



MANAGEMENT'S REPORT

To the Shareholders of HSE Integrated Ltd.:

The accompanying consolidated financial statements of HSE Integrated Ltd. and all of the information in this annual report are the responsibility of Management and have been approved by the HSE Board of Directors.

Management has prepared the consolidated financial statements in accordance with Canadian generally accepted accounting principles and where alternative accounting methods exist, Management has chosen those that it deems most appropriate.

Financial statements are not precise since they include amounts based on estimates and judgments. Such amounts have been determined on a reasonable basis to ensure the financial statements are presented fairly in all material respects. Management has prepared the financial information in this annual report and has ensured it is consistent with the consolidated financial statements.

The Corporation maintains internal accounting and administrative controls designed to provide reasonable assurance that the financial information is relevant, reliable, and accurate and that the Corporation's assets are appropriately accounted for and adequately safeguarded.

The HSE Board of Directors is responsible for ensuring Management fulfills its responsibilities for financial reporting and for reviewing and approving the financial statements. This is carried out principally through the Audit Committee. HSE's auditors have full access to the Audit Committee.

(signed) "David L. Yager"

Chief Executive Officer

(signed) "Lori L. McLeod-Hill C.A."

Chief Financial Officer

March 23, 2011



KPMG LLP
Chartered Accountants
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INDEPENDENT AUDITORS' REPORT

To the Shareholders

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of HSE Integrated Ltd. ("the Company"), which comprise the consolidated balance sheets as at December 31, 2010 and 2009, the consolidated statements of loss, other comprehensive loss, deficit and accumulated other comprehensive loss, and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Company as at December 31, 2010 and 2009, and the results of its consolidated operations and its consolidated cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

A handwritten signature in blue ink that reads 'KPMG LLP'.

Chartered Accountants

Calgary, Canada

March 23, 2011

CONSOLIDATED BALANCE SHEETS

(stated in thousands of dollars)				
Years ended December 31			2010	2009
ASSETS				
Current				
Cash and cash equivalents	\$	1,479	\$	460
Accounts receivable (note 14)		18,099		16,156
Inventory		171		199
Prepaid expenses and other assets		1,675		1,654
Income taxes recoverable		705		398
		22,129		18,867
Property and equipment (note 5)		25,051		28,595
Intangible assets (note 4)		2,732		3,260
	\$	49,912	\$	50,722
LIABILITIES				
Current				
Accounts payable and accrued liabilities	\$	5,911	\$	4,667
Income taxes payable		423		72
Current portion of obligations under capital leases (note 8)		104		233
Current portion of long-term debt (note 6)		1,304		5,222
Current portion of deferred gain (note 15)		137		137
		7,879		10,331
Deferred gain (note 15)		182		319
Obligations under capital leases (note 8)		16		122
Long-term debt (note 6)		2,919		818
Convertible debentures – debt component (note 7)		1,628		–
Future income taxes (note 9)		3,161		4,170
		15,785		15,760
SHAREHOLDERS' EQUITY				
Share capital (note 10)		60,040		60,040
Convertible debentures – equity component (note 7)		221		–
Contributed surplus (note 11)		4,948		4,755
Deficit		(30,927)		(29,770)
Accumulated other comprehensive loss		(155)		(63)
		34,127		34,962
	\$	49,912	\$	50,722
Commitments and contingencies (note 15 and note 18)				
Subsequent event (note 19)				

See accompanying notes to the consolidated financial statements.

On behalf of the Board:

(Signed) "David L. Yager"
Director

(Signed) "Martin Hall"
Director

CONSOLIDATED STATEMENTS OF LOSS

(stated in thousands of dollars except per-share amounts)			
Years ended December 31			
		2010	2009
REVENUE	\$	82,028	\$ 81,601
COSTS			
Operating and materials		70,341	72,530
Selling, general and administrative		7,936	8,226
Amortization of property and equipment		5,152	6,171
Amortization of intangible assets		528	528
Stock-based compensation (note 12)		210	293
Interest on long-term debt		339	471
Other interest and bank charges		148	73
Foreign exchange gain		(4)	–
(Gain) loss on disposal of property and equipment		(102)	311
		84,548	88,603
LOSS BEFORE THE UNDERNOTED ITEMS	\$	(2,520)	\$ (7,002)
Expiry of contingent consideration liability (note 6)		810	–
Impairment of property and equipment (note 5)		–	(1,641)
		810	(1,641)
LOSS BEFORE INCOME TAX		(1,710)	(8,643)
Income taxes (note 9)			
Current provision (recovery)		423	(928)
Future reduction		(976)	(1,081)
		(553)	(2,009)
NET LOSS	\$	(1,157)	\$ (6,634)
Loss per share			
Basic	\$	(0.03)	\$ (0.18)
Diluted	\$	(0.03)	\$ (0.18)
Weighted average shares outstanding			
Basic		37,576	37,576
Diluted		37,576	37,576

See accompanying notes to the consolidated financial statements.

