
Management's Report

To the shareholders of
HSE Integrated Ltd.

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

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

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

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

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

David L. Yager

Chief Executive Officer

March 28, 2008

Tony Hidalgo C.A.

Chief Financial Officer



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Chartered Accountants
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AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheets of HSE Integrated Ltd. as at December 31, 2007 and 2006 and the consolidated statements of earnings (loss) and retained earnings (deficit), and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2007 and 2006 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants
Calgary, Canada
March 28, 2008

HSE Integrated Ltd.

Consolidated Balance Sheets

(Stated in thousands)	Year ended December 31 2007	Year ended December 31 2006
ASSETS		
Current		
Cash and cash equivalents	\$ —	\$ 6,551
Short term investments	—	802
Accounts receivable	24,851	22,892
Inventory	216	221
Prepaid expenses and other assets	1,758	1,977
Income taxes recoverable	720	—
	<u>27,545</u>	32,443
Property and equipment (note 6)	41,314	44,745
Goodwill (note 4)	—	23,641
Intangible assets (note 4)	4,513	6,109
	<u>\$ 73,372</u>	\$ 106,938
LIABILITIES		
Current		
Bank indebtedness	\$ 616	\$ —
Accounts payable and accrued liabilities	8,220	9,540
Income taxes payable	—	1,602
Current portion of obligations under capital leases (note 8)	1,328	1,458
Current portion of long-term debt (note 7)	216	4,199
	<u>10,380</u>	16,799
Obligations under capital leases (note 8)	1,453	3,039
Long-term debt (note 7)	14,995	12,834
Future income taxes (note 9)	5,748	7,454
	<u>32,576</u>	40,126
SHAREHOLDERS' EQUITY		
Share capital (note 10)	60,036	61,471
Contributed surplus (note 11)	4,144	1,423
Retained earnings (deficit)	(23,384)	3,918
	<u>40,796</u>	66,812
	<u>\$ 73,372</u>	\$ 106,938

Commitments and contingencies (note 14 and note 17)

On behalf of the Board.

(Signed) "David L. Yager"
Director

(Signed) "James Hill"
Director

See accompanying notes to the consolidated financial statements.

HSE Integrated Ltd.
Consolidated Statements of Earnings (Loss) and Retained Earnings
(Deficit)

(Stated in thousands, except per share amounts)	Year ended December 31 2007	Year ended December 31 2006
REVENUE	\$ 97,342	\$ 100,539
COSTS		
Operating and materials	80,829	75,655
Selling, general and administrative	9,524	9,572
Amortization of property and equipment	6,844	6,429
Amortization of intangible assets	1,246	1,189
Stock-based compensation (note 12)	1,131	977
Interest on long-term debt	1,167	1,317
Other interest and bank charges	87	81
Foreign exchange loss (gain)	36	(93)
Loss on disposal of property and equipment	939	406
	101,803	95,533
EARNINGS (LOSS) BEFORE THE UNDERNOTED ITEMS	(4,461)	5,006
Goodwill impairment (note 4)	(25,003)	-
Intangible asset impairment (note 4)	(502)	-
	(25,505)	-
EARNINGS (LOSS) BEFORE INCOME TAX	(29,966)	5,006
Income taxes (note 9)		
Current (recovery)	(731)	1,811
Future reduction	(1,933)	(266)
	(2,664)	1,545
NET EARNINGS (LOSS)	(27,302)	3,461
RETAINED EARNINGS, beginning of year	3,918	457
RETAINED EARNINGS (deficit), end of year	\$ (23,384)	\$ 3,918
Earnings (loss) per share (note 10)		
Basic and diluted	\$ (0.73)	\$ 0.10

See accompanying notes to the consolidated financial statements.

HSE Integrated Ltd.

