

**HSE Integrated Ltd.**  
**Management Discussion and Analysis (“MD&A”)**  
**For the years ended December 31, 2009 and 2008**

The following management discussion and analysis is dated March 24, 2010 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, 2009 and 2008. This MD&A should be read in conjunction with HSE’s other documents filed on SEDAR at [www.sedar.com](http://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 24, 2010. 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, 2009	Year-over-year % change	Year ended Dec. 31, 2008	Year-over-year % change	Year ended Dec. 31, 2007
Revenue	\$ 81,601	-28.3%	\$ 113,763	16.9%	\$ 97,342
Operating and materials	72,530	-21.7%	92,673	14.7%	80,829
Operating margin	9,071	-57.0%	21,090	27.7%	16,513
Operating margin %	11.1%		18.5%		17.0%
Selling, general and administrative	8,226	-23.1%	10,699	12.3%	9,524
Net earnings (loss)	(6,634)		248		(27,302)
Per-share basic	(0.18)		0.01		(0.73)
Per-share diluted	(0.18)		0.01		(0.73)
EBITDA <sup>(1)</sup>	\$ 845	-91.9%	\$ 10,391	48.7%	\$ 6,989
EBITDA %	1.0%		9.1%		7.2%
Total assets	\$ 50,722	-26.4%	\$ 68,934	-6.0%	\$ 73,372
Total long-term liabilities	\$ 5,429	-69.4%	\$ 17,731	-20.1%	\$ 22,196

(1) See Non-GAAP Measures

**FINANCIAL REVIEW**

**Overview**

HSE operates in two geographical sectors providing health and safety services to industry. The Company provides a package of integrated asset, worker and community health and safety protection services including: onsite 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 shower (decontamination) services; onsite medical services; first aid; emergency medical response; worker safety training; industrial hygiene services; and safety management.

For the current year, total revenues decreased 28.3% from \$113.8 million in 2008 to \$81.6 million in 2009. Operating margin of \$9.1 million was 11.1% of revenues, down from \$21.1 million or 18.5% of revenues in 2008. Selling, general and administrative expense (“SG&A”) decreased to \$8.2 million from \$10.7 million in the prior year. As a percentage of revenue, SG&A increased from 9.4% of revenue in fiscal 2008 to 10.1% in 2009. HSE reported a loss of \$6.6 million or (\$0.18) per share compared to

earnings of \$0.25 million or \$0.01 per share in the prior year. EBITDA was \$0.8 million or 1.0% of revenue in 2009, down 91.9% from \$10.4 million or 9.1% of revenue in 2008.

## Revenue

The Company provides health and safety services to customers in two main business areas: Industrial and Oilfield. Industrial services are provided to customers operating in a wide variety of industries, including: non-conventional upstream oil development and production (including oilsands extraction); oil and gas processing and refining; petrochemicals; pulp and paper; utilities; power generation; and diverse manufacturing industries. Industrial also includes worker safety training and safety management services. Oilfield services are used by oil and gas exploration, drilling and production companies that operate within the conventional upstream, or “wellhead”, sector of the oil and gas industry. This includes oil and gas well exploration, drilling, completion and workover operations.

The Company tracks billings to customers by defined revenue groupings, but uses a common pool of equipment and manpower resources to provide these services. Management and administration services are provided from a common personnel pool.

The revenue for these business areas is shown below:

	Year ended Dec. 31, 2009	Year ended Dec 31, 2008	Year-over-year % change
Industrial	\$ 54,298	\$ 62,499	-13.1%
Oilfield	27,303	51,264	-46.7%
Total Revenue	\$ 81,601	\$ 113,763	-28.3%
As a percentage of revenue:			
Industrial	66.5%	54.9%	11.7%
Oilfield	33.5%	45.1%	-11.7%
Total Revenue	100.0%	100.0%	

### **Industrial**

The Industrial health and safety services component of the Company’s total revenue declined in 2009 due to the negative effects of the global recession which include reduced commodity prices, plant shutdowns, project cancellations or delays, and postponed plant maintenance and turnaround expenditures. This general downward trend of industry spending on all goods and services took place to some degree in virtually every industry and geographical sector in which HSE operates.

Industrial revenue decreased \$8.2 million (13.1%) to \$54.3 million from \$62.5 million in the prior year. Industrial health and safety services comprised 66.5% of total revenues, up from 54.9% in 2008. Without a significant recovery in Oilfield activity, Industrial revenues will continue to be significantly greater than Oilfield revenues for the foreseeable future.

The areas in which revenues were the strongest on a year-over-year basis were the oilsands region of northeast Alberta, as well as New Brunswick, where HSE continues to work on major capital projects in the nuclear power and LNG sectors. The new location in Newfoundland and Labrador opened in the first quarter of 2009 and continues to grow. Other industrial markets – particularly Southern Ontario – continue to suffer from the general industry downturn in the mining, steel and automotive sectors. The non-oilsands industrial activity in Western Canada is also depressed as clients work to conserve cash by either deferring some maintenance and capital programs and/or seeking lower-cost service providers.

On a year-over-year basis, the decline in Industrial revenues took place in Western Canada. Industrial revenues from our Eastern operations increased from 2008.

During the year, the Company had one customer representing more than 10% of revenue (2008 – none). The Company had sales of \$8.9 million to the customer during the year related to ongoing long-term industrial projects.

### **Oilfield**

Oilfield revenues in the year decreased by 46.7% in 2009 compared to 2008. This significant year-over-year decline is due to lower overall activity levels in Western Canada in the conventional upstream, or “wellhead”, sector of the oil and gas industry: oil and natural gas well exploration, drilling, completion and workover (repair and maintenance of existing production wells) operations in the Western Canadian Sedimentary Basin. Figures from the Canadian Association of Oilwell Drilling Contractors indicate the total number of new wells drilling in Western Canada in 2009 was 9,342, down 54.8% from 20,679 in 2008.

Oilfield revenue fluctuates between reporting periods relative to changes in conventional oilfield activity in the markets served, including seasonal variations caused by weather in Western Canada. However, HSE’s revenue fluctuations are not always directly related to overall activity levels. All remote operations – exploration, construction, oil or gas – require workers to secure safety training and developers to provide first aid services. Drilling, completion and workover services related to “sour”, or hydrogen sulphide gas, require a higher level of worker and community protection services including breathing air and air quality monitoring. Well-completion techniques, particularly the use of acid stimulation or fracturing with hydrocarbons, involve the use of HSE’s shower and fire protection services. The services within HSE’s Oilfield group are more oriented towards natural gas development, particularly gas containing hydrogen sulphide. These services are also regularly used during the development and production of “sour” oil, or oil reservoirs with a hydrogen sulphide content. Some oil reservoirs tend to go “sour” over time due to the injection of water for secondary recovery, thus increasing the requirement for safety services.

