

## HSE Integrated Ltd. Management Discussion and Analysis (“MD&A”) For the Quarters Ended March 31, 2007 and 2006

The following management discussion and analysis is dated May 10, 2007, and is a review of the financial results of HSE Integrated Ltd. (“HSE”, “We”, “Our”, or the “Company”) for the quarters ended March 31, 2007 and 2006. This should be read in conjunction with the documents filed on SEDAR at www.sedar.com. Unless otherwise disclosed, the financial information presented in this discussion has been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”) and takes into consideration information available to management up to May 10, 2007. Unless otherwise stated, dollar figures presented are expressed in thousands of Canadian dollars and per-share figures in dollars per weighted-average common share. The following MD&A contains forward-looking information and statements. We refer you to the end of the MD&A for the disclaimer on forward looking statements.

### Selected Financial Information

	Quarter Ended Mar. 31, 2007	Quarter Ended Mar. 31, 2006	% Change
Revenue	\$27,948	\$27,465	1.8%
Operating and materials	20,631	19,734	4.5%
Operating margin	7,317	7,731	(5.3%)
Operating margin %	26.2%	28.1%	(1.9%)
Selling, general & administrative	2,515	2,183	15.2%
Net earnings	904	2,353	(61.6%)
- per share basic and diluted	0.02	0.07	(71.4%)
EBITDA <sup>(1)</sup>	4,802	5,548	(13.4%)
EBITDA %	17.2%	20.2%	(3.0%)
Total Assets	105,220	94,115	11.8%
Total Long-Term Liabilities	\$21,659	\$23,859	(9.2%)

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

### Financial Review

#### Revenue

HSE operates in a single industry segment, which involves providing a variety of asset, worker and community safety-protection services including: on-site safety supervision; gas detection; air-quality monitoring; breathing equipment rentals and services; firefighting and fire protection services and equipment; worker decontamination (shower) services; on-site medical services; and safety training. For the quarter ended March 31, 2007 the Company had one customer representing slightly more than 10% of revenue and for the quarter ended March 31, 2006, the Company had no customer representing more than 10% of revenue.

The Company currently provides services to its customers in the following main business areas: Oilfield Services (“Oilfield”), Industrial Services (“Industrial”), and Environment Monitoring Services (“Environment”). Oilfield is the provision of the Company’s services within the conventional upstream, or “wellhead”, sector of the oil and gas industry. Industrial represents the services delivered to non-conventional upstream oil and gas plants and facilities and the provision of training and safety management services for multiple industrial sectors. Environment focuses on air-quality monitoring to protect people, livestock, wildlife and equipment from an array of airborne contaminants.

The revenue for these services is shown below:

	<b>Quarter Ended Mar. 31, 2007</b>	Quarter Ended Mar. 31, 2006	% Change
Oilfield	<b>\$16,354</b>	\$21,797	(25.0%)
Industrial	<b>7,541</b>	3,899	93.4%
Environment	<b>4,053</b>	1,769	129.1%
<b>Total Revenue</b>	<b>\$27,948</b>	\$27,465	1.8%

As a % of Revenue:

Oilfield	<b>58.5%</b>	79.4%
Industrial	<b>27.0%</b>	14.2%
Environment	<b>14.5%</b>	6.4%
<b>Total Revenue</b>	<b>100.0%</b>	100.0%

Continued execution of the diversification strategy was demonstrated in the quarter, as revenue has increased slightly from the prior year to \$27.9 million, with declines in Oilfield revenues being offset by growth in Industrial and Environment revenues.

Oilfield revenues have declined by 25%, to \$16.4 million as compared to the prior year. The largest contributor to this decrease has been reduced overall activity levels within the conventional upstream, or “wellhead”, sector of the oil and gas industry. Industry sources have indicated that, as compared to the same period in the prior year, Western Canadian Sedimentary Basin (“WCSB”) new conventional oil and gas well drilling activity levels in the quarter have declined, as had well servicing activity on existing wells. Although HSE has been able to maintain its pricing levels with its customers, additional capacity added by competitors in a marketplace with overall reduction in demand has also contributed to the Company’s lower volume levels for the services provided to this sector.