Consolidated Statements of Cash Flows

(Stated in thousands)	Year ended December 31 2007	Year ended December 31 2006
Cash provided by (used in)		
Operations		
Net earnings (loss)	\$ (27,302)	\$ 3,461
Charges to income not involving cash		
Goodwill impairment (note 4)	25,003	-
Intangible asset impairment (note 4)	502	-
Amortization	8,090	7,618
Stock-based compensation (note 12)	1,131	977
Future income tax reduction	(1,933)	(266)
Loss on disposal of property and equipment	939	406
Change in non-cash working capital (note 15)	(4,914)	(3,713)
Cash provided by operations	<u>1,516</u>	<u>8,483</u>
Financing		
Bank indebtedness	616	-
Repayment of operating line of credit	-	(1,597)
Repayment of obligations under capital leases	(1,855)	(1,744)
Issuance of long-term debt	-	23,435
Repayment of long-term debt	(1,964)	(8,543)
Issuance of share capital, net of costs	6	13,235
Settlement of liabilities at acquisition (note 5)	-	(3,318)
Cash provided by (used in) financing	<u>(3,197)</u>	<u>21,468</u>
Investing		
Purchase of property and equipment	(4,108)	(6,966)
Acquisitions (note 5)	(1,884)	(17,479)
Proceeds from disposal of property and equipment	1,122	663
Cash used in investing	<u>(4,870)</u>	<u>(23,782)</u>
Net increase (decrease) in cash and cash equivalents	(6,551)	6,169
Cash and cash equivalents, beginning of year	<u>6,551</u>	<u>382</u>
Cash and cash equivalents, end of year	<u>\$ -</u>	<u>\$ 6,551</u>
Supplementary cash flow information		
Interest paid	\$ 1,254	\$ 1,323
Income taxes paid	\$ 1,405	\$ 1,010

See accompanying notes to the consolidated financial statements.

HSE Integrated Ltd.

Notes to the Consolidated Financial Statements

For the years ended December 31, 2007 and 2006
(Stated in thousands of dollars)

NOTE 1 – NATURE OF BUSINESS

Nature of business

HSE Integrated Ltd. (the “Company”) is an oilfield and industrial safety services Company incorporated under the laws of the province of Alberta. The Company provides safety supervision personnel, rental of breathing apparatus and associated equipment for personnel operating in high hazard environments, fire/shower units for workers and equipment protection where flammable or corrosive substances are employed, safety training, on-site medical services and hazardous gas detection and monitoring across Canada.

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES

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

Basis of presentation

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

Consolidation

These consolidated financial statements include the accounts of the Company and its subsidiaries (from the date of acquisition), all of which are wholly owned. All intercompany balances and transactions have been eliminated on consolidation.

Cash and cash equivalents

Cash and cash equivalents include bank balances and highly liquid short term money market instruments with original maturities of three months or less.

Inventory

Inventory is carried at the lower of cost, determined under the first-in, first-out, method, and net realizable value if for sale, or replacement cost if for use.

HSE Integrated Ltd.

Notes to the Consolidated Financial Statements

For the years ended December 31, 2007 and 2006
(Stated in thousands of dollars)

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES (continued)

Property and equipment

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

Amortization is calculated using the straight-line method over the estimated useful life of the assets as follows:

Buildings and improvements	5 – 40 years
Safety equipment	5 – 20 years
Vehicles	7 – 20 years
Vehicles and equipment under capital lease	7 – 10 years
Other property and equipment	2 – 10 years

Intangible assets

Intangible assets, consisting of acquired customer relationships, non-compete agreements, technology and intellectual property, are carried at cost less accumulated amortization. Amortization is calculated on a straight line basis over a period of 1 to 10 years depending upon the assets estimated useful life.

Impairment of long-lived assets

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

Goodwill

Goodwill represents the excess of the purchase price of a business acquisition over the fair value of the acquired net assets. Goodwill is not amortized, but is tested for impairment at least annually. The impairment test is carried out in two steps. In the first step, the carrying amount of the reporting unit is compared with its fair value. When the fair value of the reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not to be impaired, and the second step is not considered necessary. The second step compares the implied fair value of the reporting unit's goodwill with its carrying amount to measure the amount of the impairment loss, if any.

HSE Integrated Ltd.

Notes to the Consolidated Financial Statements

For the years ended December 31, 2007 and 2006

(Stated in thousands of dollars)

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES (continued)

Revenue recognition

The Company recognizes service revenue when the services have been provided to the customer, the product has been delivered, the sales price has been fixed or determinable and collectability is reasonably assured. Generally services are provided over a relatively short time period.

Income taxes

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

Foreign currency translation

All of the Company's operations are considered integrated and are translated into Canadian dollars using the temporal method. Accordingly, all monetary items denominated in foreign currencies are translated to Canadian dollars at exchange rates in effect at the balance sheet date and non-monetary items are translated at rates of exchange in effect when the assets were acquired or obligations incurred. Revenue and expenses are translated at rates in effect at the time of the transaction. Foreign exchange gains and losses are included in earnings.

Stock-based compensation plans

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

The Company applies the intrinsic value method of accounting to all liability-classified stock-based compensation arrangements for both employees and non-employees. Compensation cost of liability-classified awards is measured at intrinsic value each balance sheet date and recognized with a corresponding increase to a liability. Changes in intrinsic value are recognized in the year they occur.