The overall depressed economic environment for the conventional oil and gas industry in 2009 has also put pressure on the prices HSE is able to charge its clients for services provided. To compensate for reduced commodity prices, clients are seeking pricing relief for input services including health and safety. Therefore, in many cases HSE has been forced to adjust its pricing downward in order to maintain clients and market share. To compensate for lower prices, HSE has undertaken a series of internal cost-reduction measures to maintain acceptable operating margins. These initiatives are discussed in detail under the Operating Materials Expense and Selling General and Administrative Expense sections below.

Activity in 2009 related to the Company’s venture with Boots & Coots, Inc. Boots & Coots HSE Services LLC (“BCHSE”) – continued to generate modest revenues as BCHSE gained customer acceptance as a capable provider of worker and asset protection services.

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

Operating and materials expense consists of costs directly attributable to the delivery of health and safety services to customers. These include: wages and benefits for field employees and contractors; equipment rentals and leases; field service center 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, 2009 totaled \$72.5 million or 88.8% of revenue, as compared to \$92.7 million or 81.5% of revenue in 2008. Operating margin for the year declined from \$21.1 million (18.5 % of revenue) in 2008 to \$9.1 million (11.1 % of revenue) in 2009.

The decrease in operating margins is due to several factors. First, there was a major revenue decline of \$32.2 million. As a result, the Company’s fixed field service location operating costs were being spread over a significantly lower revenue base. Second, the portion of revenue derived from higher-margin

equipment rentals as a percentage of total sales declined. Third, as discussed in more detail in the Outlook section, the Company experienced a certain amount of pricing pressure compared to 2008.

As discussed in the first, second and third quarter MD&A, the Company undertook a series of cost reductions including staff reductions, pay cuts and operating cost reductions. The Company incurred additional expenses totaling \$0.5 million (\$0.3 million in the first quarter and \$0.2 million in the second quarter) to effect these cost reductions.

A new system of paying field service technicians came into effect June 1, 2009. Previously, most field service personnel in Western Canada were paid a base salary together with a job bonus. Effective June 1, this was changed to an hourly pay structure similar to the system already in place for the Company's Eastern operations. For Western operations, this makes labour expenses a variable cost for the first time, thus improving profitability during periods of low activity.

Included in operating expenses is a \$0.3 million provision for doubtful accounts to reflect increased collection risks as a result of the deterioration in the general business environment. The allowance for doubtful accounts receivable was \$1.3 million (7.2% of trade accounts receivable) at the end of the year compared to \$1.4 million or 5.2% of trade accounts receivable at December 31, 2008. During the year, the Company wrote off \$0.4 million of previously recorded accounts receivable after all methods of recovery were exhausted. The largest portion of this amount was a receivable for \$0.3 million that had been allowed for in 2007.

## **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 executive management; corporate head-office functions and support services; administrative personnel; corporate sales and marketing costs; liability insurance; professional fees; and investor-relations expenses.

SG&A for the year ended December 31, 2009 totaled \$8.2 million (10.1% of revenue), down from \$10.7 million (9.4% of revenue) in the prior year. Personnel costs declined as staff numbers declined year-over-year and the impact of salary reductions on March 1, 2009 came into effect. Travel and advertising costs declined as part of a company-wide initiative to reduce all costs in response to reduced operating levels.

In 2009, the Company incurred expenses of approximately \$0.2 million to defend against an unsolicited bid for the shares of HSE that commenced July 20, 2009. While the bid was ultimately subject to a cease-trade order by the Alberta Securities Commission and was, therefore, never legally constituted, the Company was nevertheless forced to spend significant funds on legal counsel, corporate secretarial services, transfer agents and teleconference services. The full costs of this event are included in the reported SG&A amounts for the year.

## **EBITDA and Net Earnings**

EBITDA (see "Non-GAAP Measures") in the year decreased 91.9% from \$10.4 million in 2008 to \$0.8 million in the current year. The EBITDA decrease was primarily because of a significant revenue decline on a year-over-year basis.

Total amortization for the year was \$6.7 million, down from \$7.3 million in 2008. Property and equipment amortization decreased compared to the prior year at \$6.2 million (compared to \$6.5 million in the prior year). HSE tightly controlled capital additions during 2009 to reflect business conditions and maintain the strongest possible balance sheet. Intangible assets amortization declined to \$0.5 million from \$0.8 million in 2008 as certain amortization periods expired during 2008, particularly for non-competition agreements.

Stock-based compensation for the year was \$0.3 million (2008 – \$0.4 million). The year-over-year decline is due to a reduction in the number of outstanding unvested options. This decline is partially offset by the increase in deferred share unit ("DSU") expense in 2009. DSU expense for the year was \$0.1 million (2008 - \$0), primarily due to more DSUs granted during the year as the independent directors voted to take their fees in the form of DSUs rather than in cash.

Interest on long-term debt and other interest and bank charges decreased from \$1.1 million in 2008 to \$0.5 million in 2009. Interest on the Company's variable rate bank debt decreased as interest rates dropped. The Company's average borrowing rate was approximately 2.6% lower in the 2009 fiscal year than in 2008. This saved the company approximately \$0.4 million in interest charges. As well, the Company had significantly lower levels of overall debt throughout the current year than it had in 2008. Capital lease obligations decreased by \$1.0 million. Long-term debt was reduced by \$5.7 million primarily in the fourth quarter of 2009.

For the year ended December 31, 2009, the loss on disposal of property and equipment was \$0.3 million with proceeds on sale of \$0.9 million. Partially offsetting the loss is the amortization of a deferred gain on sale / leaseback of real estate assets as discussed in the 2008 annual MD&A (\$0.1 million – 2009, \$0.1 million – 2008). The remainder of asset divestitures consisted of retirement of vehicles replaced through the Company's fleet management program.

At year end, the Company reviewed its long-lived assets to determine whether changes in the business climate indicated that future cash flows generated by the long-lived assets would be sufficient to recover their carrying value. As part of the impairment review, Management identified certain assets that were disposed of subsequent to year end at a point significantly before the end of their previously estimated useful lives. The disposal of these assets confirmed that their carrying values exceeded the amounts recoverable from them and accordingly an impairment loss of \$1.6 million was recorded with respect to these assets. Based on Management's assessment, no other impairment of long-lived assets existed at December 31, 2009.

HSE had a \$2.0 million income tax recovery for the year versus an income tax expense of \$0.6 million for 2008. The change can be attributed primarily to the decrease in taxable income between years.

Net loss for the year was \$6.6 million or \$(0.18) per share versus earnings of \$0.25 million or \$0.01 per share in 2008. The year-over-year decline was primarily due to the significant decrease in revenue and EBITDA as described above.

