pricing scenarios. While the total impact of this major policy change on the Company and its clients has yet to be determined, management is of the view that any events that reduce the cash flow from hydrocarbon production generated by HSE's clients will ultimately have a negative impact.

Building upon the acquisition of PWS in Weyburn, Saskatchewan in the third quarter of 2007, the Company is confident that this market will generate higher levels of demand for safety equipment and services than the previous owner was able to satisfy. To this end, the Company continues to move more equipment from Alberta to this market and expand its staffing levels.

The Company believes its continued investment in sector and geographic diversification, organic growth, skilled safety professionals and internal process improvements and operational efficiency will ultimately increase shareholder value.

## Quarterly Results

	2007				2006			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Revenue	\$26,464	\$23,578	\$19,352	\$27,948	\$26,198	\$26,952	\$19,924	\$27,465
Net earnings (loss)	(9,173)	(15,920)	(3,113)	904	984	1,197	(1,073)	2,353
EBITDA <sup>(1)</sup>	2,601	1,376	(1,790)	4,802	4,341	4,283	1,140	5,548
Income (loss) per share – basic and diluted	\$(0.25)	\$(0.42)	\$(0.08)	\$0.02	\$0.03	\$0.03	\$(0.03)	\$ 0.07

See Non-GAAP Measures for <sup>(1)</sup>

HSE's business has a somewhat seasonal component. Revenue for the Oilfield services side of the business tends to be highest in the first and fourth quarters and lower in the second quarter because this

sector uses equipment that can only access well locations during certain times of the year and because of the effects of weather on field activity. On the Industrial revenue side, the second and third quarters tends to be higher due to greater levels of safety service projects supporting scheduled facility maintenance and repair activities at client sites. Environment revenue tends to be less seasonal in nature.

### **Related Party Transactions**

During the year, the Company had the following transactions with related parties all of which are measured at exchange amounts, which approximate an arm's length equivalent at fair market value:

- Included in accounts receivable is a promissory note of \$49, (2006 - \$49) which is due from an officer and director of the Company. This note is payable on demand. In 2007, the Company paid rent and property taxes to a corporation related to this same officer and director of the Company in the amount of \$284 (2006 – \$285). The rent is for a regional office.
- In 2007, the Company also paid rent and property taxes of \$64 (2006 – \$41), and \$371 (2006 - \$342) for regional offices to two different corporations. In 2007, the Company also paid rent of \$21 (2006 - \$nil) for a regional office to a corporation and received \$3 (2006 - \$nil) on the sale of miscellaneous small tools from the same corporation. Each corporation is controlled by different members of senior management of the Company.

### **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 various other 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 is material to the Company's financial reporting results are as follows:

#### ***Allowance for Doubtful Accounts Receivable***

The Company assesses its accounts receivable through a continuous process of reviewing its receivables both on an individual customer basis and on an overall basis. The review includes assessment of current aging status of customers, historical collection experience, financial condition of customers, industry economic trends, and other factors. Based on the review, allowances for specific customers are determined. The process involves a high degree of judgment and can frequently involve significant dollar amounts. Accordingly, the Company's financial position, results of operations, and cash flows can be affected by adjustments to the allowance due to actual write-offs that differ from estimates.

#### ***Intangible Assets and Goodwill***

The Company's intangible assets consist of customer relationships, non-compete agreements, and technology and intellectual property. These intangible assets are carried at cost less accumulated amortization, which is calculated on a straight line basis over their estimated useful lives.

Goodwill represents the excess of purchase price for acquisitions over the fair market value of the acquired Company's net assets. Goodwill is tested for impairment at least annually. This impairment test is a two step process. In the first step, the carrying amount of the Company's assets is compared with their fair value. When fair value exceeds the carrying amount, goodwill is not considered to be impaired and the second

step of the impairment test is not required. The second step compares the implied fair value of goodwill with its carrying amount to measure the impairment loss, if any. Assumptions used to determine fair market values include estimates as to future operating performance as well as various earnings multiples. These assumptions and estimates are subject to risks and uncertainties, and changes in estimates could occur that may affect the existence or quantum of goodwill impairment.