The Company is continuing its business diversification strategy, and reports a 93% increase in Industrial revenues to \$7.5 million, as compared to the first quarter of 2006. The increase in Industrial revenues has come mainly in the areas of safety services to oil and gas processing facilities, thermal heavy oil recovery and oilsands extraction and construction projects in Alberta; the provision of safety services, fire, gas detection and breathing-air equipment sales and service to industrial and commercial markets in British Columbia, Alberta, and Ontario; and safety services for the refining, mining, offshore drilling and production and other industries in Atlantic Canada. Increased classroom capacity and course offerings, as well as greater marketing efforts have also increased the training component of industrial revenues.

As a result of the additional environment monitoring capacity added in the prior year, Environment revenues increased in the quarter by 129% to over \$4 million as compared to the first quarter of 2006.

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

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

Operating and materials expense for the quarter ended March 31, 2007 totaled \$20.6 million or 73.8% of revenue as compared to \$19.7 million or 71.9% of revenue in the first quarter of 2006. Operating margin has declined from \$7.7 million (28.1% of revenue) in the first quarter of 2006, to \$7.3 million (26.2% of revenue) the first quarter of 2007.

Execution of the Company's diversification strategy enabled HSE to redeploy personnel resources to the Industrial market; however this area is characterized by lower margins than the Oilfield sector at the operating level because of a lower proportion of equipment rentals in the total revenue mix. The usage associated with the capital cost of the Company's rental assets (which includes such items as fire trucks, ambulances, worker decontamination units, breathing air units, and air quality monitors) is reflected in the amortization line within the statement of earnings.

Although there was a decline in equipment utilization due to reduced activity within the conventional upstream oil and gas sector, the Company benefited from \$1.5 million of higher margin well control and emergency response work in the first quarter (2006 - \$0.5 million).

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

Selling, general and administrative ("SG&A") expense consists of costs not directly attributable to the provision of services for customers. These include costs generally associated with the following: corporate head-office functions and services; administrative personnel; corporate sales and marketing costs; liability insurance; professional fees; and investor relations expenses.

SG&A for the quarter ended March 31, 2007 amounted to \$2.5 million, versus \$2.2 million in the comparable quarter in 2006. SG&A as a percentage of revenue in the quarter has increased to 9.0%, from 7.9% a year earlier.

The increase in SG&A costs in comparison to the prior year is a result of higher business development and corporate costs necessary to support the Company's increased size.

### **EBITDA and Net Earnings**

Despite relatively stable revenue levels in the quarter as compared to the prior year, EBITDA (see "Non-GAAP Measures") has declined to \$4.8 million (17.2% of revenue), from \$5.5 million (20.2% of revenue) for the same period a year earlier. This was caused mainly by reduced rental equipment utilization levels, as a result of lower activity within the Oilfield services side of the business, as well as, increased investment in SG&A costs required to support the future growth in the Company.

Net earnings in the quarter have decreased to \$0.9 million or 3.2% of revenue, from \$2.3 million or 8.5% of revenue in the prior year. The decrease in net earnings is primarily due to lower levels of EBITDA, greater levels in amortization, stock-based compensation and interest, and offset by lower levels of income tax.

Total amortization for the quarter was \$1.9 million and consisted of \$1.6 million in property and equipment amortization, and \$0.3 million in intangibles amortization. Property and equipment amortization has increased by \$0.4 million when compared to the prior year due to previous investments in capital and from capital assets acquired through acquisitions. As well, the recognition of intangible assets on acquisitions made in the prior year has also contributed to the increase in amortization.

Stock-based compensation of \$357 (2006 - \$149) has increased due to additional grants of stock options to employees of the Company.

Interest on long term debt and other interest and bank charges increased from \$290 in the first quarter of 2006 to \$332 million in 2007. The change was caused primarily by term debt loans used to fund acquisitions made in 2006, interest on a larger base of capital leases, and higher interest rates.