HSE Integrated Ltd.

Notes to the Consolidated Financial Statements

For the years ended December 31, 2007 and 2006
(Stated in thousands of dollars)

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES (continued)

Per share amounts

Basic per share amounts are calculated using the weighted average number of common shares outstanding during the year. Under the treasury stock method, diluted per share amounts are calculated based upon the weighted average number of shares issued and outstanding during the year, adjusted by the total of the additional common shares that would have been issued assuming exercise of all stock options with exercise prices at or below the average market price for the year, offset by the reduction in common shares that would be purchased with the exercise proceeds plus the related unamortized stock based compensation costs. No adjustment is made for options if the result of this calculation is anti-dilutive.

Fair values of financial assets and liabilities

The Company has estimated the fair value of its financial assets and liabilities, which include cash and short-term deposits, accounts receivable, operating lines of credit, accounts payable and accrued liabilities, capital leases and long-term debt. The fair value of all financial assets and liabilities approximates their carrying amounts due to their current maturities or market rates of interest.

Credit risk

Trade accounts receivable are recorded at the invoiced amount and do not bear interest. The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in the Company's existing accounts receivable. The Company determines the allowance based on historical write-off experience, account aging and the oil and gas industry economic cycle. The Company reviews its allowance for doubtful accounts monthly. Past due balances over 90 days and over a specified amount are reviewed individually for collectability. All other balances are reviewed on a pooled basis. Account balances are charged off against the allowance after all appropriate means of collection have been exhausted and the potential for recovery is considered remote. Based on its customer base, the Company does not believe that it has any significant concentrations of credit risk other than its concentration in the oil and gas industry. The Company does not have any off balance sheet credit exposure related to its customers.

Interest rate risk

The Company is exposed to interest rate risk to the extent that it has an operating line of credit and long-term debt that carry a variable interest rate.

Measurement uncertainty

The Company evaluates its estimates including those related to bad debts, inventory obsolescence, property plant and equipment useful lives, goodwill, intangible assets, income taxes, contingencies and litigation, on an ongoing basis. The Company bases its estimates on historical experience and on various other assumptions that are believed at the time to be reasonable under the circumstances. Under different assumptions or conditions, the actual results may differ, possibly materially, from those previously estimated. Many of the conditions affecting these assumptions and estimates are outside of the Company's control.

Comparative figures

Certain prior year figures have been reclassified to conform to the current year's presentation.

HSE Integrated Ltd.

Notes to the Consolidated Financial Statements

For the years ended December 31, 2007 and 2006
(Stated in thousands of dollars)

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES (continued)

Other Recent Pronouncements

Three new Canadian accounting standards have been issued. Two of the standards 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. The third standard relates to inventory and is effective for interim and annual financial statements beginning on or after January 1, 2008. The new standard requires that inventory be carried at the lower of cost and net realizable value, provides more guidance on cost and requires impairment testing as well as expanded disclosures.

NOTE 3 – CHANGE IN ACCOUNTING POLICIES

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, long-term debt and capital lease obligations are classified as “other financial liabilities” which are measured at amortized cost.

At the inception of these new standards we have classified deferred financing costs of \$29 previously 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 year ended December 31, 2007 or that would result in an adjustment to opening balances for accumulated other comprehensive income or loss.

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

HSE Integrated Ltd.

Notes to the Consolidated Financial Statements

For the years ended December 31, 2007 and 2006

(Stated in thousands of dollars)

NOTE 4 – GOODWILL AND INTANGIBLE ASSET IMPAIRMENT

Management has, in accordance with the Company's accounting policy for goodwill, determined a goodwill impairment of \$25,003. The Company has experienced reduced business activity relating primarily to weaker economic fundamentals faced by customers operating in the conventional upstream oil and gas industry.

Goodwill	December 31 2007	December 31 2006
Balance, January 1	\$ 23,641	\$ 7,276
Goodwill acquired	1,362	16,338
Impairment of goodwill	(25,003)	-
Goodwill adjustment of prior year acquisition	-	27
Balance, December 31	\$ -	\$ 23,641

The Company also reviewed for impairment its purchased intangible assets subject to amortization. As a result, Management has, in accordance with the Company's accounting policy for long-lived assets, determined an intangible asset impairment of \$502, on non-compete agreements.

