

## Management Discussion and Analysis (“MD&A”) For the three-month and six-month periods ended June 30, 2011 and 2010

The following Management discussion and analysis is dated August 11, 2011 and is a review of the financial results of HSE Integrated Ltd. (“HSE”, “We”, “Our”, or the “Corporation”) for the three and six-month periods ended June 30, 2011 and 2010. 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 International Accounting Standard 34 *Interim Financial Reporting*. The consolidated interim financial information is for part of the period covered by the first International Financial Reporting Standards (IFRS) consolidated annual financial statements and IFRS 1 *First-time Adoption of International Financial Reporting Standards* has been applied. This MD&A takes into consideration information available to Management up to August 11, 2011. Unless otherwise stated, tabular amounts 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. Please refer to the end of the MD&A for the disclaimer on forward-looking statements.

### SELECTED FINANCIAL INFORMATION

	Three months ended June 30, 2011	Three months ended June 30, 2010 <sup>(2)</sup>	Year-over- year % change	Six months ended June 30, 2011	Six months ended June 30, 2010 <sup>(2)</sup>	Year-over- Year % change
Revenue	\$ 24,905	\$ 18,350	35.7%	\$ 49,386	\$ 39,257	25.8%
Operating and materials	19,266	16,034	20.2%	39,214	33,016	18.8%
Operating margin <sup>(1)</sup>	5,639	2,316	143.5%	10,172	6,241	63.0%
Operating margin %	22.6%	12.6%		20.6%	15.9%	
Selling, general and administrative	\$ 2,391	\$ 1,905	25.5%	4,438	3,864	14.9%
Net earnings (loss)	541	(783)	169.1%	1,048	(659)	259.0%
Per-share basic	0.01	(0.02)		0.03	(0.02)	
Per-share diluted	0.01	(0.02)		0.03	(0.02)	
EBITDA <sup>(1)</sup>	\$ 3,248	\$ 411	690.3%	\$ 5,734	\$ 2,377	141.2%
EBITDA %	13.0%	2.2%		11.6%	6.1%	
Total assets				\$ 51,799	\$ 49,134	5.4%
Total long-term liabilities				\$ 9,053	\$ 9,764	(7.3%)

(1) See “Non-GAAP Measures” ([Page 15](#))

(2) IFRS transition date was January 1, 2010; 2010 financial results have been adjusted to conform to IFRS

## FINANCIAL REVIEW

### Overview

HSE operates in two geographic segments – Canada and the United States – providing health and safety services to industry and the public sector. The Corporation offers 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 consulting and supervision.

Total revenue for the three months ended June 30, 2011 increased 35.7% to \$24,905 from \$18,350 in 2010. The operating margin was \$5,639 or 22.6% of revenues, up 143.5% from \$2,316 or 12.6% of revenues in 2010. Selling, general and administrative expense (“SG&A”) increased to \$2,391 from \$1,905 in the prior year. As a percentage of revenue, SG&A decreased from 10.4% of revenue in fiscal 2010 to 9.6% in 2011. HSE reported earnings of \$541 or \$0.01 per share for the second quarter of 2011 compared to a loss of \$783 or (\$0.02) per share for the same period in 2010. EBITDA – Earnings before interest, taxes, depreciation and amortization (see “Non-GAAP Measures”, ([Page 15](#)), for the period was \$3,248 or 13.0% of revenue in 2011, a 690.3% increase from \$411 or 2.2% of revenue in 2010.

Total revenue for the six-month period increased 25.8% from \$39,257 in 2010 to \$49,386 in 2011. Operating margin of \$10,172 was 20.6% of revenue compared to \$6,241 or 15.9% of revenue in the prior year. SG&A was \$4,438 for the period, an increase

of 14.9% from \$3,864 in the prior year. As a percentage of revenue SG&A declined from 9.8% of revenue in 2010 to 9.0% in 2011. The company reported earnings of \$1,048 or \$0.03 per share compared to a loss of \$659 or (\$0.02) per share for the first six months of the 2010 fiscal year. EBITDA for the period was \$5,734 or 11.6% of revenue, compared to \$2,377 or 6.1% of revenue a year ago.

## Revenue

The Corporation provides health and safety services to customers in two distinct client classifications: Industrial and Oilfield. The differentiation takes place primarily because of the industries served and activity drivers that affect demand.

Industrial health and safety services are those provided to multiple industries and the public sector and include a wide range of clients including manufacturing, processing and other facilities that operate continuously on a year-round basis. The customers operate in diverse industries and the public sector including: non-conventional upstream oil development and production (including oilsands extraction); oil and gas processing and refining; petrochemicals; pulp and paper; utilities; power generation; agriculture food and beverage; offshore operations; and manufacturing industries. Industrial also includes worker safety training and safety supervision and consulting services. Industrial health and safety services are in most cases delivered to permanent production, manufacturing, processing facilities or other operations that operate continuously.

Oilfield operations are associated exclusively with conventional upstream oil and gas activity, which is often short-term, remote, mobile, and temporary because they are related to interruptible exploration, drilling, completion, and workover activities. Demand for Oilfield health and safety services is historically highly cyclical due to external factors such as commodity prices, currency exchange, capital markets, weather, and government policy. Even if other factors are stable, demand for Oilfield health and safety services is highly seasonal in Canada because field activity is greatly affected by weather and road access.

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

The revenue for these business areas is shown below:

	Three months ended June 30, 2011	Three months ended June 30, 2010	Year-over-year % change	Six months ended June 30, 2011	Six months ended June 30, 2011	Year-over-year % change
Industrial	\$ 16,699	\$ 11,926	40.0%	\$ 29,256	\$ 23,850	22.7%
Oilfield	8,206	6,424	27.7%	20,130	15,407	30.7%
Total Revenue	\$ 24,905	\$ 18,350	35.7%	\$ 49,386	\$ 39,257	25.8%
As a percentage of revenue:						
Industrial	67.1%	65.0%		59.2%	60.8%	
Oilfield	32.9%	35.0%		40.8%	39.2%	
Total Revenue	100.0%	100.0%		100.0%	100.0%	

For the three months ended June 30, 2011, one customer provided more than 10% of the Corporation's total revenue. Sales to this customer amounted to \$3,032 during the period related to ongoing long-term energy related projects located entirely in Canada. For the three months ended June 30, 2010, no one customer provided more than 10% of the Corporation's total revenue.