CONSOLIDATED STATEMENTS OF OTHER COMPREHENSIVE LOSS

(stated in thousands of dollars)			
Years ended December 31	2010		2009
NET LOSS	\$	(1,157)	\$ (6,634)
Unrealized loss on translating financial statements of self-sustaining foreign operations		(92)	(187)
COMPREHENSIVE LOSS	\$	(1,249)	\$ (6,821)

CONSOLIDATED STATEMENTS OF DEFICIT AND ACCUMULATED OTHER COMPREHENSIVE LOSS

(stated in thousands of dollars)			
Years ended December 31	2010		2009
DEFICIT, BEGINNING OF YEAR	\$	(29,770)	\$ (23,136)
Net Loss		(1,157)	(6,634)
DEFICIT, END OF YEAR	\$	(30,927)	\$ (29,770)
ACCUMULATED OTHER COMPREHENSIVE (LOSS) INCOME, BEGINNING OF YEAR	\$	(63)	\$ 124
Unrealized loss on translating financial statements of self-sustaining foreign operations		(92)	(187)
ACCUMULATED OTHER COMPREHENSIVE LOSS, END OF YEAR	\$	(155)	\$ (63)

See accompanying notes to the consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(stated in thousands of dollars)			
Years ended December 31	2010		2009
CASH PROVIDED BY OPERATIONS			
Net loss	\$ (1,157)	\$	(6,634)
Charges to income not involving cash:			
Amortization	5,680		6,699
Stock-based compensation (note 12)	210		293
Future income tax reduction	(976)		(1,081)
(Gain) loss on disposal of property and equipment	(102)		311
Expiry of contingent consideration – liability (note 6)	(810)		–
Property and equipment impairment	–		1,641
	2,845		1,229
Net change in non-cash working capital (note 16)	(702)		5,511
Cash provided by operations	2,143		6,740
FINANCING			
Repayment of obligations under capital leases	(235)		(936)
Non-revolving term loan facility	5,000		–
Issue of convertible debenture (note 7)	1,925		–
Repayment of long-term debt	(5,986)		(5,686)
Deferred financing fees	(97)		–
Cash provided by (used by) financing activities	607		(6,622)
INVESTING			
Purchase of property and equipment	(2,319)		(1,644)
Proceeds from disposal of property and equipment	601		865
Cash used in investing activities	(1,718)		(779)
Cash flow from operating, financing and investing activities	1,032		(661)
Effect of exchange rate on foreign currency held	(13)		7
NET CHANGE IN CASH AND CASH EQUIVALENTS	1,019		(654)
Cash and cash equivalents, beginning of year	460		1,114
Cash and cash equivalents, end of year	\$ 1,479	\$	460
Supplementary cash flow information			
Interest paid	\$ 308	\$	468
Income taxes paid	\$ 271	\$	53

See accompanying notes to the consolidated financial statements.

NOTE 1 – NATURE OF BUSINESS

HSE Integrated Ltd. (“HSE” or the “Corporation”) is incorporated under the laws of the province of Alberta. The Corporation provides health and safety services to a range of customers in the energy, manufacturing, construction, and other industries including: safety supervision and rescue personnel; rental of breathing apparatus and associated equipment for personnel operating in high hazard environments; fixed and mobile firefighting and fire protection services and equipment; worker shower (decontamination) services; onsite medical services; worker safety training; hazardous gas detection; industrial hygiene services; and safety management.

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES

The following is a summary of significant accounting policies used in the preparation of these consolidated financial statements:

Basis of presentation

These consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles (“GAAP”). In preparing these consolidated financial statements, Management is required to make estimates and assumptions that affect reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as at the date of the financial statements and the reported amounts of revenue and expenses during the reported period. Actual results could differ from these estimates.

Measurement uncertainty

These financial statements, prepared in accordance with Canadian GAAP, include amounts determined by, in part, estimates made by Management. These estimates include:

- The allowance for doubtful accounts;
- The allowance for inventory obsolescence;
- The estimated useful lives of assets;
- The recoverability of property and equipment;
- The recoverability of intangible assets;
- Contingencies and litigation;
- The amount and composition of income tax assets and income tax liabilities, including the amount of unrecognized tax benefits on an ongoing basis.

The Corporation bases its estimates on historical experience and on various other assumptions that are believed at the time to be reasonable under the circumstances. Under different assumptions or conditions, the actual results may differ, possibly materially, from those previously estimated. Many of the conditions affecting these assumptions and estimates are outside of the Corporation’s control.

Consolidation

These consolidated financial statements include the accounts of the Corporation and its subsidiaries (from the date of acquisition or formation). With the exception of the Corporation’s U.S. subsidiary Boots & Coots HSE Services LLC (note 17), all subsidiaries are wholly owned. All intercompany balances and transactions have been eliminated on consolidation.

Cash and cash equivalents

Cash and cash equivalents include bank balances and highly liquid short-term money market instruments with original maturities of three months or less. Cash and cash equivalents are classified as a liability on the balance sheet (described as “Bank indebtedness”) when the amount of the cheques written but not cleared by the bank exceeds the amount of the cash and temporary investments. Amounts drawn on the Corporation’s operating facility are disclosed as a separate line on the financial statements (note 6).

Inventory

Inventory consists of products held for sale to customers or for consumption in the rendering of services provided by the Corporation. Inventory is carried at the lower of cost, determined under the first-in, first-out method, and net realizable value.