### **Fourth Quarter 2009 Results Versus Fourth Quarter 2008**

In the fourth quarter of 2009, total revenues were \$19.1 million, a 36.2% decrease over revenues of \$29.9 million for the same period in 2008. Revenues from Oilfield health and safety services decreased by \$8.0 million over the same period last year.

Operating expenses decreased by \$7.8 million from \$24.3 million (81.2% of revenue) in the fourth quarter of 2008 to \$16.5 million (86.5% of revenue) for the same period in 2009. Operating cost decreases reflect the full impact of the field staff pay restructuring, total manpower reductions, and other cost containment activities.

SG&A decreased to \$2.1 million (10.9% of revenue) in the fourth quarter of 2009 from \$2.9 million (9.8% of revenue) in 2008. The change was partially due to the cost control items previously described. Contributing to the decrease in 2009 were legal fees in the fourth quarter of 2008 for the settlement of a legal claim against an acquired company in the amount of \$0.2 million.

EBITDA decreased by 81.7% from \$2.7 million in 2008 to \$0.5 million in the fourth quarter of 2009. The decrease in EBITDA was due to lower overall revenue. The Company had a net loss of \$2.2 million in the fourth quarter of 2009 versus net earnings of \$0.4 million in the fourth quarter of 2008.

### **Fourth Quarter 2009 Results Versus Third Quarter 2009**

In the fourth quarter of 2009, total revenues were \$19.1 million, a 7.1% decrease over revenues of \$20.5 million for the third quarter. Revenues from Oilfield health and safety services increased by \$0.3 million over the third quarter of 2009 as a modest recovery in drilling activity took place. Industrial health and safety revenues declined because the third quarter traditionally contains higher amounts of plant shutdown and maintenance activities that take place prior to the onset of winter.

Operating expenses decreased by \$1.0 million from \$17.5 million (85.0% of revenue) to \$16.5 million (86.5% of revenue) for the fourth quarter.

SG&A remained consistent with the third quarter at \$2.0 million (10.9% and 10.1% of revenue respectively).

## 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:

<b>Years ended December 31</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>Total</b>
Capital lease obligations	\$ 233	\$ 105	\$ 14	\$ 3	\$ –	\$ 355
Vehicle and equipment operating leases	2,677	1,987	785	17	–	5,466
Rental facilities	2,976	2,291	1,816	1,438	1,063	9,584
Long-term debt	5,325	818	–	–	–	6,143
Total contractual obligations	\$ 11,211	\$ 5,201	\$ 2,615	\$ 1,458	\$ 1,063	\$ 21,548

### *Liquidity*

On July 29, 2009, the Company amended its existing credit facilities with its current lender. The amended facility consists of a single \$15 million revolving operating facility. This facility, which matures July 27, 2010, is margined to property and equipment and accounts receivable. The facility bears interest at the bank's prime rate (or U.S. base rate) plus a fixed margin or at bankers' acceptance rates with a fixed stamping fee. An additional standby fee is also required on any unused portion of the credit facility. The facility is subject to certain covenants including a covenant with respect to the ratio of total liabilities to net worth (as defined in the agreement), a current-ratio covenant, an interest-coverage covenant and other positive and negative covenants. The credit facility is collateralized under a general security agreement. The Company complied with all covenants required under the credit facility.

During the year, the Company paid down the facility by \$5.5 million. At the end of the fourth quarter, the Company had \$9.7 million available under its revolving operating facility.

At December 31, 2009, the Company had cash on hand of \$0.5 million.

### *Cash Provided by Operations*

Cash provided by operations in the year was \$6.7 million in 2009 compared to \$8.1 million in 2008. Reduced revenue levels during the year resulted in lower operating cash flow excluding changes in working capital. Non-cash working capital during the year decreased primarily due to changes in receivables and payables. Receivables decreased year over year due to the lower revenue levels and payables decreased as activity decreased. Days-sales-outstanding ("DSO") remained relatively constant at 76 days at December 31, 2009 compared to 77 days at December 31, 2008.

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

During the year the Company made scheduled debt reductions of \$1.2 million towards capital lease and other long-term debt obligations. The Company paid \$5.5 million on its \$15.0 million revolving operating line leaving \$9.7 million available to be drawn.

Purchases of property and equipment for the year amounted to \$1.6 million, the majority of which was revenue-generating health safety services rental equipment. Proceeds from the disposal of property and equipment were \$0.9 million.

## **Working Capital**

At December 31, 2009, the Company had working capital (not including current portions of long-term debt obligations) of \$14.1 million. This compares to \$20.5 million December 31, 2008. The decline from December 31, 2008 is related primarily to a reduction in accounts receivable based on lower revenue as compared to the prior year and offset by reduced accounts payable and accrued liabilities.

## **Outlook**

On a year-over-year basis, the outlook for HSE in the first quarter of 2010 is improved over the same period in 2009. The 2009 fiscal year began with collapsed commodity prices, restricted equity capital markets, tight credit and lending availability, reduced capital expenditures, plant closures, delayed or postponed oilsands projects, postponed plant shutdown and turnaround programs, layoffs, and high degrees of economic uncertainty. The focus of the Company in early 2009 was to reduce internal spending in every way possible in order to offset a decline in revenue.

As HSE enters 2010, the outlook for the Company is improved. Commodity prices, particularly crude oil and natural gas, have recovered from 12-month lows. Equity capital markets are again functioning for the right investments, and debt markets have improved. Several new oilsands projects are underway or scheduled to begin. Plant shutdowns and turnaround activities should return to more historic patterns. HSE has started to re-hire on a selective basis. The Company has emerged from a difficult year with lower debt levels and a strong working capital position. This is a sound foundation from which to resume growth.

But challenges remain. Customers have become increasingly price-sensitive as they attempt to regain historic margins of profitability by reducing input costs from vendors like HSE. Overcapacity in certain markets ensures a competitive marketplace. Downward re-pricing of services for key customers to maintain business has eroded some of the competitive advantages the Company created with its cost-reduction strategies in 2009.

Regardless, management believes the worst is over for HSE and the Company will return to growth in 2010, albeit at a lower level than in past years.

### ***Industrial***

Industrial health and safety services in all locations across Canada remains a bright spot for the Company as we continue to demonstrate successful expansion by introducing new products, moving into new markets and gaining clients that we have never worked with before.

Although business declined somewhat in 2009, HSE believes this was primarily due to the recession. No major obstacles exist to prevent the Company from resuming growth because the size of this market opportunity is so much greater than HSE's market share. The contraction in total Industrial revenue in 2009 compared to 2008 has been discussed above. What is remarkable about what has become the major component of the Company's business going forward is the growth that continues despite the severity of the worst global recession in decades.