HSE's income tax expense of \$0.6 million in the first quarter has declined from \$1.1 million for the comparable quarter in 2006 due to lower profitability levels. The effective tax rate of 40.5% in the quarter is higher than the 32.8% in the prior year primarily due to higher levels of non-deductible tax costs (such as stock based compensation).

## Quarterly Results

	2007		2006		2005			
	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2
Revenue	<b>\$27,948</b>	\$26,198	\$26,952	\$19,924	\$27,465	\$17,280	\$15,080	\$9,410
Net Income (loss)	<b>904</b>	984	1,197	(1,073)	2,353	(59)	786	(1,482)
EBITDA <sup>(1)</sup>	<b>4,802</b>	4,341	4,283	1,140	5,548	1,501	2,224	(845)
Income (loss) per share – basic and diluted	<b>\$0.02</b>	\$0.03	\$0.03	\$(0.03)	\$ 0.07	\$( 0.01)	\$ 0.02	\$( 0.06)

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

HSE's business has a seasonal component. For a description of this seasonality, please refer to the Company's 2006 Annual Report.

## Liquidity and Capital Resources

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

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

(\$'000)	2007	2008	2009	2010	2011	Total
Capital lease obligations	\$1,212	1,622	1,208	287	93	\$4,422
Vehicle operating leases	\$1,271	1,431	1,164	1,127	658	\$5,651
Property & other leases	\$1,635	2,022	1,670	1,131	577	\$7,035
Long term debt	\$3,145	4,896	3,985	3,951	-	\$15,977
Total contractual obligations	<b>\$7,263</b>	<b>9,971</b>	<b>8,027</b>	<b>6,496</b>	<b>1,328</b>	<b>\$33,085</b>

### ***Cash provided by (used in) operations***

Cash provided by operations in the quarter was \$1.2 million as compared to cash used in operations of almost \$3 million in the prior year. Improved methods for the timely collection of outstanding trade receivables have been the main contributor to this.

### ***Cash provided by (used in) financing and investing***

During the quarter, the Company made payments of \$0.5 million for its capital leases, and \$1.1 million towards repayment of long term debt.

Purchases of property and equipment in the quarter amounted to \$1.5 million, the majority of which consists of field safety equipment, and the construction costs related to medical treatment centre units, and fire and shower units. The Company continues to monitor current operating conditions to ensure that the addition of capacity is optimally utilized.

## Liquidity

As at March 31, 2007, HSE had \$14.8 million of total non-revolving instalment credit facility outstanding, with \$10 million of un-drawn operating facility, and \$5 million of un-drawn revolving instalment credit facility. The Company's credit facilities provide a \$20-million non-revolving instalment credit facility amortizing equally over five years, a \$5-million revolving instalment credit facility amortizing equally over five years, and an operating line of \$10 million (seasonally decreased to \$8 million) margined to accounts receivable.

At March 31, 2007, the Company was in compliance with its financial covenants. At this time HSE believes that operating cash flows, bank credit facilities and equity financing will be adequate to finance its capital expenditure and acquisition program.

### **Off Balance Sheet Arrangements**

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

### **Related-Party Transactions**

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

In the first quarter of 2006, a company controlled by a former director of HSE subcontracted the provision of certain goods and services to HSE. For the first quarter of 2006, HSE billed this company \$473 in respect of the goods and services provided, and paid the company \$10 for goods and services. These products and services were sold at rates agreed to as part of the acquisition of the assets of the company. Included in accounts receivable is \$464 (2006 - \$877) owed by this company to HSE.

Included in accounts receivable is a promissory note of \$49, (2006 – \$54) which is due from an officer and director of the Company. This note is payable on demand. In the first quarter of 2007, the Company paid rent to a corporation related to this same officer and director of the Company in the amount of \$57 (2006 – \$61).

In the first quarter of 2007, the Company also paid rent of \$11 (2006 – \$10) and \$74 (2006 – \$74) to two corporations each associated with senior management of the Company.