### Industrial

The Industrial health and safety services component of the Corporation's total revenue increased \$4,773 (40.0%) to \$16,699 in the second quarter of 2011 from \$11,926 in the second quarter of 2010. For the six-month period ended June 30, 2011, the Industrial health and safety services component of the Corporation's total revenue increased \$5,406, (22.7%) to \$29,256 from \$23,850 for the same period in 2010. This was due to a large industrial project and the increase in plant shutdown and turnaround work. One project, which was taken on by the Corporation on short notice, required the mobilization of equipment and manpower from across the country.

Industrial health and safety services generated 59.2% of total revenues year-to-date 2011 down from 60.8% in the same period of 2010.

### **Oilfield**

Oilfield revenues in the second quarter increased by \$1,782 (27.7%) compared to second quarter of 2010. This is the first year-over-year revenue increase for this business sector in the second quarter since 2008 despite a wet spring and flooding in parts of Western Canada. For the first six months of the current fiscal year, Oilfield revenue was \$20,130, 30.7% higher than \$15,407 generated in the same period of 2010. This year-over year increase in Oilfield revenues was generated from the Western Canadian Sedimentary Basin (WCSB) and the southern United States. Factors behind the recovery of activity in the WCSB include rising oil prices, improved development economics in Alberta, continued success by Exploration and Production companies using horizontal drilling and multi-stage fracturing extraction technologies in mature oilfields and in tight oil-bearing reservoirs, and a trend towards deeper wells requiring more drilling days. Increased drilling days may increase the number of days medical services may be required, deeper wells increases the likelihood that sour gas may be encountered and the requirement for breathing air and gas detection services, and fracturing with acid or hydrocarbon fluids increases demand for the Corporation's shower and fire protection services.

In the United States, Boots & Coots HSE Services LLC ("BCHSE"), the Corporation's venture with Boots & Coots Services, a division of Halliburton, contributed \$867 to revenue in the second quarter of 2011 compared to \$397 in the same period of 2010. For the six months ended June 30, 2011 revenue was \$1,402, an increase of \$815 over the six months ended June 30, 2010.

The increase in upstream oil industry activity in the United States positively impacted the revenue from BCHSE as did BCHSE's increased capacity and market penetration in the United States.

BCHSE was launched in May 2008, and was unprofitable during its initial period of operations, as it encountered difficulties in breaking into a market during a recession. The demand for BCHSE's services in the U.S. continues to increase, and BCHSE has responded to this demand with additional equipment and manpower.

## **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 second quarter increased to \$19,266 or 77.4% of revenue compared to \$16,034 or 87.4% of revenue in the second quarter of 2010. Operating margin for the second quarter increased to \$5,639 (22.6% of revenue) in 2011 from \$2,316 (12.6 % of revenue) in 2010.

For the first six months, operating and materials expense totaled \$39,214 or 79.4% of revenue compared to \$33,016 or 84.1% of revenue for the six months ended June 30, 2010. Operating margin for the first six months increased from \$6,241 or 15.9% of revenue to \$10,172 or 20.6% of revenue in the first six months of 2011. In Q2 2011 several initiatives contributed to this improvement: a more effective fleet and equipment management plan; more efficient manpower utilization; and the establishment of performance-measurement standards for lower-producing stations.

The allowance for doubtful accounts receivable was \$425 or 2.0% of trade accounts receivable at the end of the second quarter compared to \$1,100 or 5.7% of trade accounts receivable at December 31, 2010. Bad debt write-offs against the allowance for the period ended June 30, 2011 were \$952. The \$952 included the removal of two accounts totaling \$641 from trade receivables and the allowance for doubtful accounts that had been fully allowed for in prior years.

## **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 public company costs.

SG&A for the quarter totaled \$2,391 (9.6% of revenue), up from \$1,905 (10.4% of revenue) in the prior year. The increase was related to the increase in sales and marketing development, as well as higher bonus accruals as a result of improved profitability.

For the first six months, SG&A increased to \$4,438 from \$3,864 in the prior year. As a percentage of revenue SG&A decreased to 9.0% from 9.8% in the first six months of 2010.

## **EBITDA and Net Earnings**

EBITDA (see “Non-GAAP Measures”, [Page 15](#)) in the quarter increased 690.3% to \$3,248 from \$411 in the second quarter of 2010. The EBITDA margin was 13.0% for the quarter, improved over the EBITDA margin of 2.2% in the second quarter of 2010. For the first six months of 2011 EBITDA was \$5,734, up 141.2% from \$2,377 in the same period of 2010. This EBITDA increase was the result of the previously mentioned improvements in operating margin and control of expenses. For the six months ended June 30, 2011 revenue increased by \$10,129 (25.8%) over the same period in 2010, yet the quarter’s SG&A expenses increased by \$574 (14.9%) over the same period in the prior year. Improved financial performance by BCHSE was also a contributing factor.

Property and equipment depreciation for the quarter was \$1,240, down from \$1,405 in the second quarter of 2010. Property and equipment depreciation for the six months ended June 30, 2011 was \$2,478, down from \$2,994 in the same period of 2010. This is a result of HSE tightly controlling capital additions in 2009 and 2010. This reduction was partially offset by HSE undertaking a larger capital expansion program in 2011 than in the prior two years. Intangible asset amortization for the quarter was \$142, up from \$103 in second quarter 2010. Intangible asset amortization for the six months ended June 30, 2011 was \$245, up from \$206 in the same period of 2011. The increase in amortization is a result of the intangible assets acquired as part of the Taylored Safety Acquisition that occurred on January 24, 2011.

Stock-based compensation for the second quarter was \$38 (2010 – \$64) consisting of equity settled awards of \$46 (2010 - \$46) and cash settled awards (“DSU”) of (\$8) (2010 – \$18). Stock-based compensation for the six months ended June 30, 2011 was \$109 (2010 - \$121) consisting of equity settled awards of \$90 (2010 - \$108) and cash settled awards of \$19 (2010 - \$13).

Finance costs for the three months June 30, 2011 totaled \$197, down from \$212 for the same period in 2010. For the six months ended June 30, 2011 finance costs totaled \$414, down from \$407 for the same period in 2010. Loans and borrowings declined in 2011 from the same period in 2010 as scheduled principal payments totaling \$326 on bank debt and \$642 on finance leases were made in the quarter resulting in a decrease to financing costs. Offsetting this was interest and accreted interest on the convertible debentures issued by the Corporation in December of 2010 and January of 2011.

During the quarter, the Corporation received Canadian income tax assessments for the 2008 and 2009 taxation years which affected the Corporation’s tax filing position for the 2006, 2007, 2008 and 2009 taxation years. The Corporation’s filing position and the assessments received differ with respect to the application and timing of certain losses for income tax purposes; consequently the Corporation has recognized an additional current income tax charge of \$707 for the three months ended June 30, 2011. This charge is comprised of rate differences applicable to different years in the amount of \$107, together with unrecoverable income tax of \$600 related to prior years.