The oilsands region of northeast Alberta continues to show promise. Several new projects have been announced and HSE is participating in all of them in some way through training, medical, breathing air, and safety supervision. HSE has introduced a new business concept to the region with a multi-client worker wellness facility associated with an independently operated worker housing facility that supports up to 3,000 workers. This facility is expected to expand to 5,000 workers by year end. Increased penetration of products and services into producing plants continues.

Atlantic Canada is a growth area for HSE. A new location in St. John's, Newfoundland and Labrador opened in January of 2009 has steadily increased revenue and clients. This operation should generate positive cash flow in 2010. A new location opened in Hamilton, Ontario in late 2008 experienced steady growth in 2009. This will continue in 2010. While revenues from some capital projects will decline in New Brunswick, growth in new clients, contracts and opportunities continues. The growth in providing offshore safety specialists for oil and gas and other operations adds a new dimension to HSE. Success on the east coast could lead to future opportunities on Canada's west coast.

HSE believes that the contraction in total Industrial revenues that occurred in 2009 is an unusual event caused primarily by the severity and breadth of the recession and intense pricing competition for existing work. Looking forward, the Company sees more normal demand for plant turnaround services in all markets as clients factor in quality along with price. To save cash in 2009, some clients turned to internal resources for their shutdowns. This is not likely to continue. The resumption of capital projects in the oilsands by current HSE clients will help grow revenue.

Having one major client single-source its safety needs on a national basis to HSE (see United States below) is a significant breakthrough in terms of persuading other clients to outsource health and safety services. HSE is currently in discussions with another national client about being the sole-source provider of safety services in multiple locations across Canada. HSE is confident this type of business will increase in future years as more industrial operators embrace the concept of outsourced safety services as a viable alternative to historic internal initiatives.

In the past three years HSE has opened three successful "greenfield" locations for Industrial health and safety in Saint John, New Brunswick; Hamilton, Ontario; and St. John's, Newfoundland and Labrador. No acquisitions were made. These markets are characterized by a large, diverse industrial base and no competitors with HSE's varied product and service offering. If St. John's performs as anticipated in 2010, all three locations will be characterized by growth and a high rate of return on invested capital.

### **Oilfield**

The Oilfield component of HSE's business is where the Company started and was the dominant business area for many years. However, due to the growth in Industrial, the revenue mix will likely change. The signals for increased business are the strongest they have been since mid-2008. In the fourth quarter of 2009 and continuing into the first quarter of 2010, there has been a marked increase in drilling and related completion activity as more drilling rigs go back to work in Canada and the U.S. Drilling activity levels in Canada in the first quarter are substantially higher than the forecast by the Canadian Association of Oilwell Drilling Contractors in November of 2009.

Since last June, oil prices have stabilized in the range of \$US 73 to \$US 83 a barrel. These are down from historic levels, but still at a price that makes many development projects economic. Most analysts believe that crude oil will remain in this price range for the remainder of the year. The average price of crude oil in the U.S. in March 2009 was below \$US 40 a barrel. In January and February 2009 the price was \$US 33 and \$US 31 respectively.

Natural gas prices have recovered significantly from the multi-year lows experienced in the third quarter of 2009. For much of the first quarter, NYMEX Henry Hub Natural Gas has traded at about \$US 5.50 per mmbtu. This is up significantly from below \$US 4 from March to September 2009, with the lowest price being below \$US 3 in August of 2009. Analysts see a trading range of \$US 4.50 to \$US 6.50 for the remainder of 2010. However, current gas prices are much lower than they were in 2006, 2007 and 2008.

Drilling activity in Canada, while improved, has seen increased spending directed towards crude oil and away from natural gas. This is because crude oil is more valuable than natural gas on a heating-equivalent basis. As well, new technology such as horizontal drilling and multi-stage fracturing has given developers a new tool with which to economically exploit mature crude oil reservoirs. Activity in Alberta has been assisted by government drilling incentive programs that include royalty credits for

drilling expenditures and a 5% maximum Crown royalty for production for the first two years after completion.

Increased drilling for crude oil is not as dangerous and therefore less safety-intensive than drilling for natural gas, particularly “sour gas” that contains toxic hydrogen sulphide. Therefore, HSE’s business as measured by the active drilling rig count is different than it has been in previous years. Further, large-volume fracturing operations associated with multi-stage fracturing of extended-reach horizontal wells usually do not use hydrocarbons or acid because of cost. These procedures, typically associated with conventional gas wells, require services from HSE such as fire and shower protection.

However, oil drilling does require worker safety training, onsite first aid in remote locations, and, depending on the completion technique employed, may require worker protection during the well-completion process. HSE has field service locations strategically located near most of the oil drilling operations that are taking place in Canada, or are likely to take place this year.

Natural gas markets in North America have undergone a major shift in recent years due to continued success in the development of shale gas reservoirs in the U.S. These reservoirs are closer to markets than Alberta, thus giving these producers a price advantage on transportation costs. This may result in a permanent change to the natural gas business in Alberta. This is important for HSE because the Oilfield health and safety services business that has evolved since the early 1990s has been primarily driven by a predominance of natural gas drilling and development.

The Alberta government is aware of this situation, and in 2009 undertook a major Competitiveness Review with industry to determine an appropriate fiscal and regulatory regime to make Alberta more competitive in North American gas markets. On March 11, 2010, Alberta announced a significant reduction in royalty rates effective January 1, 2011, and introduced a permanent 5% reduced-royalty period for all new oil and gas wells drilled. These policy changes will enhance the prospects for HSE’s Oilfield group in the months and years ahead, because investments by exploration and production companies will be substantially more profitable than they would have been otherwise.

Nevertheless, service pricing will create challenges going forward. In an attempt to make reserve replacement more profitable, customers have requested pricing relief from all their suppliers, including HSE. Exploration and production companies are revisiting pricing with all their vendors in an attempt to reduce drilling and service costs sufficiently to make more prospects economical for development. The total health and safety capacity in Western Canada significantly exceeds demand at current activity levels.

Fortunately, the major adjustment to field service labour costs undertaken in the second quarter will help HSE maintain at least some of its operating margin in the face of price reductions. It may be possible that reduced drilling and development costs will increase total revenues, because clients will be able to drill more wells than they would have otherwise. Our Company will continue to be extremely diligent on costs and efficiencies.

Revenues from HSE’s Oilfield health and safety services declined for four consecutive years from a peak of \$76.1 million in 2006 to \$27.3 million in 2009. While the challenges remain as outlined above, if current levels of drilling continue and the Alberta government’s royalty changes have the impact the industry expects, this important component of HSE’s business may see modest growth in 2010 and will most certainly perform better in 2011 and beyond.