Property and equipment

Property and equipment is stated at cost less accumulated amortization. Major betterments are capitalized. Repairs and maintenance expenditures which do not extend the useful life of the property and equipment are expensed.

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Amortization expense includes amortization of leasehold improvements and vehicles and equipment under capital leases. Amortization is calculated using the straight-line method over the estimated useful life of the assets as follows:

Buildings and improvements	5 – 20 years
Safety equipment	5 – 20 years
Vehicles	7 – 20 years
Vehicles and equipment under capital lease	7 – 10 years
Other property and equipment	2 – 10 years

Intangible assets

Intangible assets, consisting of acquired customer relationships, technological knowledge and intellectual property, are carried at cost less accumulated amortization. Amortization is calculated on a straight-line basis over a period of one to 10 years depending upon the asset's estimated useful life.

Impairment of long-lived assets

Long-lived assets, such as property and equipment and intangible assets subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of an asset's carrying value is initially tested by comparing the carrying amount of the asset group to estimated undiscounted future cash flows expected to be generated by the group. If the carrying amount of an asset exceeds its estimated future cash flows, the asset is considered to be impaired, and an impairment charge is recognized for the amount by which the carrying amount of the asset exceeds its fair value.

Revenue recognition

The Corporation derives most of its revenues from the provision of services and the rental of equipment. The Corporation recognizes service and rental revenue as the service is provided to the customer, provided that the sales price has been fixed or is determinable, and that collectability is reasonably assured. Sales of goods are recognized when the product has been delivered provided that collectability is reasonably assured. Generally services are provided over a relatively short time period.

Income taxes

The Corporation follows the liability method of accounting for income taxes. Under this method, the Corporation records future income taxes for the effect of any differences between the accounting and income tax basis of an asset or liability, using the substantially enacted tax rates and laws that will be in effect when the differences are expected to reverse. The effect on future tax assets and liabilities of a change in the tax rate is recognized in income in the period in which the change occurs. The Corporation records a valuation allowance in each reporting period when Management believes that it is more likely than not that any future tax asset created will not be realized. The computation of the provision for income taxes involves the interpretation of tax legislation and regulations that are continually changing. There are tax matters that have not yet been confirmed by taxation authorities; however, Management believes that the provision for income taxes is reasonable.

Foreign currency translation

All of the Corporation's foreign operations are considered to be self-sustaining. Accordingly, the Corporation translates assets and liabilities at year-end exchange rates and income and expense accounts at average exchange rates for the year. Adjustments resulting from these translations are reflected in the consolidated statement of other comprehensive income.

Stock-based compensation plans

The Corporation applies the fair-value method of accounting to all equity-classified stock-based compensation arrangements for both employees and non-employees. Compensation cost of equity-classified awards to employees are measured at fair value at the grant date and recognized over the vesting period with a corresponding increase to contributed surplus. Compensation cost of equity-classified awards to non-employees are initially measured at fair value, and remeasured to fair value until the non-employee's performance is complete, and recognized over the vesting period with a corresponding increase to contributed surplus. Upon the exercise of the award, consideration received, together with amounts previously recognized in contributed surplus, is recorded as an increase to share capital.

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The Corporation has adopted a deferred share unit (“DSU”) plan for non-executive Directors. Under the terms of this plan, the Corporation awards DSUs to Directors from time to time. The DSUs granted under this plan vest immediately. At the time the DSU is awarded, an expense equal to the number of units issued multiplied by the Corporation’s closing stock price on the trading day immediately preceding the award date is recorded as stock compensation expense. Subsequent to the date awarded, the DSUs are revalued to a value equal to the closing price of the Corporation’s common shares, with any increase or decrease in value being charged or credited to stock compensation expense. When a Director tenders his resignation, the Director is paid a cash amount equal to the number of DSUs awarded times the Corporation’s closing share price on the redemption date specified by the Director. This redemption date must be a date which is after the date on which the notice of redemption is filed with the Corporation and within the period beginning on the Director’s termination date and ending on December 15 of the first calendar year commencing immediately after the Director’s termination date.

Per-share amounts

Basic per-share amounts are calculated using the weighted average number of common shares outstanding during the year. Diluted per-share amounts are calculated using the treasury-stock method for stock options and the “if-converted” method for Debentures. Under the treasury-stock method, the weighted-average number of shares issued and outstanding during the year is adjusted by the total of the additional common shares that would have been issued assuming exercise of all stock options with exercise prices at or below the average market price for the year, offset by the reduction in common shares that would be purchased with the exercise proceeds plus the related unamortized stock-based compensation costs. Under the if -converted method, the weighted-average number of shares issued and outstanding during the year is adjusted by the number of common shares that would be issued if all debenture holders converted their debenture holdings to common shares at the earliest date which the debenture’s Trust Indenture allows for conversion. Net income and other comprehensive income are adjusted to add back the after-tax impact of interest and accretion expense related to the debentures. No adjustment is made to basic earnings per share if the result of the calculation would be anti-dilutive.

Financial instruments – recognition and measurement

The Corporation has estimated the fair value of its financial assets and liabilities, which include cash and cash equivalents, accounts receivable, bank indebtedness, accounts payable and accrued liabilities, long-term debt, and debentures. The fair value of all financial assets and liabilities approximates their carrying amounts due to their current maturities or market rates of interest.