### ***Impairment of Long-Lived Assets***

The Company evaluates potential impairment of long-lived assets and intangible assets when indicators of impairment are present. Estimates of undiscounted future net cash flows to be derived from the long-lived assets over their remaining estimated useful lives, as well as any salvage value are calculated and compared to the carrying value of the long-lived assets to determine whether the assets are deemed to be impaired. Parts of our business are cyclical in nature and the estimate of future cash flows requires the use of assumptions and judgment. Periods of prolonged down cycles in the industry could have a significant impact on the carrying value of these assets and may result in impairment charges.

### ***Depreciation and Amortization of Property and Equipment***

Property and equipment is recorded at cost less accumulated amortization. The useful lives of the depreciable assets are based on historical experience and judgment of management. This judgment includes an assessment of expected utilization, job mix assumptions and preventative maintenance programs. Although management believes that the estimated useful lives and salvage values are reasonable there can be no certainty that the reduction in depreciable asset values over time matches amortization expense using estimated useful lives. If depreciation estimates are not correct, the Company may record a disproportionate amount of gains or losses on disposition of these assets. Management believes their estimates of useful lives to be materially correct.

### ***Future Income Tax Liabilities***

The Company follows the liability method of accounting for income taxes. Under this method, future income taxes are recorded for the effect of any differences between the accounting and income tax basis of an asset or liability using the substantively enacted tax rates. The Company will establish valuation allowances to reduce future income tax assets when it is more likely than not that some or all of a future tax asset will not be realized. Estimates of future taxable income are considered in assessing the utilization of available tax losses. Changes in circumstances and assumptions may require changes to valuation allowances associated with the Company's future tax assets.

### ***Accounting Pronouncements***

On January 1, 2007, the Company adopted the new accounting standards issued by the Canadian Institute of Chartered Accountants regarding the recognition, measurement, disclosure and presentation of financial instruments. Under these standards, financial instruments must be classified into one of five categories: (i) held-for-trading; (ii) held-to-maturity; (iii) loans and receivables; (iv) available-for-sale; and (v) other financial liabilities. The new standards require that all financial instruments within the scope of the standards, including all derivative instruments, be recognized on the balance sheet initially at fair value. Subsequent measurement of all financial assets and liabilities – except those in the held-for-trading and available-for-sale categories – must be determined at amortized cost using the effective interest rate method. Held-for-trading financial instruments are measured at fair value with changes in fair value recognized in earnings. Available-for-sale financial instruments are measured at fair value with changes in fair value recognized in comprehensive income until the investment is derecognized or impaired at which time the amounts would be recorded in net earnings.

Under adoption of these new standards, the Company designated accounts receivable as “loans and receivables”, which are measured at amortized cost. Short-term investments have been designated as “held-for-trading”, which are measured at fair values with changes in such value included in earnings.

Accounts payable and accrued liabilities and long-term debt are classified as “other financial liabilities” which are measured at amortized cost. We have classified deferred financing costs of \$29 previously included in prepaid expenses and other assets as unamortized debt issues costs which now reduce the carrying value of the long-term debt. The debt issue costs will be accreted to the carrying value of long-term debt using the effective interest method. Comparative amounts for prior periods have not been restated.

The Company also adopted as of January 1, 2007 new standards with respect to comprehensive income. The new standards require a statement of comprehensive income, if there are items that give rise to comprehensive income or loss. The Company did not identify any such items giving rise to comprehensive income or loss in the year ended December 31, 2007, or that would result in an adjustment to opening balances for accumulated other comprehensive income or loss.

The Company was also required to adopt new accounting standards with respect to hedging activities. As the Company does not currently have a hedging program that is affected by this accounting standard, the adoption of these standards has no impact on the financial statements.