### **United States**

For the first time, HSE has reported segmented financial information for its two U.S. operations – CRS Technologies Inc. (“CRS”) which operates from Taylor, Michigan (a suburb of Detroit), and Boots & Coots HSE Services LLC (“BCHSE”) which operates from a head office in Houston, Texas. The combined financial results of both operations are contained in the notes to the 2009 Audited Financial Statements.

The Taylor location was part of an acquisition in Sarnia, Ontario in 2005. It has always been a modest performer and a contributor to cash flow but has never really broken through in a meaningful way considering the density of heavy, safety-intensive industry that exists in Michigan and nearby states such as Illinois, Ohio, New Jersey and New York. In the third quarter of 2009 a national contract for plant maintenance services was signed with a global supplier of industrial products. In the fourth quarter, this resulted in CRS making a meaningful contribution to revenues. The client needed a single-source supplier for industrial safety services in order to ensure a uniform level of service and quality across its operations. This contract should also contribute in 2010 and beyond and provide an example of a different way of doing business for other clients.

In early 2009, HSE's new BCHSE business unit began operations in West Texas. This is a limited-liability company with Boots & Coots, Inc. of Houston, Texas. This is an Oilfield health and safety services project designed to determine if U.S. clients were prepared to recognize and support a new player with state-of-the art equipment and services. BCHSE arrived at the same time as a significant downturn in oilfield activity in the U.S., and thus incurred higher startup costs than planned. All of the operating losses in the U.S. in 2009 came from BCHSE. However, as the year progressed, the combination of good service, good equipment, increased demand, marketing and cost control helped bring BCHSE to near break-even EBITDA on a monthly basis. This is without the full utilization of its oilfield firefighting assets. Based on this growth, HSE will be making a modest capital investment in Q1 2010 to help move BCHSE to the break-even level and beyond. If BCHSE can create a market for its mobile oilfield firefighting and asset protection equipment, this market may contribute to higher utilization rates for an underutilized asset class in Canada.

### **Sales and Marketing**

The focus for the Company in 2009 was cost cutting. An added focus in 2010 will be sales and marketing in multiple markets. HSE has an enviable client base across all the markets in which it operates. However, hiring of the Company's services tends to be more site or project-specific than national or strategic.

Therefore, in 2010 and beyond HSE will more aggressively pursue sales and marketing through national contracts; doing more work in more markets for existing clients; providing more services to existing clients; and approaching new clients that have operations near HSE sites that could benefit from a single-source health and safety services provider.

HSE is also for the first time actively pursuing international health and safety opportunities. Few competitors offer HSE's comprehensive service package. The world market for the Company's products and services has always been large, but in the past HSE has been manpower constrained. This has limited the ability to provide the quality, experienced Canadian health and safety professionals that attract new clients. That situation has changed, and HSE's approach has changed with it.

### **Quarterly Results**

	2009				2008			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Revenue	\$19,090	\$20,544	\$19,566	\$22,401	\$29,905	\$28,202	\$28,087	\$27,569
Net earnings (loss)	(2,178)	(722)	(1,928)	(1,806)	431	396	(568)	(11)
EBITDA <sup>(1)</sup>	496	1,016	(451)	(216)	2,713	2,858	2,187	2,633
Income (loss) per share – basic and diluted	\$ (0.06)	\$ (0.02)	\$ (0.05)	\$ (0.05)	\$ 0.01	\$ 0.01	\$ (0.02)	\$ 0.00

(1) See Non-GAAP Measures

HSE's business has two offsetting seasonal components. Revenue for Oilfield health and safety services is historically highest in first and fourth quarters and lowest 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. Industrial revenue includes a mix of year-round contracts and "turnarounds" – scheduled major maintenance projects and repair activities on client facilities. These turnarounds tend to be scheduled during the second and third quarters to avoid the possibility of adverse effects from freezing weather. As a result, Industrial revenue tends to be highest in the second and third quarters.

Revenue by quarter for the last eight quarters is as follows:

	2009				2008			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Industrial	\$ 12,533	\$ 14,375	\$ 15,249	\$ 12,141	\$ 15,308	\$ 16,163	\$ 19,420	\$ 11,608
Oilfield	6,557	6,169	4,317	10,260	14,597	12,039	8,667	15,961
Total revenue	\$ 19,090	\$ 20,544	\$ 19,566	\$ 22,401	\$ 29,905	\$ 28,202	\$ 28,087	\$ 27,569

## Related-Party Transactions

During the year, the Company had the following transactions with related parties all of which are measured at exchange amounts.

- In 2009, the Company paid rent and property taxes of \$0.3 million (2008 - \$0.3 million) for a regional office to a corporation related to a Director of the Company.
- In 2009, the Company also paid rent and property taxes of \$0.3 million (2008 – \$0.3 million) for a regional office to a corporation controlled by a Senior Manager 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, 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 are 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 at least monthly. 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 when actual write-offs differ from estimates.

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

The Company evaluates potential impairment of property and equipment and intangible assets with finite lives 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 values 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.

### ***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 amortization 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 establishes valuation allowances to reduce future income tax assets when management believes 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.

## **Newly Applicable Accounting Pronouncements**

### ***Goodwill And Intangible Assets***

On January 1, 2009 the Company adopted the revised Canadian accounting standards regarding Goodwill and Intangible Assets. These standards provide guidance with respect to the recognition, measurement and disclosure of goodwill and intangible assets. The provisions of the new standards relating to the definition of intangible assets and their initial recognition have been changed to coincide with those in the equivalent International Financial Reporting Standard. This change had no effect on the Company's reported results.

### ***Financial Instruments – Presentation***

Effective for annual financial statements related to years ending after September 30, 2009, the Accounting Standards Board adopted changes with respect to the disclosure for fair value measurements of financial instruments and with respect to the liquidity risk associated with financial instruments. Items measured at fair value are required to be placed in one of three categories: Level 1 – fair values measured using quoted prices in active markets for identical instruments; Level 2 – fair values measured using directly or indirectly observable inputs, other than those included in level 1; Level 3 – fair values measured using inputs that are not based on observable market data. This change had no effect on the Company's reported results.

## Accounting Standards Pending Adoption

### ***Business Combinations, Consolidated Financial Statements and Non-controlling Interests***

In January 2009, the Canadian Accounting Standards Board (“AcSB”) issued three new recommendations regarding business combinations, consolidated financial statements and non-controlling interests. While these standards are effective for fiscal years beginning on or after January 1, 2011, early adoption is permitted if all three standards are adopted simultaneously. The new standards include:

- Section 1582, which will replace Section 1581, deals with accounting for business combinations. The new standard harmonizes Canadian accounting standards with IFRS 3 – Business Combinations. Section 1582 is applicable prospectively to business combinations entered into after adoption.
- Sections 1601 and 1602 together will replace existing section 1600. Section 1601 provides standards for the preparation of consolidated financial statements, while section 1602 provides standards with respect to accounting for non-controlling interests in subsidiaries. The new standard harmonizes Canadian accounting standards with proposed revisions to IAS 27 – Consolidated and Separate Financial Statements. It makes changes to the circumstances under which the Company must consolidate an entity, as well as to disclosure requirements.