Net earnings for the quarter were \$541 or \$0.01 per share compared to a loss of \$783 or (\$0.02) per share in 2010. The year-over-year increase was due to improvements in revenue, increased operating margins, and reduced amortization charges.

## **Current Quarter versus Q1 2011**

Revenue for the second quarter increased 1.7% to \$24,905 from \$24,481 in the previous quarter. Oilfield health and safety revenue decreased by \$3,718 as seasonal reductions in demand relating to spring breakup occurred. Industrial revenue increased by \$4,142 as a number of significant turnaround projects were undertaken by HSE’s Industrial sector. The Corporation’s push to compensate for traditionally poor second quarter Oilfield revenue by increasing its Industrial work had a positive impact in 2011.

Operating expenses decreased by \$682 from \$19,948 (81.5% of revenue) to \$19,266 (77.4% of revenue). This is due to a number of factors, including improvements in personnel and equipment efficiencies and continued focus on cost reductions.

SG&A increased from \$2,047 in the previous quarter to \$2,391 in the current quarter as a result of increases in professional fees and bonus accruals due to improved profitability.

## **Liquidity and Capital Resources**

The Corporation’s principal sources of capital are cash flows from operations, borrowings under an established credit facility with its senior lender, convertible debentures, finance leases and equity financing.

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

<b>Years ended December 31</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>Thereafter</b>	<b>Total</b>
Finance lease obligations	\$ 1,204	\$ 1,323	\$ 380	\$ 119	\$ 39	\$ –	\$ 3,065
Rental facilities & equipment	1,685	3,142	2,706	2,294	1,797	3,605	15,229
Convertible debentures				2,000			2,000
Term debt <sup>(1)</sup>	651	1,304	1,304	436	–	–	3,695
<b>Total contractual obligations</b>	<b>\$ 3,540</b>	<b>\$ 5,769</b>	<b>\$ 4,390</b>	<b>\$ 4,849</b>	<b>\$ 1,836</b>	<b>\$ 3,605</b>	<b>\$ 23,989</b>

(1) Principal portion only

### **Liquidity**

At June 30, 2011, the Corporation had cash on hand of \$681.

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 revolving operating loan facility for general operating purposes and a \$5,000 non-revolving reducing loan facility.

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 that includes accounts receivable and property and equipment.

On May 13, 2011, the Corporation signed a revised credit facility which reflected the effects of the conversion to IFRS. The Corporation complied with all covenants under the credit facility at June 30, 2011.

At June 30, 2011 the total outstanding on the term-loan facility was \$3,695, of which \$1,304 was current. During the quarter the Corporation made scheduled principal long-term debt payments of \$326 and finance lease payments of \$620.

On December 21, 2010 (\$1,925) and January 15, 2011 (\$75), the Corporation issued \$2,000 in Subordinated Secured Convertible 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. The proceeds from the convertible debenture were used to fund part of the Corporation's 2011 capital program.

The Debentures consist of both debt and equity components that 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 obligation and the principal payment due at maturity, using the rate of interest that would have been applicable to a non-convertible debt instrument of the comparable term and risk at the date of issue. The residual portion of the Debenture 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 Debenture. At June 30, 2011 the debt component of the convertible debenture was \$1,809 all of which is long-term.

The Corporation also has finance leases related to its light vehicles. The lease terms range from 3 to 5 years. The Corporation's obligations under finance leases are secured by the lessors' title to the leased assets. The terms and conditions of the finance lease contract do not specify any contingent rents, escalation clauses or any financial restrictions, conditions or covenants in respect of the Corporation's financial position or the related leased assets. At June 30, 2011 the total outstanding on the finance leases was \$2,867, of which \$1,835 was current.

### **Cash Provided by Operations**

Cash provided by operations in the six months ended June 30, 2011 was \$3,029 compared to \$2,732 for the same period in 2010. Improved revenue levels and operating margins during the period resulted in higher operating cash flow before

considering changes in working capital. The change in non-cash working capital of (\$1,789) was primarily a result of higher trade receivables in the period which was due to increased revenues.

Days-sales-outstanding (“DSO”) was 77 days for the quarter compared to 74 days at December 31, 2010 and 79 days at the end of the same quarter in 2010.

### ***Cash Provided Used in Financing and Investing***

During the quarter, the Corporation made scheduled payments totaling \$326 against its existing term debt facility and \$642 towards outstanding finance leases.

Purchases of property and equipment for the quarter amounted to \$861, virtually all of which was for revenue-generating health safety services rental equipment. Proceeds from the disposal of property and equipment were \$256.

## **Working Capital**

At June 30, 2011, the Corporation had working capital of \$12,943. This compares to \$12,016 at December 31, 2010 and \$9,042 at June 30, 2010 (adjusted to conform to IFRS).

## **Acquisition**

On January 24, 2011 the Corporation acquired all of the outstanding common shares of Taylored Safety Services Inc. (“Taylored”) with the issue of 1,137,532 shares at a price of \$0.54. Taylored provides safety consulting and industrial health services, and training to industry and is headquartered in Halifax, Nova Scotia.

## **Outlook**

Having posted net earnings for the fourth quarter in a row, the outlook for the Corporation’s second half of 2011 continues to be positive for the following reasons:

- Despite increased volatility in the commodity and capital markets, most of HSE’s larger clients, particularly those in crude-oil related enterprises, have resumed long term investment in major projects. These commitments help provide confidence in HSE’s long term growth plans for increased safety services.
- The Corporation’s long-term Strategic Framework was launched in first quarter 2011. Recognizing that the Corporation’s historic Oilfield revenue base of sour-gas well drilling was unlikely to return to its previous levels, the plan calls for HSE to expand in other areas. The Corporation identified seven key locations in which it could increase market share through organic growth; i.e., to expand in locations in which it already operates. One aspect of the plan was to empower the Corporation’s business unit managers to become involved not just in quality control, but also in such areas as operations and budgeting. The record Q2 results for 2011 suggest that HSE’s Strategic Framework is beginning to show results.