### **Critical Accounting Policies and Estimates**

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

The accounting policies and estimates believed to require the most difficult, subjective or complex judgments and which is material to the Company's financial reporting results include: allowance for doubtful accounts, intangible assets and goodwill, impairment of long lived assets, depreciation and amortization of property and equipment, and future income tax liabilities. A full description of these accounting policies and estimates can be found in HSE's 2006 Annual Report.

### **Accounting Pronouncements**

On January 1, 2007, the Company adopted the new accounting standards issued by the Canadian Institute of Chartered Accountants regarding the recognition, measurement, disclosure and presentation of financial instruments. Under these standards, financial instruments must be classified into one of five categories: (i) held-for-trading, (ii) held-to-maturity, (iii) loans and receivables, (iv) available-for-sale, and (v) other financial liabilities. The new standards require that all financial instruments within the scope of the standards, including all derivative instruments, be recognized on the balance sheet initially at fair value. Subsequent measurement of all financial assets and liabilities – except those in the held-for-

trading and available-for-sale categories – must be determined at amortized cost using the effective interest rate method. Held-for-trading financial instruments are measured at fair value with changes in fair value recognized in earnings. Available-for-sale financial instruments are measured at fair value with changes in fair value recognized in comprehensive income until the investment is derecognized or impaired at which time the amounts would be recorded in net earnings.

Under adoption of these new standards, the Company designated accounts receivable as “loans and receivables”, which are measured at amortized cost. Short-term investments have been designated as “held-for-trading”, which are measured at fair values with changes in such value included in earnings. Accounts payable and accrued liabilities and long-term debt are classified as “other financial liabilities” which are measured at amortized cost. We have classified previously deferred financing costs of \$29 included in prepaid expenses and other assets as unamortized debt issues costs, which now reduces the carrying value of the long-term debt. The debt issue costs will be accreted to the carrying value of long-term debt using the effective interest method. Comparative amounts for prior periods have not been restated.

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

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

Two new Canadian accounting standards have been issued which will require additional disclosure in the Company’s financial statements commencing January 1, 2008 about the Company’s financial instruments as well as its capital and how it is managed.

## **Business Risks**

The activities the Company undertakes involve a number of risks and uncertainties, some of which are: crude oil and natural gas prices, cyclical or seasonal nature of industry, merger and acquisition activity, availability of qualified staff and financing, financial instruments, and litigation and contingencies. Additional risks and uncertainties that the Company may be unaware of, or that were determined to be immaterial, may also become important factors that affect the Company. A discussion on the business risks faced by the Company can be found in HSE’s 2006 Annual Report.

## **Internal Control over Financial Reporting**

### ***Disclosure Controls and Procedures***

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

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

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

The Company has experienced rapid growth in recent years both organically and through acquisitions. As a result, the Company has identified weaknesses in its internal controls over financial reporting. These weaknesses include:

- The Company employs a process for recording field service activity that does not currently include sufficient controls to ensure the timely invoicing of customers. This weakness has a tendency to understate revenue in each reporting period. The Company mitigates this risk by employing manual methods of comparing job dispatch records to amounts invoiced to customers. As well, several levels of infrastructure at the operating level and senior management of the Company continually review revenue figures for reasonability. The Company is actively reviewing all economically feasible alternatives for improving the internal controls in this area.
- The Company has an inability to design or effect change to a design of an internal control over financial reporting for a company it acquires until after the acquisition is completed. This is an inherent weakness that exists due to the Company's strategy of growth through acquisitions. Management is aware of this issue and will ensure that, to the extent appropriate and possible, a review of the design of the internal control over financial reporting for companies it intends to acquire occurs during its due diligence process or within a reasonable period of time after the acquisition.
- Due to a limited number of staff, there is a weakness in the system of internal controls in achieving appropriate segregation of duties. As well, the Company employs a limited number of finance personnel with appropriate technical accounting knowledge that may not result in identifying weaknesses with respect to accounting for complex, non-routine accounting and taxation transactions on a timely basis. Management and Board review, as well as, the use of external consultants are utilized to mitigate the risk of misstatement in financial reporting. The addition of accounting staff is anticipated as the Company grows, and this is expected to remediate these weaknesses.