The impact of these standards on the Company’s financial statements will depend upon the timing and nature of any future acquisitions.

## International Financial Reporting Standards

On February 13, 2008, the Canadian Accounting Standards Board (“AcSB”) confirmed the requirement for all publicly accountable enterprises to adopt International Financial Reporting Standards (“IFRS”) for fiscal years beginning on or after January 1, 2011. Effective January 1, 2011 HSE will be required to report its interim and annual financial statements in accordance with IFRS including comparative information for the 2010 period.

HSE has commenced the process to transition from current Canadian GAAP to IFRS. A project team led by Finance has been established. Representatives from other areas of HSE participate as required. Regular reporting to the Audit Committee of the Board of Directors on the status of the IFRS project has been implemented.

HSE has developed a project plan that consists of three major phases: initial assessment, detailed assessment and design, and implementation.

Initial assessment – this phase involved performing a high-level impact assessment to identify the areas that would be affected by the transition to IFRS. As a result of these procedures, the potentially impacted areas were identified as high, medium and low impact. The level of impact was determined based on the relative significance of the account balance and the nature of the differences between current HSE accounting policies and the accounting policies required by IFRS.

Detailed assessment and design – this phase involves the specification of changes required to existing accounting policies, information systems and business processes, together with an analysis of policy alternatives allowed under IFRS and the development of a template for IFRS financial statements and notes. HSE’s efforts are currently focused on this phase of the project.

Implementation – this phase includes execution of changes to information systems and business processes, completing formal authorization processes to formally approve recommended accounting policy changes and training programs for the finance group and other areas of the company as required.

HSE has identified differences between accounting policies under Canadian GAAP and accounting policy choices under IFRS, both on an ongoing basis and with respect to certain choices available on

conversion made under IFRS 1. HSE undertook a thorough analysis of all standards to confirm the classification of the differences into high, medium and low impact. Differences in accounting policies related to property and equipment, leases, impairments, stock-based compensation and disclosures have been identified as high and medium impact.

HSE is making progress towards determining the major components in its property and equipment. The Company has also begun preliminary calculations to quantify the impacts of differences expected on the consolidated financial statements.

HSE has completed a review of all new disclosures required under IFRS to identify any system or business process changes required. HSE will be preparing a draft template for IFRS financial statements and notes in second quarter 2010.

Training for key employees has occurred and will continue throughout 2010.

Most adjustments required on transition to IFRS will be made, retrospectively, against retained earnings on the first comparative balance sheet. However, IFRS 1 *First-Time Adoption of International Financial Reporting Standards* provides entities adopting IFRS for the first time with a number of optional exemptions and mandatory exceptions, in certain areas, to the general requirement for full retrospective application to IFRS. The Company is analyzing the various accounting policy choices and will implement those determined to be the most appropriate in the circumstances. Significant exemptions available to HSE under consideration are:

- An exemption allowing business combinations to be accounted for under IFRS standards starting at a date of the Company's choosing, rather than requiring that all acquisitions be restated as they would have been under IFRS.
- An exemption allowing the Company to apply IFRS accounting for stock compensation on a prospective basis to stock options granted and vested prior to transition.
- An exemption allowing an entity to value fixed asset components at their fair value at the conversion date, rather than retrospectively restating amortization of components and recording disposals and additions of components that were expensed as required under Canadian GAAP.

Described below are the high priority areas where changes in accounting policies are expected to impact the Company's consolidated financial statements. The list below should not be regarded as a complete list of changes that will result from HSE's transition to IFRS. It is intended to highlight the areas that we consider most significant, however, analysis of changes is still in progress and not all decisions have been made where choices of accounting policies are available. The differences described below are those existing based on Canadian GAAP and IFRS as of today.

#### ***Property, Plant and Equipment – IAS 16***

IAS 16 defines property, plant and equipment as tangible items that are held for use in the production or supply of goods and services, for rental to others, or for administrative purposes; and are expected to be used during more than one period.

IFRS and Canadian GAAP contain the same basic principle for property, plant and equipment; however, there are some differences. IFRS requires that major components of an asset for which different depreciation methods or rates are appropriate to be depreciated separately and depreciation commences when the asset is available for use. IFRS also permits property, plant and equipment to be measured at fair value or at amortized cost.

As indicated above, IFRS 1 contains an elective exemption where the Company may elect to reset as the new cost basis for property, plant and equipment, its fair value on the date of transition.

### ***Impairment of Assets – IAS 36***

Canadian GAAP impairment testing compares the asset-carrying values with undiscounted future cash flows to determine whether impairment exists. If the carrying amount exceeds the recoverable amount, the carrying value is written down to estimated fair value.

IAS 36, uses a one-step approach for both testing for and measurement of impairment, with carrying values compared directly to the higher of fair value less costs to sell and value in use (which uses discounted cash flows). This may result in more frequent write-downs where carrying values of assets were previously supported under Canadian GAAP on an undiscounted cash-flow basis, but could not be supported under a discounted cash-flow basis.

IAS 36 also contains a requirement to reverse any previous impairment losses where circumstances have changed such that the impairments have reduced. Canadian GAAP prohibits the reversal of impairment losses.

### ***Leases – IAS 17***

IAS 17 classifies a lease as either a finance lease or an operating lease. In respect of lessors, there is a subcategory of finance lease for manufacturer or dealer leases.

Both Canadian GAAP and IFRS lease classification depends on whether substantially all the risks and rewards of ownership of a leased asset have been transferred from the lessor to the lessee, and is made at the inception of the lease. A number of indicators are used to assist in lease classification. However, under Canadian GAAP in practice the quantitative thresholds included in certain of the indicators are treated as “bright lines” and there are fewer indicators to be considered.

Immediate gain recognition from the sale and leaseback of an asset depends upon whether or not the sale takes place at fair value, and whether the leaseback is classified as an operating lease or finance lease.

## **Financial and Other Instruments**

The Company’s financial instruments include cash and cash equivalents, accounts receivable, income taxes receivable, bank indebtedness, accounts payable and accrued liabilities, obligations under capital leases and long-term debt. The carrying value of these instruments approximates their fair value either because of their short maturities or because the interest rates to which they are subject approximate market rates.