Three new Canadian accounting standards have been issued which will require additional disclosure in the Company's financial statements commencing January 1, 2008 regarding the Company's financial instruments as well as its capital and how it is managed. The third standard relates to inventory and is effective for interim and annual financial statements beginning on or after January 1, 2008. The new standard requires that inventory be carried at the lower of cost and net realizable value, provides more guidance on cost and requires impairment testing as well as expanded disclosures.

### **Business Risks**

The activities the Company undertakes involve a number of risks and uncertainties, some of which are summarized below. Additional risks and uncertainties that the Company may be unaware of, or that were determined to be immaterial may also become important factors that affect the Company.

#### ***Business Cyclicity***

The demand for HSE's Oilfield services is highly dependent upon the level of expenditures made by oil and gas companies on exploration, development and production activities. The price received by our customers for crude oil and natural gas directly impacts their cash flow available to purchase our services. Fluctuations in crude oil and natural gas prices can produce periods of high and low demand for the Company's services. These fluctuations in commodity prices can cause cyclical demand swings in the Company's activity levels and operating results. As the Company's client base diversifies to material levels, so does the exposure to business cycles and contraction risks in other industrial sectors such as forestry, pulp and paper, automotive, manufacturing and other segments of the economy that could experience reduced demand or significant fluctuations of the market value of their finished goods.

#### ***Availability of Qualified Staff***

The Company's ability to provide reliable service is dependent upon attracting and retaining skilled employees. The demand for skilled workers is high and supply limited.

#### ***Availability of Financing***

Historically, the Company has funded the growth of its operations and its acquisitions from bank debt and share issuances in addition to cash generated from operations. There is no certainty the Company will continue to be able to obtain sufficient financing at competitive rates. The Company's ability to grow as planned may be limited if sources of competitively priced financing are unavailable.

### ***Litigation and Contingencies***

In the ordinary course of business activities, the Company may be contingently liable for litigation and claims with customers, suppliers, former employees, and third parties. Management believes that adequate provisions have been recorded in the accounts where required. Although it may not be possible to accurately estimate the extent of potential costs and losses, if any, management believes that the ultimate resolution of such contingencies would not have a material adverse effect on the financial position of the Company.

In March 2008, the Company was served with a legal claim relating to a company acquired in 2006. Due to the recency of the receipt of this claim the outcome is undeterminable at this time.

### **Disclosure Controls and Procedures**

An evaluation was performed under the supervision and with participation of the Company's management, including the Chief Executive Officer (CEO) and Chief Financial Officer (CFO), of the effectiveness of the design and operation of the Company's disclosure controls and procedures as defined in Multilateral Instrument 52-109. Based on that evaluation, the Company's management, including the CEO and CFO, concluded that the Company's disclosure controls and procedures were designed to provide a reasonable level of assurance over disclosure of material information, and are effective as at December 31, 2007.

### **Management's Report on Internal Control over Financial Reporting**

The CEO and CFO of HSE Integrated Ltd. are responsible for designing internal controls over financial reporting or causing them to be designed under supervision. The Company's internal controls over financial reporting are designed to provide reasonable assurance regarding the reliability of the Company's financial reporting and its preparation of financial statements for external purposes in accordance with Canadian generally accepted accounting principles. Internal controls over financial reporting, no matter how well designed, have inherent limitations. Therefore, internal controls over financial reporting can provide only reasonable assurance with respect to financial statement preparation and may not prevent or detect all misstatements.

During 2006, the Company identified revenue completeness, internal control over financial reporting for acquisitions, segregation of duties and technical expertise as internal control weaknesses. In the current period, Management is satisfied that it has implemented adequate compensating controls to address these weaknesses.

During the third quarter of 2007, the Company acquired the outstanding shares of PWS of Weyburn, Saskatchewan in a business combination to be accounted for using the purchase method. The Weyburn operation has been integrated into our operations, which included assessing and designing internal controls over financial reporting and disclosure controls and procedures.