However, challenges remain. Factors that will impact HSE negatively are summarized as follows:

- The overall upturn in activity – in Alberta in particular – is tightening labour markets, which puts continual pressure on manpower costs and availability. As a national company, HSE has the ability to bring workers from other parts of Canada. While this provides a competitive advantage, it does not mitigate all labour-force concerns.
- Natural gas prices remain depressed and show little likelihood of returning to a historic 6:1 BTU equivalent parity with crude oil prices. Historically, much of the demand for HSE’s Oilfield services suite has been for natural gas, particularly toxic hydrogen sulphide gas.
- Second quarter 2011 benefitted from two large major industrial projects that are not recurring.

### ***Industrial***

The industries, companies, and markets the Corporation services through its Industrial health and safety services packages are showing generally positive signs of recovery. There is a great demand for health, safety and environment monitoring services in oilsands and in-situ heavy-oil facilities such as refineries, petrochemical plants, and upgraders that process oil and bitumen. In some markets – like northeast Alberta – there are significant capital expenditures planned for the next few

years. In other more mature markets, normal shutdown, turnaround, and maintenance activities have resumed. For HSE, Newfoundland has been transformed from an investment opportunity to a cash-positive business unit. With both industrial services and offshore safety services expanding, the opportunity for growth in the Maritimes looks strong.

In the first quarter of 2011 HSE expanded into the new business area of safety supervision and consulting services with the establishment of a Consulting Services Division, which will provide expert safety supervisors to projects on a contract basis. A major recruiting campaign was launched in second quarter of 2011 and HSE is now positioned to actively market this service. HSE is confident that this business unit can capitalize on the current trend towards outsourcing of safety services to expert third parties, and a growing emphasis on quality safety supervision for all types of safety-intensive operations. HSE believes that Consulting Services will provide strong vertical integration for HSE as it is complementary to our customers' needs and to other services the Corporation offers.

### **Oilfield**

After nearly three years of significant changes, the Oilfield health and safety services market in the Western Canadian Sedimentary Basin ("WCSB") has stabilized to a certain level of predictability, with "predictability" defined as clients finding profitable reserves of oil and liquids-rich natural gas to develop, and making longer term plans to do so.

In a press release dated June 1, 2011, the Canadian Association of Oilwell Drilling Contractors ("CAODC") released a forecast update for 2011. The revision shows a change in the level of activity anticipated over the balance of the year. The CAODC is predicting an increase in the total number of rig-operating days in 2011 to 154,300 (October 2010 forecast: 128,600) and the number of wells completed is predicted to be 13,128 (October 2010 forecast: 11,811). The revised forecast assumes 11.8 drilling days/well, up from 10.8 drilling days/well. The forecast also confirms the shift to oilwell completions away from natural gas drilling. The Petroleum Services Association of Canada ("PSAC") has revised its forecast to 13,325 wells for 2011, up 375 wells from PSAC's April forecast. PSAC is basing its updated 2011 forecast on average natural gas prices of CDN\$3.75/mcf (AECO) and crude oil prices of US\$99/barrel (WTI). In its July press release, PSAC stated that "all signs going forward indicate a continuing positive outlook for the services sector, given new technologies, innovations and efficiency gains that accompany strong oil prices." (*PSAC Media Release, July 27, 2011*).

This shift to drilling fewer, deeper wells with oil as the target instead of gas has changed demand for HSE's Oilfield health and safety services. A rise in the number of rig-operating days is good for HSE's medical services business. This level and type of activity also increases the demand for HSE's mobile fire and shower services because many of these oilwells are completed using large volumes of flammable hydrocarbon fracturing fluids or abrasive hydrochloric acid.

As mentioned, the outlook for natural gas remains challenged. While some gas reservoirs contain more valuable natural gas liquids and are therefore being developed, reservoirs that contain hydrogen sulphide gas (sour gas wells) are suffering from squeezed economics due to higher operating and processing costs. Hydrogen sulphide requires special handling and must be removed prior to the gas entering the sales pipeline.

Nevertheless, the outlook for HSE's Oilfield health and safety services is the best it has been since early 2008.

### **United States**

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 with a stand-alone regional BCHSE service location in Midland, Texas, as well as through other Boots & Coots Services, a division of Halliburton service locations in the region.

BCHSE contributed \$867 to revenue for the three months ended June 30, 2011, more than doubling its revenue of \$397 for the same period in 2010. In January of 2011, with \$830 budgeted for rental equipment expansion, BCHSE was able to respond to increasing customer demand with additional equipment and manpower. The revenue generated by BCHSE in the first half of 2011 suggests that the division has gained customer acceptance in the U.S., and that it will be a major contributor to HSE's future expansion. Recent high-profile events such as the Macondo blowout in the Gulf of Mexico have raised awareness of the importance of health and safety among responsible oil and gas operators.

CRS contributed \$534 to revenue for the three months ended June 30, 2011, compared to \$491 for the same period in 2010. The Taylor, Michigan location was part of an acquisition in Sarnia, Ontario in 2005. The growth potential remains significant given the access to numerous markets and industries with operations that are hazardous to workers, assets, and the community. But as a mature market, it is also competitive with numerous suppliers. The Taylor location demonstrated meaningful growth in the 2010 fiscal year with HSE gaining new clients that appreciate the Corporation's commitment to

quality services, personnel, and equipment. HSE believes that in the future, further penetration of the large U.S. industrial health and safety services market is possible from this location.

## Quarterly Results

	2011		2010 <sup>(2)</sup>				2009 <sup>(2)</sup>	
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
Revenue	\$ 24,905	\$ 24,481	\$ 22,422	\$ 20,349	\$ 18,350	\$ 20,907	\$ 19,090	\$ 20,544
Net earnings (loss)	541	507	923	176	(783)	124	(2,178)	(722)
EBITDA <sup>(1)</sup>	3,248	2,486	2,459	1,956	411	1,966	496	1,016
Income (loss) per share – basic and diluted	\$ 0.01	\$ 0.01	\$ 0.02	0.00	(0.02)	\$ 0.00	\$ (0.06)	\$ (0.02)

(1) See “Non-GAAP Measures” (Page 15)

(2) IFRS transition date was January 1, 2010; 2010 financial results have been adjusted to conform to IFRS; 2009 financial results have not been restated and are presented in previous Canadian GAAP

HSE’s business has two 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:

	2011		2010 <sup>(1)</sup>				2009 <sup>(1)</sup>	
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
Industrial	\$ 16,699	\$ 12,557	\$ 12,040	\$ 11,384	\$ 11,926	\$ 11,924	\$ 12,533	\$ 14,375
Oilfield	8,206	11,924	10,382	8,965	6,424	8,983	6,557	6,169
Total revenue	\$ 24,905	\$ 24,481	\$ 22,422	\$ 20,349	\$ 18,350	\$ 20,907	\$ 19,090	\$ 20,544