The Company is committed to continually improving its internal control environment in line with its strategy for growth. Other than the continual impact of the corrective actions discussed above, there were no changes in the first quarter of 2007 in the Company's internal controls over financial reporting that have materially affected, or are reasonably likely to affect the Company's internal controls over financial reporting.

### **Common Shares Outstanding**

At March 31, 2007, there were 37,465,675 common shares of HSE outstanding, compared with 37,462,342 common shares outstanding as at December 31, 2006.

### **Outlook**

The Company continues to execute on its strategy of market diversification for its services. Reduced conventional oil and gas exploration, development and production activity levels in the WCSB, relative to the record activity levels experienced over the past few years, have negatively affected the Oilfield safety

services side of the business, and visibility remains poor for the remainder of 2007. However, the redeployment of capacity and resources into the Industrial component of the business, coupled with growing customer interest in the Company's environment monitoring services have, and are expected to continue to assist in reducing the impact of cyclical and seasonality of safety services provided to the conventional upstream oil and gas sector.

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

### **Forward-Looking Statements**

This report contains forward-looking information and statements within the meaning of applicable securities laws. These forward-looking statements concern, among other things, the Company's prospects, expected revenues, expenses, profits, financial position, strategic direction, and growth initiatives, all of which are subject to risks, uncertainties and assumptions. These forward-looking statements are identified by their use of terms and phrases such as *expect, anticipate, estimate, believe, may, will, intend, plan, continue, project, objective* and other similar terms and phrases. These statements are based on certain assumptions and analyses made by the Company based on its experience and assessment of current conditions, known trends, expected future developments and other factors it believes are appropriate under the circumstances. Such statements are subject to numerous external variables, both known and unknown, such as changes in commodity prices for natural gas and oil, changes in drilling activity, weather conditions, industry-specific and general economic conditions and exchange rate fluctuations. If any of these risks and uncertainties materializes or if assumptions are incorrect, actual results may differ materially from those expressed or implied in the forward-looking statements. The forward-looking statements included in this MD&A are not guarantees of future performance and should not be unduly relied upon. Such information and statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking information and statements.

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

## Non-GAAP Measures

This report makes reference to EBITDA, a measure that is not recognized under generally accepted accounting principles (GAAP). 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, taxes, amortization, foreign exchange gains or losses, gains or losses on the disposal of property and equipment, and the non-cash effect of stock-based compensation expense. Investors should be cautioned that EBITDA should not be construed as an alternative to net earnings determined by GAAP as an indication of the Company's performance. HSE's method of calculating EBITDA may differ from that of other companies and accordingly may not be comparable to measures used by other companies.

### EBITDA calculation (\$ 000's)

For the Quarters Ended March 31	2007	2006
Net earnings	\$904	\$2,353
Add (deduct):		
Amortization	1,888	1,428
Stock based compensation	357	149
Interest	332	290
Foreign exchange (gain) loss	(1)	-
Loss on disposal of property and equipment	707	179
Income taxes	615	1,149
<b>EBITDA</b>	<b>\$4,802</b>	<b>\$5,548</b>

### Quarterly EBITDA calculation (\$ 000's)

	2007		2006		2005			
	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2
Net earnings (loss)	\$904	\$984	\$1,197	\$(1,073)	\$2,353	\$(58)	\$786	\$(1,483)
Add (deduct):								
Amortization	1,888	2,458	1,862	1,870	1,428	1,007	894	928
Stock based compensation	357	285	312	231	149	98	70	94
Interest	332	403	346	359	290	34	16	114
Foreign exchange (gain) loss	(1)	(93)	-	-	-	16	-	-
Loss (gain) on disposal of property and equipment	707	(26)	(19)	272	179	177	186	8
Income taxes	615	330	585	(519)	1,149	226	272	(506)
<b>EBITDA</b>	<b>\$4,802</b>	<b>\$4,341</b>	<b>\$4,283</b>	<b>\$1,140</b>	<b>\$5,548</b>	<b>\$1,500</b>	<b>\$2,224</b>	<b>(\$ 845)</b>

### Additional Information

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