Financial instruments are initially recorded at fair value, then classified into one of five categories, based on the characteristics and purpose of the instrument: (i) held-for-trading; (ii) held-to-maturity; (iii) loans and receivables; (iv) available-for-sale; and (v) other financial liabilities. Subsequent to initial recognition, each category of financial instrument is measured based on its classification. 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. Held-to-maturity financial instruments, loans and receivables, and other financial liabilities are measured at amortized cost using the effective-interest-rate method.

The Corporation has designated accounts receivable as “loans and receivables”. Accounts payable and accrued liabilities, long-term debt, and the liability component of the convertible debentures are classified as “other financial liabilities”. Unamortized debt-issue costs are offset against the long-term debt to which they relate. The carrying value of long-term debt is accreted using the effective-interest-rate method.

Transaction costs associated with financial liabilities are recognized against its carrying value and are being amortized over the term of the financial liabilities.

International Financial Reporting Standards

In 2008, the Canadian Accounting Standards Board (“AcSB”) confirmed that publicly accountable enterprises will be required to adopt IFRS, for interim and annual reporting purposes, beginning on or after January 1, 2011. The adoption date of January 1, 2011 will require the restatement of the Corporation’s consolidated financial statements, for comparative purposes for its year ended December 31, 2010, and of the opening balance sheet as at January 1, 2010.

HSE Integrated Ltd.

Notes to the Consolidated Financial Statements for the Years ended December 31, 2010 and 2009
(stated in thousands of dollars)

NOTE 3 – CAPITAL MANAGEMENT

Management's policy is to maintain an appropriate capital base that allows the Corporation to maintain investor, creditor and market confidence and to sustain future development of the business. The Corporation seeks to manage its capital structure to ensure that it has the financial capacity and liquidity to fund its operating and investment activities. The Corporation generally relies on operating cash flows to fund capital expenditures, but may occasionally need to use external sources to facilitate acquisition or expansionary activities.

To ensure that the Corporation maintains an appropriate balance between debt and shareholders' equity, it monitors the ratio of debt to total capital. As at December 31, 2010 and 2009, these ratios were as follows:

Years ended December 31	2010		2009	
Bank debt	\$	4,223	\$	6,040
Convertible debentures – debt component		1,628		–
	\$	5,851	\$	6,040
Shareholders' equity		34,369		34,962
Convertible debentures – equity component		221		–
Total capitalization	\$	40,441	\$	41,002
Debt to total capitalization		0.14		0.15

The Corporation is subject to various financial covenants (note 6) associated with its existing debt facility. These covenants are monitored on a regular basis and controls are in place to maintain ongoing compliance with these covenants. The Corporation was in compliance with all debt covenants at December 31, 2010.

NOTE 4 – INTANGIBLE ASSETS

	December 31, 2010			
	Cost	Accumulated Amortization	Net Book Value	
Customer relationships	5,579	2,899	2,680	
Technical knowledge	104	52	52	
	\$ 5,683	\$ 2,951	\$ 2,732	
December 31, 2009				
	Cost	Accumulated Amortization	Net Book Value	
Customer relationships	5,579	2,382	3,197	
Technical knowledge	104	41	63	
	\$ 5,683	\$ 2,423	\$ 3,260	

NOTE 5 – PROPERTY AND EQUIPMENT

				December 31, 2010	
	Cost	Accumulated Amortization	Net Book Value		
Buildings and improvements	\$ 1,366	\$ 938	\$ 428		
Safety equipment	40,254	24,207	16,047		
Vehicles	12,110	6,319	5,791		
Vehicles and equipment under capital lease	2,271	1,598	673		
Furniture and equipment	1,516	975	541		
Other property and equipment	5,981	4,410	1,571		
Total property and equipment	\$ 63,498	\$ 38,447	\$ 25,051		

				December 31, 2009	
	Cost	Accumulated Amortization	Net Book Value		
Buildings and improvements	\$ 1,137	\$ 606	\$ 531		
Safety equipment	41,657	23,595	18,062		
Vehicles	13,713	8,264	5,449		
Vehicles and equipment under capital lease	3,331	1,923	1,408		
Furniture and equipment	1,343	639	704		
Other property and equipment	7,027	4,586	2,441		
Total property and equipment	\$ 68,208	\$ 39,613	\$ 28,595		

At December 31, 2010 the Corporation reviewed its property and equipment for indicators of impairment. Management determined that no impairment of long-lived assets existed at December 31, 2010. For the year ended December 31, 2009, Management identified certain assets that were disposed of subsequent to the year end. The disposal of the property and equipment confirmed that the proceeds were less than the carrying value. Accordingly, an impairment of \$1,641 related to these specific assets was recorded at year end. No other impairment of long-lived assets existed at December 31, 2009.

NOTE 6 – OPERATING FACILITIES AND LONG-TERM DEBT

On April 27, 2010 the Corporation entered into a \$15,000 credit facility with a regional financial institution. The facility consists of a \$10,000 operating revolving loan facility for general operating purposes and a \$5,000 non-revolving reducing loan facility. The two facilities were used to retire the \$5,300 existing bank debt.