### **Common Shares Outstanding**

At March 19, 2008, there were 37,567,675 common shares of HSE outstanding, compared with 37,462,342 common shares outstanding as at December 31, 2006.

### **Non-GAAP Measures**

This report makes reference to EBITDA, a measure that is not recognized under generally accepted accounting principles. Management believes that, in addition to net earnings, EBITDA is a useful supplementary measure. EBITDA provides investors with an indication of earnings before provisions for interest and bank charges, taxes, amortization, foreign exchange gains or losses, gains or losses on the disposal of property and equipment, and the non-cash effect of stock-based compensation expense. Investors should be cautioned that EBITDA should not be construed as an alternative to net earnings determined by GAAP as an indication of the Company's performance. HSE's method of calculating

EBITDA may differ from that of other companies and accordingly may not be comparable to measures used by other companies.

### EBITDA Calculation

For the years ended December 31	2007	2006	2005
Net earnings (loss)	<b>\$(27,302)</b>	\$3,461	\$1,833
Add (deduct):			
Amortization	<b>8,090</b>	7,618	3,618
Impairment of goodwill and intangible assets	<b>25,505</b>	-	-
Stock-based compensation	<b>1,131</b>	977	342
Interest and bank charges	<b>1,254</b>	1,398	301
Foreign exchange loss (gain)	<b>36</b>	(93)	16
Loss on disposal of property and equipment	<b>939</b>	406	277
Income tax	<b>(2,664)</b>	1,545	1,209
<b>EBITDA</b>	<b>\$6,989</b>	\$15,312	\$7,596

### Quarterly EBITDA Calculation

	2007				2006			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Net earnings (loss)	<b>\$(9,173)</b>	<b>\$(15,920)</b>	<b>\$(3,113)</b>	<b>\$904</b>	\$984	\$1,197	\$(1,073)	\$2,353
Add (deduct):								
Amortization	<b>2,243</b>	<b>2,004</b>	<b>1,955</b>	<b>1,888</b>	2,458	1,862	1,870	1,428
Impairment of goodwill and intangible assets	<b>10,505</b>	<b>15,000</b>	-	-	-	-	-	-
Stock-based compensation	<b>255</b>	<b>186</b>	<b>333</b>	<b>357</b>	285	312	231	149
Interest and bank charges	<b>311</b>	<b>309</b>	<b>302</b>	<b>332</b>	403	346	359	290
Foreign exchange loss (gain)	<b>12</b>	<b>22</b>	<b>3</b>	<b>(1)</b>	(93)	-	-	-
Loss (gain) on disposal of property and equipment	<b>103</b>	<b>99</b>	<b>30</b>	<b>707</b>	(26)	(19)	272	179
Income taxes	<b>(1,655)</b>	<b>(324)</b>	<b>(1,300)</b>	<b>615</b>	330	585	(519)	1,149
<b>EBITDA</b>	<b>\$2,601</b>	<b>\$1,376</b>	<b>\$(1,790)</b>	<b>\$4,802</b>	\$4,341	\$4,283	\$1,140	\$5,548

### Forward-Looking Statements

This report contains forward-looking information and statements within the meaning of applicable securities laws. These forward-looking statements concern, 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*, *continue*, *project*, *objective* 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 materializes or if assumptions are incorrect, actual results may differ materially from those expressed or implied in the forward-looking statements. The forward-looking statements included in this MD&A are not guarantees of future performance and should not be unduly relied upon. Such information and statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking information and statements.

The forward-looking information and statements contained in the MD&A speak only as of the date of this MD&A, and none of the Company or its subsidiaries assumes any obligation to publicly update or revise them to reflect new events or circumstances, except as may be required pursuant to applicable laws.

### **Additional Information**

Additional information relating to HSE is available under our profile on the SEDAR website at [www.sedar.com](http://www.sedar.com) and at [www.hseintegrated.com](http://www.hseintegrated.com).