(1) IFRS transition date was January 1, 2010; 2010 financial results have been adjusted to conform to IFRS; 2009 financial results have not been restated and are presented in previous Canadian GAAP

## Related-Party Transactions

### Key Management Personnel and Director Transactions

Members of key management personnel, officers, or director, or their related parties, hold positions in other entities that result in them having control or significant influence over the financial or operating policies of these entities. A number of these entities transacted with the Corporation in the reporting period. The aggregate value of transactions and outstanding balances relating to key management personnel and entities over which they have control or significant influence are as follows:

**HSE Integrated Ltd.**

## Management Discussion and Analysis

For the three-month and six-month periods ended June 30, 2011 and 2010

Director / key management personnel	Transaction	Note	Transaction value three months ended June 30		Transactions value six months ended June 30		Balances outstanding at	
			2011	2010	2011	2010	Jun. 30, 2011	Dec. 31, 2010
Director	Office rent and property taxes	(i)	\$ 97	\$ 105	\$ 154	\$ 165	–	–
Director	Supplies and sub-license fees (per agreement)	(ii)	\$ 449	\$ 85	\$ 623	\$ 85	\$ 150	\$ 55
Key Manager	Office rent and property taxes	(iii)	\$ 96	\$ 78	\$ 187	\$ 156	–	–
Directors / Officers	Convertible debentures	(iv)	–	–	\$ 40	–	–	–

- (i) The Corporation paid rent and property taxes for one of its regional offices to a corporation which is controlled by a member of the Board of Directors. The term of the lease is 15 years and expires on January 31, 2019.
- (ii) The Corporation purchased various safety supplies and performed maintenance on safety equipment under a sub-license agreement with a corporation which is controlled by a member of the Board of Directors.
- (iii) The Corporation paid rent and property taxes for one of its regional offices to a corporation controlled by a Senior Manager for a subsidiary in the United States. The term of the lease is 5 years and expires on December 31, 2015.
- (iv) A placement of convertible debentures to related parties occurred in December 2010 and January 2011. The related parties were directors, family of directors, and officers of HSE.

Significant subsidiaries	Country of Incorporation	Ownership Interest	
		2011	2010
HSE Integrated Inc. ("INC")	USA	100%	100%
Boots & Coots HSE Services, LLC ("BCHSE")	USA	90%	90%
CRS Technologies Inc. ("CRU")	USA	100%	100%

**Critical Accounting Policies and Estimates**

This MD&A summarizes HSE's financial condition and results of operations which are based upon its Interim Financial Statements, which has been prepared in accordance with IFRS. The unaudited interim consolidated financial statements require management to select significant accounting policies which are contained within the notes to statements. These significant accounting policies involve critical accounting estimates due to complex judgments and assumptions required to be made by management. These estimates, judgments and assumptions are based on the circumstances that exist at the reporting date and may affect the reporting amounts of earnings and expenses during the reporting periods and the carrying amounts of assets, liabilities, accruals, provisions, contingent liabilities, and other financial obligations as well as the determination of fair values.

**Allowance for Doubtful Accounts Receivable**

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

### ***Impairment Tests***

The Corporation assesses, at the end of each reporting period, whether there is an indication that an asset group may be impaired. Goodwill is reviewed for impairment annually or more frequently if there are indications that impairment may have occurred. If any indication of impairment exists, HSE estimates the recoverable amount of the asset group. External triggering events include, for example, changes in customer or industry dynamics, commodity prices, drilling levels and economic declines. Internal triggering events for impairment include lower profitability or obsolescence.

The Corporation's impairment tests compare the carrying amount of the asset or cash generating unit ("CGU") to its recoverable amount. The recoverable amount is the higher of fair value less costs to sell and value in use. The determination of value in use requires the estimation and discounting of cash flows which involves key assumptions that consider all information available on the respective testing date. Management uses its judgment, considering past and actual performance as well as expected developments in the respective markets and in the overall macro-economic environment and economic trends to model and discount future cash flows.

### ***Property, Plant and Equipment and Intangible Assets***

Property, plant and equipment and intangible assets are recorded at cost less accumulated amortization and accumulated impairment losses. The depreciation methods used and estimates of useful lives and residual values of assets are established by management based on industry norms, historical experience and other information. If these estimates are incorrect, asset values, depreciation expense and gain / loss on disposal of assets could be affected.

### ***Acquisitions***

The assets and liabilities acquired through business combinations are recognized at fair value on the date HSE effectively obtains control. The measurement of business combinations is based on the information available at the acquisition date. The determination of fair value of the acquired intangible assets (including goodwill), property, plant and equipment and other assets and the liabilities assumed at the date of acquisition, as well as the useful lives of the acquired intangible assets and property, plant and equipment, is based on projected cash flows and market conditions at the date of acquisition. These amounts are based on various assumptions and could be materially affected if these assumptions are inaccurate.

### ***Lease Classification***

The Classification of a lease as operating or financing depends upon whether substantially all the risks and rewards of the asset are transferred. The Corporation has determined that its facility leases are operating leases since the rent paid to the landlords is increased to market rates at regular intervals and the Corporation does not participate in the residual value of any of the buildings. The Corporation has determined that its light duty vehicles are finance leases since the lease payments cover effectively 100% of the value of the leased asset.

### ***Income Taxes***

Tax interpretations, regulations and legislation in the various jurisdictions in which the Corporation and its subsidiaries operate are subject to change. In addition, the Corporation's tax liabilities may be affected by complexities introduced as a result of business acquisitions. As such, income taxes are subject to measurement uncertainty and the interpretations can impact net earnings through the income tax expense arising from the change in current and deferred income tax assets or liabilities.

## **Future Accounting Pronouncements**

In October, 2010 the IASB published amendments to IFRS 9 "Financial Instruments", which is the result of the first phase of the International Accounting Standards Board's (IASB) project to replace IAS 39 "Financial Instruments: Recognition and Measurement". The amendments are effective January 1, 2013, with early adoption permitted. The Corporation intends to adopt the changes in its financial statements commencing January 1, 2013. The new standard replaces the current multiple classification and measurement models of financial assets and liabilities with a single model that has only two classification categories: amortized cost and fair value. As well, it requires various changes to the treatment of gains and losses on financial assets and liabilities measured at fair value. The adoption of this standard is not expected to have a material impact on the Corporation's Consolidated Financial Statements.

In October, 2010 the IASB also issued amendments to IFRS 7 "Financial Instruments: Disclosures", effective for fiscal years beginning on or after January 1, 2012. The Corporation intends to adopt the amendments effective January 1, 2012. The changes

provide for additional disclosures with respect to transferred financial assets where the assets are not derecognized in the financial statements. The changes are not expected to have a material impact on the Corporation's financial statements.