The \$5,000 non-revolving term facility is repayable in monthly payments of \$109 starting July 1, 2010. The facility is payable in full 48 months after initial drawdown. The operating facility is renewable annually and is margined to accounts receivable. Both facilities bear interest at prime plus a fixed percentage. A standby fee is also required on any unused portion of the operating facility. Both facilities are subject to certain covenants including a working-capital covenant, a debt-to-equity covenant, a fixed-charge coverage ratio and other positive and negative covenants. The facilities are collateralized under a general security agreement which includes accounts receivable and property and equipment.

HSE was compliant with all debt covenants at December 31, 2010. As at December 31, 2010, the total outstanding on the loan facility was \$4,300, of which \$1,300 was current.

Deferred financing costs associated with the financing facilities have been shown as a reduction of the carrying value of the long-term debt and are being amortized over the term of the debt using the effective-interest-rate method.

The Corporation's existing long-term debt agreements contain a clause to address the transition of accounting standards to IFRS. Although there is a risk that the Corporation's financial reporting under IFRS could result in a breach of an existing financial covenant, the Corporation expects that it will be able to amend the existing long-term debt agreements to make any changes covenant neutral, however no absolute assurances can be made in this regard.

HSE Integrated Ltd.

Notes to the Consolidated Financial Statements for the Years ended December 31, 2010 and 2009
(stated in thousands of dollars)

NOTE 6 – OPERATING FACILITIES AND LONG-TERM DEBT (CONTINUED)

Years ended December 31	2010	2009
Equipment financing contracts	\$ –	\$ 33
Non-revolving term loan facility	4,347	5,300
	4,347	5,333
Accrued consideration on share-purchase acquisition	–	810
	4,347	6,143
Less unamortized debt-issue costs	(124)	(103)
Less current portion	(1,304)	(5,222)
	\$ 2,919	\$ 818

Outstanding principal repayments are due as follows:

Years ended December 31	2010	2009
2010	\$ –	\$ 5,325
2011	1,304	818
2012	1,304	–
2013	1,304	–
2014	435	–
	4,347	6,143
Less current portion and unamortized debt-issue costs	(1,428)	(5,325)
	\$ 2,919	\$ 818

The accrued consideration on a share-purchase acquisition of \$810 was derecognized at December 31, 2010. The derecognition has been recorded as a separate line on the Consolidated Statements of Loss and Consolidated Statements of Cash Flows since all goodwill from the purchase was derecognized at December 31, 2007.

NOTE 7 – CONVERTIBLE SUBORDINATED SECURED DEBENTURES

On November 9, 2010 HSE announced the issue of up to \$2,000 in Subordinated Secured Convertible Debentures (the “Debentures”). The Debentures mature on January 15, 2014 and bear interest at 10.0% per annum, payable quarterly in arrears on April 15, July 15, October 15 and January 15 in each year beginning April 15, 2011.

On December 21, 2010, HSE completed the first closing with total proceeds of \$1,925. On January 18, 2011, HSE completed the final closing with proceeds of an additional \$75.

The Debentures consist of both debt and equity components, which are presented separately in the Corporation's consolidated balance sheet. The debt component is measured by calculating the present value of both the quarterly interest obligations and the principal payment due at maturity, using the rate of interest that would have been applicable to a non-convertible debt instrument of comparable term and risk at the date of issue. The residual portion of the Debentures' proceeds is allocated to equity. As a result, the debt component of the Debentures is less than the principal amount that would be paid at maturity, assuming no conversion occurs. The discount to face value of the debt component presented on the consolidated balance sheet will be accreted using the effective-interest method over the term of the Debentures.

The equity component represents the difference between the face value of the Debentures (\$1,925) and the accounting value assigned to the debt component of the Debentures at the date of issue as described above. This equity component amount will remain constant over the term of the Debentures unless a conversion occurs. If Debentures are converted into common shares; a proportionate amount of both the debt and equity components will be transferred to share capital. Interest and accretion expense on the Debentures is included within interest on long-term debt in the consolidated statements of loss.

Related parties purchased \$335 (17%) of the Debentures for the year ended December 31, 2010.

NOTE 7 – CONVERTIBLE SUBORDINATED SECURED DEBENTURES (CONTINUED)

Provision for conversion

The Debentures are convertible at the holder's option into common shares of the Corporation at a conversion price of \$0.50 per share (the "Conversion Price") at any time prior to the close of business on the earlier of the business day prior to the maturity date and the business day immediately preceding the date fixed for redemption of the Debentures, subject to adjustments in certain events including dividend protection for the declaration of dividends outside of the normal course. Holders converting their Debentures will receive accrued and unpaid interest thereon to the date of conversion. The ability to convert the Debentures would cease immediately prior to a "Change of Control" as defined in the offering document. In the event Debentures are converted prior to maturity, the difference between the carrying amount of such Debentures and their face value would be charged to interest expense.