The Company is exposed to the following risks from its financial instruments:

- credit risk
- liquidity risk
- market risk

These risks, and the Company’s method of mitigating the risks, are described below:

### ***Credit Risk***

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Company’s receivables from customers. The maximum credit exposure associated with trade accounts receivable is the carrying value.

The Company’s accounts receivable are due from customers in a variety of industries including a significant proportion with customers operating in the energy and manufacturing industries. The ability of customers within the energy industry to pay us is partially affected by fluctuations in the price they receive for various hydrocarbon products.

The Company follows a credit policy under which the Company reviews each new customer individually for credit worthiness before the Company's standard payment and delivery terms and conditions are offered. The Company's review includes external ratings, where available, and trade references. Customers that fail to meet the Company's credit worthiness criteria may transact with the Company only on a prepayment basis. On an on going basis, the Company also reviews the payment patterns of its existing customers and the customers' continued credit worthiness.

Trade accounts receivable are recorded at the invoiced amount and do not bear interest. Standard payment terms are net 30. However, these may be varied by agreements with particular customers. As well, industry practices, particularly within the upstream oil and gas industry, allow for payment terms of up to 60 days.

The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in the Company's existing accounts receivable. The Company determines the allowance by reviewing individual accounts past due for collectability, historical write-off experience adjusted for changes in both general and industry-specific economic conditions and overall account aging. The Company reviews its allowance for doubtful accounts on an ongoing basis, but at least monthly.

### ***Liquidity Risk***

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company requires liquidity to meet financial obligations as they come due and to fund our operating and investing activities. Our financial obligations include trade and other payables, income tax liabilities and interest and principal payments on our debt obligations including capital leases, equipment loans and the revolving operating credit facility.

HSE manages its liquidity risk by ensuring to the extent possible that it has access to funding sources at competitive rates. The Company generally uses operating cash flow to provide liquidity to meet its financial obligations. As a result, the Company is exposed to a loss of liquidity if its customers delay their payments beyond the levels that they have in the past. To mitigate this, the Company has projected its operating cash flows under different scenarios with respect to receivables aging to determine the effect on operating cash inflows. The Company monitors its receivables collections to ensure that, if collections are delayed, there are sufficient operating funds available to meet our financial obligations. As well, the Company has access to undrawn operating lines of credit of \$9.7 million to fund operations. HSE believes it has sufficient funding through these sources to meet its obligations as they come due.

### ***Market Risk***

Market risk is the risk that changes in market prices of financial assets and liabilities, including foreign exchange rates, interest rates and equity prices, will affect the Company's financial position, results of operations and cash flows.

HSE is exposed to currency risk on U.S.-dollar denominated financial assets and liabilities. The Company adjusts the reported amounts of foreign-currency denominated financial assets and liabilities to their Canadian-dollar equivalent at each balance sheet date. For amounts held directly by the Company, any related foreign exchange gains and/or losses are recognized in the consolidated statement of earnings. For amounts held by the Company's self-sustaining foreign operations, the amount is included in other comprehensive income. At December 31, 2009 the extent of this exposure was not material.

HSE is exposed to interest-rate risk on its prime-based revolving operating facility. Based on amounts outstanding at December 31, 2009 a 1% increase in the average prime interest rate for the year would cost the Company \$0.05 million in additional interest expense.

## Business Risks

The activities the Company undertakes involve a number of risks and uncertainties, some of which are: economic and market events including disruptions in international credit markets and reductions in macroeconomic activity; business cyclicality within the industries in which HSE's customers operate; competitive conditions including pricing pressures; risks of customer credit default; deterioration in the financial condition of financial institutions and insurance companies that HSE deals with; availability of financing at competitive rates; changes in foreign exchange rates and interest rates and litigation and contingencies. 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. Further details regarding specific risks that may affect the Company are provided below:

### ***Business Cyclicality***

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. These expenditures are in turn affected by a number of factors:

- 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. Alternatively, a number of factors that are beyond our customers' control, including weather, geopolitical conditions and the strength of the global economy may reduce demand for their products, which, in turn, will reduce the price they receive.
- Since crude oil and natural gas prices are normally denominated in U.S. currency, fluctuations in the Canadian dollar exchange rate relative to the U.S. dollar can also affect the cash flow available to our customers to purchase our services.
- Exploration, development and production activity levels within particular markets are influenced by factors including royalty, regulatory and taxation changes, weather and access to pipeline capacity.
- Changes in equity- and debt- markets independent of any individual company's circumstances may reduce access to capital which is used to fund exploration, development and production activities.

These fluctuations in activity can cause cyclical demand swings in the Company's activity levels and operating results.

The demand for HSE's Industrial services are exposed to business cycles and contraction risks in the oil and gas industry and other industrial sectors such as forestry, pulp and paper, automotive, manufacturing, mineral extraction and other segments of the economy that could experience reduced demand or significant fluctuations of the market value of their finished goods. As well, a significant portion of our Industrial services are provided to customers in the non-conventional upstream oil and gas industry, including oilsands extraction. These customers are exposed to similar risks with respect to crude oil pricing as customers for whom we provide Oilfield services.

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

The Company's ability to provide reliable service is dependent upon attracting and retaining skilled employees. While the overall downturn in the economy and rising unemployment levels have improved the Company's access to qualified staff, the demand for workers with particular skills used by the Company is high and the supply remains limited.

### ***Competitive Conditions***

While no one competitor provides the full suite of services that the Company provides, HSE has competitors in each area of service that we provide. These competitors may provide pricing pressure

that may affect our margins and market position within particular lines of business. The Company attempts to mitigate this risk by providing an integrated suite of services that our competitors cannot provide, and by distinguishing ourselves through higher levels of service and expertise.

### ***Customer Credit***

We generally invoice our customers in arrears for our services. Because of this, we are subject to the risk that our customers may delay payment of our invoices through a variety of means or fail to pay the invoice at all. Changes in economic conditions, either in general or within a particular industry, may increase this risk.

### ***Financial Institutions***

As a result of changes in economic conditions, a number of financial institutions and insurance companies have reported deterioration in their financial condition. We have no indication that either our lenders or our insurers would be unable to fulfill their obligations under credit agreements or insurance policies. If this were to occur and if we were unable to find suitable replacements at reasonable rates, our liquidity, operating results and cash flows could be adversely affected.

### ***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.

### ***Foreign Exchange Exposure***

HSE's consolidated financial statements are presented in Canadian dollars, but include the results of our U.S. subsidiaries for which the functional currency is U.S. dollars. Changes in the U.S.-dollar exchange rate versus the Canadian-dollar rate may have material effects on net income and other comprehensive income reported by our U.S. subsidiaries.

### ***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.

## **Internal Control Over Financial Reporting**

### ***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 National 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, 2009.