In May, 2011 the IASB issued the new standards IFRS 10 "Consolidated Financial Statements", IFRS 11 "Joint Arrangements" and IFRS 12 "Disclosure of Interests in Other Entities". As a consequence, the IASB reissued IAS 27 "Consolidated and Separate Financial Statements" as IAS 27 (2011) "Separate Financial Statements" and reissued IAS 28 "Investments in Associates" as IAS 28 (2011) "Investments in Associates and Joint Ventures". These standards are all required to be adopted for fiscal years beginning on or after January 1, 2013, with early adoption permitted. IFRS 12 may be early adopted without the adoption of the other standards, but if any other provisions are adopted, all standards must be adopted concurrently.

IFRS 10 provides a single model, based on a revised definition of control, for purposes of determining when an entity is considered to be a subsidiary, with the consequent requirement to consolidate the entity's assets and liabilities and results of operations. IFRS 11 provides revised guidance for the classification of entities subject to joint control, and more restrictive treatment as to the acceptable methods of accounting for entities subject to joint control. IFRS 12 contains the disclosure requirements with respect to investments in subsidiaries, joint arrangements, associates and unconsolidated structured entities. These disclosures are intended to provide additional information about the nature of the Corporation's interests in other entities, the consequent risks to the Corporation and the effects of these interests on the Corporation's financial position, financial performance and cash flows.

As a consequence of the issuance of IFRS 10, IAS 27 has been amended to remove any prior guidance with respect to consolidated financial statements. It carries forward the existing guidance with respect to preparation of separate financial statements. As well, IAS 28 was amended to clarify the accounting in specific cases related to discontinued operations and to changes in interests held in associates and joint ventures.

The Corporation intends to adopt these changes effective January 1, 2013. The Corporation does not expect the adoption of these amendments to have a material effect on the financial statements.

In May, 2011 the IASB issued IFRS 13 "Fair Value Measurement", to be applied prospectively effective January 1, 2013. IFRS 13 replaces the fair value measurement guidance provided in individual standards with a single definition of fair value. It does not change the circumstances where fair value is permitted or required, but instead provides guidance as to how to measure fair value in circumstances where fair value is appropriate. The Corporation intends to adopt IFRS 13 prospectively effective January 1, 2013. The Corporation does not expect IFRS 13 to have a material impact on the financial statements.

## **Financial and Other Instruments**

The Corporation's financial instruments include cash and cash equivalents, accounts receivable, other long-term receivables, bank indebtedness, accounts payable and accrued liabilities, and loans and borrowing. 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 Corporation is exposed to the following risks from its financial instruments:

- Credit risk
- Liquidity risk
- Market risk

These risks, and the Corporation's method of mitigating the risks, are described following:

### ***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 maximum credit exposure associated with trade accounts receivable is the carrying value.

The Corporation's trade receivables 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 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 receivables 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, result in payment terms of up to 60 days.

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

### ***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 operating and investing activities. The Corporation's contractual financial liabilities include interest payments, trade and other payables, income taxes payable, a revolving operating line of credit, a non-revolving term-debt facility, a convertible debenture and finance leases for equipment and vehicles.

HSE manages its liquidity risk by ensuring, to the extent possible, that it has access to funding sources at competitive rates 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 uses operating cash flow to provide liquidity to meet its financial obligations. As a result, the Corporation 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 Corporation has projected its operating cash flows under different scenarios with respect to receivables aging to determine the effect on operating cash inflows. The Corporation monitors its receivables collections to ensure that, if collections are delayed, there are sufficient operating funds available to meet its financial obligations. As well, the Corporation has access to undrawn operating lines of credit of \$10,000 to fund operations. These credit lines are renewable annually and are margined to accounts receivable. 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 Corporation'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 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 foreign operations, the amount is included in other comprehensive earnings. At June 30, 2011 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 June 30, 2011 a 1% increase in the average prime interest rate for the year would cost the Corporation \$37 in additional interest expense.

## **Business Risks**

The activities the Corporation 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 with which HSE deals; availability of financing at competitive rates; changes in foreign exchange rates and interest rates; and litigation and contingencies. Additional risks and uncertainties that the Corporation may be unaware of, or that were determined to be immaterial, may also become important factors that affect the Corporation. Further details regarding specific risks that may affect the Corporation are provided below:

### ***Business Cyclicity***

The demand for HSE's Oilfield services is highly dependent upon the level of expenditures made by oil and gas companies on exploration, development and production activities. These expenditures are in turn affected by a number of factors:

- The price received by HSE's customers for crude oil and natural gas directly impacts their cash flow available to purchase the Corporation's services. Fluctuations in crude oil and natural gas prices can produce periods of high and low demand for the Corporation's services. Alternatively, a number of factors that are beyond the control of HSE's customers, 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 the Corporation's customers to purchase its services.
- Exploration, development and production activity levels within particular markets are influenced by factors including royalties, regulatory and taxation changes, weather, and access to pipeline capacity.
- Changes in equity and debt-financing markets independent of any individual company's circumstances may reduce access to capital that is used to fund exploration, development, and production activities.

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

The demand for HSE's Industrial services is 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 the Corporation's 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 HSE provides Oilfield services.

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

The Corporation's ability to provide reliable service is dependent upon attracting and retaining skilled employees. The demand for workers with particular skills used by the Corporation is high and the supply remains limited.

### ***Competitive Conditions***

The Corporation's main competitor is its own customer base. There is a risk, typically under distressed economic conditions, that customers may elect to use their own personnel to perform services that HSE currently provides. The Corporation attempts to mitigate this risk by providing staff with more training and safety service experience than the customer is able to provide on its own.

While no one competitor in Canada provides the full suite of services that the Corporation provides, HSE has competitors in each market it serves. These competitors are typically privately owned, regionally based companies that provide a specialized set of services. These competitors may provide pricing pressure that may affect our margins and market position within particular lines of business. The Corporation 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.

Recently, a larger private-equity-financed U.S. safety services provider commenced operations in Canada. While this provider is currently restricting its activities to providing Industrial safety services within a small portion of the industries and geographic locations in which the Corporation provides services, there is a risk that this competitor may begin to market its services to a wider array of customers and locations. Management is of the view that this may provide an opportunity for additional business for the Corporation as customers may be more likely to outsource safety services work when there is more than one provider available.