Provision for redemption

The Debentures will not be redeemable before January 15, 2012 except in the event of the satisfaction of certain conditions after a Change of Control has occurred. On and after January 15, 2012 and prior to January 15, 2013, provided that the current market price (as calculated pursuant to the indenture) of the Shares is at least 133% of the conversion price, the Debentures may be redeemed at the option of the Corporation in whole or in part from time to time at a redemption price equal to their principal amount plus accrued and unpaid interest thereon up to (but excluding) the redemption date. On and after January 15, 2013 and prior to the maturity date, the Debentures may be redeemed at the option of the Corporation in whole or in part from time to time at a redemption price equal to 105% of their principal amount plus accrued and unpaid interest thereon up to (but excluding) the redemption date. If HSE wishes to redeem any Debentures, it must provide not more than 60 or fewer than 40 days prior notice of redemption.

Notwithstanding the foregoing, in the event of a Change of Control, the Debentures will be redeemable at the Corporation's option, in whole or in part, at a price equal to 125% of the principal amount thereof plus accrued and unpaid interest for the first two years; thereafter, this amount will decline by 1.5% per month.

NOTE 8 – OBLIGATIONS UNDER CAPITAL LEASE

Amounts due under capital lease arrangements are repayable in blended monthly payments of \$8 (2009 – \$30) and bear interest at rates averaging 6.2% (2009 – 7.8%) per annum. On certain leases, the Corporation has options to acquire the leased assets at various times throughout the term to 2013.

Years ended December 31	2010		2009	
2010	\$	–	\$	255
2011		111		112
2012		15		15
2013		2		3
	\$	128	\$	385
Less interest		(8)		(30)
	\$	120	\$	355
Less current portion		(104)		(233)
	\$	16	\$	122

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NOTE 9 – INCOME TAXES

Years ended December 31	2010		2009	
a) Provision for income taxes:				
Loss before income taxes	\$	(1,710)	\$	(8,643)
Expected income tax recovery at 28.0% (2009 – 29.8%)	\$	(479)	\$	(2,576)
Non-deductible/non-taxable amounts		(137)		171
United States start-up losses		–		378
United States rate differences		132		3
Other		(69)		15
Income tax recovery	\$	(553)	\$	(2,009)
b) Future income tax assets and liabilities are as follows:				
Canada				
Property and equipment	\$	3,228	\$	3,598
Intangible assets		14		671
Share-issue and financing costs		(81)		(99)
	\$	3,161	\$	4,170
United States				
Property and equipment	\$	1	\$	(103)
Intangible assets		(604)		(558)
	\$	(603)	\$	(661)
Less United States valuation allowance		603		661
	\$	–	\$	–
Future income tax liability	\$	3,161	\$	4,170

NOTE 10 – SHARE CAPITAL**a) Authorized:**

Unlimited number of common shares without par value

Unlimited number of preferred shares, issuable in series

b) Issued and outstanding:

	2010		2009	
Common shares	Shares (in thousands)	Amount	Shares (in thousands)	Amount
Balance, January 1	37,576	\$ 60,040	37,576	\$ 60,040
Changes (net of share-issue costs)	–	–	–	–
Balance, December 31	37,576	\$ 60,040	37,576	\$ 60,040

NOTE 11 – CONTRIBUTED SURPLUS

	2010		2009	
Balance, January 1	\$	4,755	\$	4,559
Stock compensation expense – employee options		193		196
Balance, December 31	\$	4,948	\$	4,755

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NOTE 12 – STOCK-BASED COMPENSATION PLANS**Incentive stock-option plan**

The weighted average fair value of options issued for the year ended December 31, 2010 was \$0.37 (2009 – \$0.36). The fair value of each option granted was estimated on the date of grant using the Merton Black-Scholes option-pricing model with the following assumptions:

	2010	2009
Vesting period (years)	3	3
Risk-free interest rate	2.20%	1.69%
Expected life (years)	5	5
Price volatility	100.00%	92.78%

Pursuant to the stock-option plan, a maximum of 10% of the issued and outstanding common shares of the Corporation are reserved from time to time for issue to eligible participants. The Directors determine option prices and vesting terms at the time of granting at an exercise price no less than market on the grant date. The term of options granted does not exceed five years.

Information about outstanding stock options is as follows:

	2010		2009	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
Outstanding, beginning of year	2,375,333	\$ 1.56	2,533,499	\$ 1.88
Granted	890,000	0.49	650,000	0.36
Forfeited/expired	(986,168)	0.76	(808,166)	1.62
Outstanding, end of year	2,279,165	\$ 1.24	2,375,333	\$ 1.56
Exercisable at end of year	1,154,479	\$ 1.96	1,360,315	\$ 2.18

The following table summarizes information about stock options outstanding at December 31, 2010:

Options Outstanding	Exercise Prices (\$)	Weighted Average Remaining Life	Number Exercisable
1,509,165	0.25 – 1.19	3.6	385,812
342,000	1.20 – 2.14	1.1	340,667
58,000	2.15 – 3.09	0.6	58,000
370,000	3.10 – 4.04	0.3	370,000
2,279,165	1.24	2.6	1,154,479

Deferred share unit plan

For the 2010 and 2009 years, the majority of Directors' retainers and meeting fees were paid with deferred share units ("DSUs"). The units are revalued quarterly based on the Corporation's stock price on the last day of the quarter and any change in value is included as an increase or decrease in stock-based compensation expense and accrued liabilities. The expense recognized was \$17 (2009 – \$97).