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

The Company's management, including the CEO and CFO, have assessed and evaluated the design and effectiveness of the Company's internal control over financial reporting as defined in National

Instrument 52-109 as at December 31, 2009. In making this assessment, the Company used the criteria established by the Committee of Sponsoring Organizations (COSO) in the “Internal Control – Integrated Framework”. The Company’s assessment included documentation, evaluation, and testing of its internal controls over financial reporting. Based on that evaluation, the Company’s management, including the CEO and CFO, concluded that the Company’s internal controls over financial reporting are effective and 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, as at December 31, 2009.

Internal control over financial reporting, no matter how well designed, has inherent limitations. Therefore, internal control over financial reporting determined to be effective can provide only reasonable assurance with respect to financial statement preparation and may not prevent or detect all misstatements.

#### ***Changes in Internal Controls Over Financial Reporting During 2009***

There have been no significant changes in the Company’s internal control over financial reporting during the year ended December 31, 2009 that have materially affected, or are reasonably likely to materially affect, its internal control over financial reporting.

### **Common Shares Outstanding**

At December 31, 2009 and March 24, 2010, 37,575,675 common shares of HSE were outstanding. At December 31, 2009, the Company had options outstanding to issue 2,375,333 shares at a weighted-average exercise price of \$1.56 per share. Of these options, 1,360,315 were exercisable. At March 24, 2010 there were 2,157,333 options outstanding at a weighted average price of \$1.55 per share. Of these options, 1,217,151 were exercisable.

### **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

Years ended December 31	2009	2008	2007
Net earnings (loss)	\$ (6,634)	\$ 248	\$ (27,302)
Add (deduct):			
Amortization	6,699	7,265	8,090
Impairment of property and equipment	1,641	–	–
Impairment of goodwill and intangible assets	–	100	25,505
Stock-based compensation	293	408	1,131
Interest and bank charges	544	1,116	1,254
Foreign exchange loss (gain)	–	(31)	36
Loss on disposal of property and equipment	311	648	939
Income tax	(2,009)	637	(2,664)
<b>EBITDA</b>	<b>\$ 845</b>	<b>\$ 10,391</b>	<b>\$ 6,989</b>

## Quarterly EBITDA Calculation

	2009				2008			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Net earnings (loss)	\$ (2,178)	\$ (722)	\$ (1,928)	\$ (1,806)	\$ 431	\$ 396	\$ (568)	\$ (11)
Add (deduct):								
Amortization	1,618	1,650	1,692	1,739	1,399	1,821	1,920	2,125
Impairment of property and equipment	1,641	–	–	–	–	–	–	–
Impairment of goodwill and intangible assets	–	–	–	–	–	–	100	–
Stock-based compensation	43	101	99	50	95	23	155	135
Interest and bank charges	135	140	120	149	200	288	331	297
Foreign exchange loss (gain)	(8)	(3)	12	(1)	(35)	4	2	(2)
Loss on disposal of property and equipment	57	35	126	93	193	129	326	–
Income taxes	(812)	(185)	(572)	(440)	430	197	(79)	89
<b>EBITDA</b>	<b>\$ 496</b>	<b>\$ 1,016</b>	<b>\$ (451)</b>	<b>\$ (216)</b>	<b>\$ 2,713</b>	<b>\$ 2,858</b>	<b>\$ 2,187</b>	<b>\$ 2,633</b>

## Forward-Looking Statements

Certain statements in this MD&A constitute forward-looking information and statements (collectively “forward-looking 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 involve known and unknown risks, uncertainties and other factors which may cause actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. When used in this MD&A, such forward-looking statements use such words as *expect*, *anticipate*, *estimate*, *believe*, *may*, *will*, *would*, *could*, *might*, *intend*, *plan*, *continue*, *ongoing*, *project*, *objective*, *should* and other similar terms and phrases. This forward-looking information reflects the Company’s current expectations regarding future events and operating performance based on assumptions and analyses made by the Company based on

its experience and an assessment of current conditions, known trends, expected future developments and other factors which management believe to be appropriate under the circumstances. These forward-looking statements include among others:

- Management believes the worst is over for HSE and the Company will return to growth in 2010.
- Although business declined somewhat in 2009, HSE believes this was primarily due to the recession.
- HSE believes that the contraction in total Industrial revenues that occurred in 2009 is an unusual event caused primarily by the severity and breadth of the recession and intense pricing competition for existing work.
- Plant shutdown and turnaround activities should return to more historic patterns.
- No major obstacles exist to prevent the Company from resuming growth in Industrial health and safety services because the size of this market opportunity is so much greater than HSE's market share.
- Natural gas markets in North America have undergone a major shift in recent years due to continued success in the development of shale gas reservoirs in the U.S. These reservoirs are closer to markets than those in Alberta, thus giving these producers a price advantage on transportation costs. This may result in a permanent change to the natural gas business in Alberta and to HSE's business.
- The major adjustment to field service labour costs undertaken in the second quarter will help HSE maintain at least some of its operating margin in the face of price reductions.
- HSE has introduced a new business concept to the oilsands region with a multi-client worker wellness facility associated with an independently operated worker housing facility that supports up to 3,000 workers. This facility is expected to expand to 5,000 workers by year end. New products and services should increase revenues.
- Success on the east coast with HSE products and services could lead to future opportunities on Canada's west coast.
- We are expecting that our newest location in St. John's, Newfoundland and Labrador will continue to increase revenue and clients. We expect this operation to generate positive cash flow in 2010. We also expect our Hamilton operation to continue with its steady growth.
- HSE expects that a contract signed by a global supplier of industrial products will continue to contribute revenues.

The forward-looking statements contained in this MD&A reflect several material factors, expectations and assumptions including, without limitation: economic conditions within Canada and the United States, both in general and within specific industries; demand for the Company's services by customers in various industries and geographic locations; pricing levels for the Company's services; commodity prices; foreign currency exchange rates; interest rates; access to financing; the Company's future operating results and financial condition; and competition within particular markets or for particular services.

Forward-looking statements involve significant risks and uncertainties and should not be read as a guarantee of future performance or results, and will not necessarily be an accurate indication of whether or not such results will be achieved. A number of factors could cause actual results to differ materially from the results discussed in the forward-looking statements including, but not limited to, the factors discussed above and other risk factors discussed herein and listed from time to time in the Company's reports and public disclosure documents including its annual report, annual information form and other filings with securities commissions in Canada as reported under the Company's profile at [www.sedar.com](http://www.sedar.com).

The Company cautions that the foregoing list of assumptions, risks and uncertainties is not exhaustive. The forward-looking statements contained in this MD&A speak only as of the date of this MD&A, and the Company assumes no 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 [www.hseintegrated.com](http://www.hseintegrated.com).