### ***Customer Credit***

HSE generally invoices its customers in arrears for its services. Because of this, the Corporation is subject to the risk that its customers may delay payment of its 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.

### ***Customer Dependence***

The Corporation has ongoing contracts or master service agreements with a variety of customers. For certain customers the volume of revenue generated approaches or exceeds 10% of the Corporation's total revenue on a quarterly or annual basis. While there is no indication that any of these customers are likely to change safety service providers, if a contract were cancelled and the Corporation were unable to replace the business with other existing or new customers, the Corporation's revenue, operating results and cash flows would be adversely affected. The Corporation attempts to mitigate this risk by providing an integrated suite of services that are not available from a single competitor, by providing access to our services on a country-wide basis, and by distinguishing itself through higher levels of service and expertise.

### ***Customer and Government Safety Requirements***

All companies are required to track and publish safety statistics. Certain customers require that their vendors maintain specific minimum standards with respect to safety in order to provide services as an accredited vendor. There is a risk that, if the Corporation's safety statistics fall below an acceptable level, it would not be allowed to provide services to these customers. If this occurred, the Corporation's revenues and profit levels would be adversely affected.

As well there is a risk that customer safety requirements and government regulations or legislation may change either as part of an ongoing review process, or in reaction to specific events such as the Macondo blowout in the Gulf of Mexico. While changes in these requirements may provide opportunities to provide health and safety personnel and equipment to the Corporation's customers in order to address new requirements, these changes may also pose the following risks to the Corporation. First, there is a risk that additional expenses may need to be incurred to refit equipment or provide additional training to staff. There is no guarantee that these costs could be passed on to customers and, as a result, the Corporation's profits may suffer if unanticipated changes are made. Second, there is a risk that additional regulations could make an activity or line of business unprofitable for our customers. This could cause them to exit the activity causing a reduction in the Corporation's revenues as customer activity decreases.

The Corporation mitigates these risks by ensuring that its field personnel are trained to levels that meet or exceed "best-practices" levels and that its equipment meets any requirements specified by the equipment manufacturer. The Corporation's industry technical specialists monitor industry sources to keep the Corporation apprised of potential changes to regulations. As well, the Corporation maintains a comprehensive internal safety program including regular senior management and Board of Directors review of safety results, the use of standardized "best-practices" procedures for all work performed, and specific procedures that require that all incidents be investigated to determine root causes of the incident and to recommend what, if any, changes to the Corporation's procedures are necessary to prevent recurrence.

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

Historically, the Corporation has funded the growth of its operations and its acquisitions from bank debt, share issues, and convertible debentures, in addition to cash generated from operations. Continued access to bank debt at competitive rates requires that the Corporation meet various financial and non-financial covenants. There is no certainty HSE will continue to be able to obtain sufficient financing at competitive rates. The Corporation's ability to grow as planned may be limited if sources of competitively priced financing are unavailable.

### ***Income Taxes***

The Corporation uses various estimates and judgments when preparing corporate tax returns. These returns are subject to audit and reassessment by various tax authorities. These reassessments could have a material effect on reported amounts for income tax assets and liabilities as well as current tax expense.

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

HSE's consolidated financial statements are presented in Canadian dollars, but include the results of its U.S. subsidiaries for which the functional currency is the U.S. dollar. 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 the Corporation's U.S. subsidiaries.

### ***Litigation and 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 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 Corporation.

## **Disclosure and Internal Controls**

### ***Disclosure Controls and Internal Controls over Financial Reporting***

The Chief Executive Officer (“CEO”) and the Chief Financial Officer (“CFO”) are responsible for designing disclosure controls and procedures (“DC&P”) and internal controls over financial reporting (“ICFR”) as defined in National Instrument 52-109 Certification of Disclosure in Issuer’s Annual and Interim Filings (“52-109”), or causing them to be designed under their supervision, in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS.

HSE’s DC&P have been designed to provide reasonable assurance that material information relating to HSE is made known to the CEO and the CFO by others and that information required to be disclosed by HSE in its annual filings, interim filings or other reports filed or submitted by HSE under securities legislation is recorded, processed, summarized and reported within the time periods specified in applicable securities legislation. There have been no changes in ICFR during the three month period ended June 30, 2011. Our ICFR have been designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS. As of June 30, 2011, the CEO and the CFO together with HSE’s management have evaluated the design and effectiveness of the Corporation’s DC&P and have concluded that they are effective.

Because of their inherent limitations, DC&P and ICFR may not prevent or detect all misstatements, errors or fraud. Control systems, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control systems are met.

## **Common Shares and Convertible Debentures Outstanding**

At June 30, 2011 and August 11, 2011, 38,713,207 common shares of HSE were outstanding (December 31, 2010 – 37,575,675). At June 30, 2011, the Corporation had options outstanding to issue of 2,298,000 shares (December 31, 2010 – 2,279,165) at a weighted-average exercise price of \$0.75 per share (December 31, 2010 – \$1.24). Of these options, 1,292,550 were exercisable (December 31, 2010 – 1,154,479). At August 11, 2011 there were 2,251,036 options outstanding at a weighted average price of 0.76 per share. Of these options, 1,292,550 were exercisable.

At June 30, 2011 the Corporation had \$2,000 of convertible debentures outstanding that were convertible to 4.0 million shares based on the applicable conversion price. At August 11, 2011 there were \$2,000 of convertible debentures outstanding that were convertible to 4.0 million shares at the applicable conversion price.

## **Non-GAAP Measures**

Certain measures in this document do not have any standardized meaning as prescribed by IFRS and, therefore, are considered non-GAAP measures.

This report makes reference to Operating Margin, a measure that is not recognized under IFRS. Management believes that, in addition to net earnings, operating margin is a useful supplementary measure. Operating margin is defined as revenue less all direct operating expenses incurred by field operations and support functions such as fleet management.

This report makes reference to EBITDA, a measure that is not recognized under IFRS. 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 Operating Margin and EBITDA should not be construed as an alternative to net earnings determined by IFRS as an indication of the Corporation’s performance. HSE’s method of calculating Operating Margin and EBITDA may differ from that of other companies’ and, accordingly, may not be comparable to measures used by other companies.