	2010		2009	
Deferred Share Units	Deferred Share Units	Amount	Deferred Share Units	Amount
Balance, January 1	195,442	\$ 104	27,000	\$ 7
Granted	204,424	70	168,442	97
Redeemed	(142,838)	(53)	–	–
Balance, December 31	257,028	\$ 121	195,442	\$ 104

NOTE 13 – RELATED-PARTY TRANSACTIONS

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

- In 2010, the Corporation paid rent and property taxes of \$275 (2009 – \$275) for a regional office to a corporation related to a Director of the Corporation.
- In 2010, the Corporation also paid rent and property taxes of \$347 (2009 – \$343) for a regional office to a corporation controlled by a senior manager of the Corporation.
- In 2010, the Corporation purchased \$265 (2009 - \$0) for supplies and commissions to a corporation related to a Director of the Corporation pursuant to the terms of an agreement that pre-dates the directorship. Of this amount, \$55 is included in accounts payable at year end.
- Related parties purchased \$335 (17%) of the Debentures for the year ended December 31, 2010.

NOTE 14 – FINANCIAL RISK MANAGEMENT**Overview**

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

- Credit risk
- Liquidity risk
- Market risk

The Board of Directors has overall responsibility for the establishment and oversight of the Corporation's risk-management framework. The Corporation's Audit Committee oversees how Management monitors compliance with the Corporation's risk-management practices and reviews the adequacy of the risk-management framework in relation to the risks faced by the Corporation. The Corporation's risk-management practices are established to identify and analyze the risks faced by the Corporation, to set appropriate risk limits and controls, and to monitor risks and adherence to limits.

Credit risk

Credit risk is the risk of financial loss to the Corporation if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Corporation's receivables from customers.

The Corporation'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 the Corporation is partially affected by fluctuations in the price they receive for various hydrocarbon products. The maximum credit exposure associated with trade accounts receivable is the carrying value.

The Corporation follows a credit policy under which the Corporation reviews each new customer individually for credit worthiness before the Corporation's standard payment and delivery terms and conditions are offered. The Corporation's review includes external ratings, where available, and trade references. Customers that fail to meet the Corporation's credit worthiness criteria may transact with the Corporation only on a prepayment basis. On an ongoing basis, the Corporation 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. The allowance for doubtful accounts is the Corporation's best estimate of the amount of probable credit losses in the Corporation's existing accounts receivable. The Corporation determines the allowance by reviewing individual accounts past due for collectability, historical write-off experience, and overall account aging. The Corporation reviews its allowance for doubtful accounts on an ongoing basis, but at least monthly.

Years ended December 31		2010		2009
Trade accounts receivable	\$	19,199	\$	17,416
Allowance for doubtful accounts		(1,100)		(1,260)
Total trade accounts receivable	\$	18,099	\$	16,156

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NOTE 14 – FINANCIAL RISK MANAGEMENT (CONTINUED)

The aging of trade receivables from the invoice date is as follows:

Years ended December 31	2010		2009	
	Gross	Allowance	Gross	Allowance
0 – 30 days from invoice date (current)	\$ 10,962	\$ –	\$ 7,938	\$ –
31 – 60 days from invoice date	4,764	–	5,135	3
61 – 120 days from invoice date	2,493	120	3,433	347
More than 120 days from invoice date	980	980	910	910
Total	\$ 19,199	\$ 1,100	\$ 17,416	\$ 1,260

The movement in the allowance for doubtful accounts receivables in respect of trade receivables during the year is as follows:

	2010	2009
Balance, January 1	\$ 1,260	\$ 1,405
Bad-debt provision	258	257
Write-offs net of recoveries	(418)	(402)
Balance, December 31	\$ 1,100	\$ 1,260

Liquidity risk

Liquidity risk is the risk that the Corporation will not be able to meet its financial obligations as they fall due. The Corporation requires liquidity to meet financial obligations as they come due and to fund its investing activities.

The Corporation's contractual financial liabilities include interest payments, trade and other payables, income taxes payable, a revolving operating line of credit margined to accounts receivable, a non-revolving term debt facility, a convertible debenture and capital leases for equipment and property and equipment (notes 6 and 7).

The Corporation's approach to managing liquidity is to ensure, to the extent possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and distressed conditions, without unacceptable losses or risking damage to the Corporation's reputation. The Corporation generally relies on operating cash flow to provide liquidity to meet its financial obligations. At December 31, 2010, the Corporation had cash on hand of \$1,479 and undrawn operating lines of credit totaling \$10,000 (note 6).

Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates, interest rates and equity prices will affect the Corporation's income.

HSE is exposed to currency risk on U.S.-dollar denominated financial assets and liabilities. The Corporation 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 Corporation, any related foreign exchange gains and/or losses are recognized in the consolidated statement of earnings. For amounts held by the Corporation's self-sustaining foreign operations, the amount is included in other comprehensive income. At December 31, 2010, the extent of this exposure was not material.

HSE is exposed to interest rate risk on its prime-based revolving operating facility and its non-revolving reducing loan facility. Based on amounts outstanding at December 31, 2010, a 1% increase in the average prime interest rate for the year would cost the Corporation \$43 annually in additional interest expense.