## EBITDA Calculation

Six-month periods ended June 30	2011	2010 <sup>(2)</sup>	2009 <sup>(2)</sup>
Net earnings (loss)	\$ 1,048	\$ (659)	\$ (3,734)
Add (deduct):			
Amortization	2,723	3,201	3,431
Stock-based compensation	109	120	149
Finance costs	414	407	280
(Gain) loss on disposal of property and equipment	1	(445)	219
Income tax	1,440	(247)	(1,012)
<b>EBITDA<sup>(1)</sup></b>	<b>\$ 5,735</b>	<b>\$ 2,377</b>	<b>\$ (667)</b>

(1) See “Non-GAAP Measures” (Page 15)

(2) HSE’s IFRS transition date was January 1, 2010; 2010 financial results have been adjusted to conform to IFRS; 2009 financial results have not been restated and are presented in previous Canadian GAAP

## Quarterly EBITDA Calculation

	2011				2010 <sup>(2)</sup>		2009 <sup>(2)</sup>	
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
Net earnings (loss)	\$ 541	\$ 507	\$ 923	\$ 176	\$ (783)	\$ 124	\$ (2,178)	\$ (722)
Add (deduct):								
Amortization	1,382	1,341	1,465	1,466	1,508	1,692	1,618	1,650
Impairment of property and equipment	—	—	—	—	—	—	1,641	—
Stock-based compensation	38	71	39	25	64	57	43	101
Finance costs	197	217	209	139	212	195	127	137
(Gain) loss on disposal of property and equipment	(35)	36	314	247	(132)	(313)	57	35
Expiry of contingent consideration liability	—	—	(810)	—	—	—	—	—
Income taxes	1,125	314	319	(97)	(458)	211	(812)	(185)
<b>EBITDA<sup>(1)</sup></b>	<b>\$ 3,248</b>	<b>\$ 2,486</b>	<b>\$ 2,459</b>	<b>\$ 1,956</b>	<b>\$ 411</b>	<b>\$ 1,966</b>	<b>\$ 496</b>	<b>\$ 1,016</b>

(1) See “Non-GAAP Measures” (Page 15)

(2) HSE’s IFRS transition date was January 1, 2010; 2010 financial results have been adjusted to conform to IFRS; 2009 financial results have not been restated and are presented in previous Canadian GAAP

## 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 Corporation’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 that may cause actual results, performance or achievements of the Corporation 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 Corporation's current expectations regarding future events and operating performance based on assumptions and analyses made by the Corporation based on its experience and an assessment of current conditions, known trends, expected future developments and other factors that Management believe to be appropriate under the circumstances.

These forward-looking statements include among others:

- Despite increased volatility in the commodity and capital markets, most of HSE's larger clients, particularly those in crude-oil related enterprises, have resumed long term investment in major projects. These commitments help provide confidence in HSE's long term growth plans for increased safety services. ([Page 6](#))
- The Corporation's long-term Strategic Framework was launched in first quarter 2011. Recognizing that the Corporation's historic Oilfield revenue base of sour-gas well drilling was unlikely to return to its previous levels, the plan calls for HSE to expand in other areas. The Corporation identified seven key locations in which it could increase market share through organic growth; i.e., to expand in locations in which it already operates. One aspect of the plan was to empower the Corporation's business unit managers to become involved not just in quality control, but also in such areas as operations and budgeting. The record Q2 results for 2011 suggest that HSE's Strategic Framework is beginning to show results. ([Page 6](#))
- The overall upturn in activity – in Alberta in particular – is tightening labour markets, which puts continual pressure on manpower costs and availability. As a national company, HSE has the ability to bring workers from other parts of Canada. While this provides a competitive advantage, it does not mitigate all labour-force concerns. ([Page 6](#))
- Natural gas prices remain depressed and show little likelihood of returning to a historic 6:1 BTU equivalent parity with crude oil prices. Historically, much of the demand for HSE's Oilfield services suite has been for natural gas, particularly toxic hydrogen sulphide gas. ([Page 6](#))
- Second quarter 2011 benefitted from two large major industrial projects that are not recurring. ([Page 6](#))
- For HSE, Newfoundland has been transformed from an investment opportunity to a cash-positive business unit. With both industrial services and offshore safety services expanding, the opportunity for growth in the Maritimes looks strong. ([Page 7](#))
- HSE is confident that the Consulting Services business unit can capitalize on the current trend towards outsourcing of safety services to expert third parties, and a growing emphasis on quality safety supervision for all types of safety-intensive operations. HSE believes that Consulting Services will provide strong vertical integration for HSE as it is complementary to our customers' needs and to other services the Corporation offers. ([Page 7](#))
- After nearly three years of significant changes, the Oilfield health and safety services market in the Western Canadian Sedimentary Basin ("WCSB") has stabilized to a certain level of predictability, with "predictability" defined as clients finding profitable reserves of oil and liquids-rich natural gas to develop, and making longer term plans to do so. ([Page 7](#))
- A rise in the number of rig-operating days is good for HSE's medical services business. This level and type of activity also increases the demand for HSE's mobile fire and shower services because many of these oilwells are completed using large volumes of flammable hydrocarbon fracturing fluids or abrasive hydrochloric acid. ([Page 7](#))
- As mentioned, the outlook for natural gas remains challenged. While some gas reservoirs contain more valuable natural gas liquids and are therefore being developed, reservoirs that contain hydrogen sulphide gas (sour gas wells) are suffering from squeezed economics due to higher operating and processing costs. Hydrogen sulphide requires special handling and must be removed prior to the gas entering the sales pipeline. ([Page 7](#))
- Nevertheless, the outlook for HSE's Oilfield health and safety services is the best it has been since early 2008. ([Page 7](#))
- The revenue generated by BCHSE in the first half of 2011 suggests that the division has gained customer acceptance in the U.S., and that it will be a major contributor to HSE's future expansion. ([Page 7](#))
- The Taylor location demonstrated meaningful growth in the 2010 fiscal year with HSE gaining new clients that appreciate the Corporation's commitment to quality services, personnel, and equipment. HSE believes that in the future, further penetration of the large U.S. industrial health and safety services market is possible from this location. ([Page 8](#))

**HSE Integrated Ltd.**

Management Discussion and Analysis

For the three-month and six-month periods ended June 30, 2011 and 2010

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- As well, the Corporation has access to undrawn operating lines of credit of \$10,000 to fund operations. These credit lines are renewable annually and are margined to accounts receivable. HSE believes it has sufficient funding through these sources to meet its obligations as they come due. ([Page 12](#))

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 Corporation's services by customers in various industries and geographic locations; pricing levels for the Corporation's services; commodity prices; foreign currency exchange rates; interest rates; access to financing; the Corporation'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 Corporation'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 Corporation's profile at [www.sedar.com](http://www.sedar.com).

The Corporation 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 Corporation 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 the Corporation's profile on the SEDAR website at [www.sedar.com](http://www.sedar.com) and [www.hseintegrated.com](http://www.hseintegrated.com).