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NOTE 15 – COMMITMENTS

The Corporation leases certain shop and office space and vehicles and equipment under operating leases for periods ending between 2011 and 2015. Payments under these leases in each of the next five years and thereafter are as follows:

	Rental Facilities	Operating Leases	Total
2011	\$ 3,383	\$ 2,146	\$ 5,529
2012	3,135	952	4,087
2013	2,705	146	2,851
2014	2,301	8	2,309
2015	1,809	–	1,809
Thereafter	3,671	–	3,671

In May 2008, the Corporation sold three of its buildings as part of a sale/lease-back arrangement. The net proceeds on the sale were \$1,712 resulting in gains on sale of \$683. The resulting gains were deferred and are being amortized over the 60-month lives of the leases.

NOTE 16 – SUPPLEMENTARY CASH FLOW INFORMATION

Years ended December 31	2010	2009
Changes in non-cash working capital from operations		
Accounts receivable	\$ (1,995)	\$ 9,563
Inventory	28	22
Prepaid expenses and other assets	(41)	164
Accounts payable and accrued liabilities	1,254	(3,547)
Income tax payable (recoverable)	52	(691)
Net change	\$ (702)	\$ 5,511

NOTE 17 – SEGMENT INFORMATION

The Corporation operates in two main geographic areas: Canada and the United States (U.S.). Each geographic area has a President responsible for the operations and strategy of his area's business. Personnel working within a particular region report to the President, and the President reports to the Chief Executive Officer.

Within each geographic segment, the Corporation uses common resources to provide services to a variety of customer industries. The Corporation groups these customer industries into two categories. "Oilfield" services are provided to customers in the conventional upstream, or "wellhead", sector of the oil and gas industry. "Industrial" services are provided to customers in a variety of other industries including: non-conventional upstream oil development and production (including oilsands extraction); oil and gas processing; petrochemicals; pulp and paper; utilities; power generation; and manufacturing. It also includes worker safety training and safety management services.

Corporate division expenses consist of salary expenses, stock compensation, and office costs related to corporate employees, as well as public Corporation costs.

For the year ended December 31, 2010, one customer provided more than 10% of the Corporation's revenue. Sales to this customer amounted to \$8,500 during the year. For the year ended December 31, 2009, one customer provided more than 10% of the Corporation's revenue. Sales to this customer amounted to \$8,900 during the year related to ongoing long-term industrial projects located entirely in Canada.

The U.S. operations for Oilfield safety services are conducted through CRS Technologies Inc. and Boots & Coots HSE Services LLC ("BCHSE"). CRS Technologies Inc. is wholly owned by the Corporation. The Corporation owns 100% of the shares of HSE Integrated Inc. ("INC"), a Delaware corporation that in turn owns a 90% interest in BCHSE, a Delaware Limited Liability Corporation. Boots & Coots Services, a division of Halliburton, owns the remaining 10% interest.

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NOTE 17 – SEGMENT INFORMATION (CONTINUED)

A non-controlling interest has not been recorded as BCHSE has incurred losses.

	December 31, 2010			
	Canada	U.S.	Corporate	Total
Revenue				
Oilfield	\$ 33,247	\$ 1,507	\$ –	\$ 34,754
Industrial	44,464	2,810	–	47,274
Total revenue	\$ 77,711	\$ 4,317	\$ –	\$ 82,028
Revenue minus operating and SG&A expenses	\$ 10,403	\$ 1,284	\$ (7,936)	\$ 3,751
Interest expense	–	–	487	487
Amortization of property and equipment and intangibles	5,562	118	–	5,680
Property and equipment	23,788	1,263	–	25,051
Intangibles	2,732	–	–	2,732
Capital expenditures ⁽¹⁾	1,576	743	–	2,319

(1) Property and equipment for Corporate is included in Canada

	December 31, 2009			
	Canada	U.S.	Corporate	Total
Revenue				
Oilfield	\$ 26,850	\$ 453	\$ –	\$ 27,303
Industrial	53,043	1,255	–	54,298
Total revenue	\$ 79,893	\$ 1,708	\$ –	\$ 81,601
Revenue minus operating and SG&A expenses	\$ 9,747	\$ (676)	\$ (8,226)	\$ 845
Interest expense	–	–	544	544
Amortization of property and equipment and intangibles	6,608	91	–	6,699
Property and equipment	27,534	1,061	–	28,595
Intangibles	3,260	–	–	3,260
Capital expenditures ⁽¹⁾	1,347	297	–	1,644

(1) Property and equipment for Corporate is included in Canada

NOTE 18 – CONTINGENCIES

In the ordinary course of business activities, the Corporation 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 applicable. Although it may not be possible to estimate accurately the extent of potential costs and losses, if any, Management believes that the ultimate resolution of such contingencies would not have a material effect on the financial position of the Corporation.

NOTE 19 – SUBSEQUENT EVENT

On January 24, 2011, the Corporation completed the acquisition of Taylored Safety Services Inc. (“Taylored”). Taylored provides safety consulting services and industrial health, and safety training to industry in Atlantic Canada. At closing, HSE acquired 100% of the Taylored shares through the issue of 1,137,532 common shares of HSE valued at \$0.54 per share on January 24, 2011. The results of operations will be included in the accounts from date of acquisition.