Intangible assets	December 31, 2007				Net Book Value
	Cost	Acquired	Accumulated Amortization	Impairment	
Marketing license	\$ 100		100		\$ -
Customer relationships	5,388	140	1,262	-	4,266
Non-compete agreements	1,786	12	1,132	502	164
Technological knowledge	104	-	21	-	83
	\$ 7,378	152	2,515	502	\$ 4,513

	December 31, 2006			Net Book Value
	Cost		Accumulated Amortization	
Marketing license	\$ 100		100	\$ -
Customer relationships	5,388		629	4,759
Non-compete agreements	1,786		530	1,256
Technological knowledge	104		10	94
	\$ 7,378		1,269	\$ 6,109

HSE Integrated Ltd.

Notes to the Consolidated Financial Statements

For the years ended December 31, 2007 and 2006
(Stated in thousands of dollars)

NOTE 5 – ACQUISITIONS

2007

On July 1, 2007, the Company acquired the shares of Prairie Wide Safety Ltd. (PWS) of Weyburn, Saskatchewan in a business combination to be accounted for using the purchase method. PWS serves the hydrocarbon-producing region of southeast Saskatchewan by providing complete oilfield and industrial safety services to drilling, completion, well servicing and field processing operations. The purchase consideration was determined based upon a predetermined formula, not to exceed \$2.2 million plus the assumption of debt, based upon historical results, with additional consideration contingent upon performance measures achieved in the first year from the acquisition date. The results of operations are included in the accounts from date of acquisition. Estimated consideration and acquisition costs were comprised of 100,000 common shares of the Company valued at \$1.64 per share, \$1,884 cash and the assumption of debt.

The purchase price allocation has not been completed, and certain items such as fair values of assets and liabilities and estimates for contingent consideration as of the acquisition date have not been finalized.

	Prairie Wide Safety Ltd.
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Net assets acquired and liabilities assumed	
Non-cash working capital	46
Property and equipment	1,365
Intangible assets	152
Goodwill	1,362
Bank indebtedness	(119)
Long-term debt	(392)
Capital lease obligations	(139)
Future income taxes	(227)
	<hr/>
	2,048
<hr/>	
Consideration paid	
Cash	1,884
Issuance of Common shares	164
	<hr/>
	2,048
<hr/>	

2006

a) On January 10, 2006, the Company completed the acquisition of the shares of two related entities, Key Safety Services Inc. (“KSS”) and Key Monitoring Solutions Corp. (“KMS”), in a business combination accounted for as a purchase. KSS performs oilfield safety services in Western Canada. KMS provides air quality monitoring services for hydrocarbon drilling and industrial projects. The results of operations are included in the accounts from date of acquisition. Consideration and acquisition costs were comprised of 2,400,000 common shares of the Company valued at \$2.80 per share, \$11,646 cash, accrued consideration and the assumption of debt.

As of December 31, 2007, \$960 of accrued consideration has been paid in cash. The remaining \$1,040 forms part of long-term debt on the balance sheet.

b) On April 5, 2006, the Company completed the acquisition of the shares of Sentry Fire Equipment Ltd. (“Sentry”) in a business combination accounted for as a purchase. Sentry performs fire suppression services for the industrial and commercial markets in southern Ontario. The results of operations are included in the accounts from date of acquisition. Consideration and acquisition costs were \$3,688 cash.

HSE Integrated Ltd.

Notes to the Consolidated Financial Statements

For the years ended December 31, 2007 and 2006
(Stated in thousands of dollars)

NOTE 5 – ACQUISITIONS (Continued)

c) On April 21, 2006, the Company completed the acquisition of the shares of Front Line Safety Ltd. (“Frontline”) in a business combination accounted for as a purchase. Frontline performs fire and industrial safety services for the petrochemical and mining industries in Atlantic Canada and offshore Canada. The results of operations are included in the accounts from date of acquisition. Consideration and acquisition costs were comprised of 666,667 common shares of the company at \$3.69 per share, \$1,080 of cash and the assumption of debt.

d) On July 1, 2006, the Company completed the acquisition of the shares of Bear’s Safety and Rescue Services Ltd. (“Bears”) in a business combination accounted for as a purchase. Bears provides industrial safety services to upstream oil and gas processing facilities, refineries, and petrochemical plants in northeast Alberta and has provided safety supervision to drilling operations in northern Canada and internationally. The results of operations are included in the accounts from date of acquisition. Consideration and acquisition costs were comprised of 100,000 common shares of the Company at \$3.39 per share and \$789 of cash.

The following table summarizes the estimated fair value of the assets acquired during 2006.

	KSS & KMS	Sentry	Front Line	Bears	Total
Net assets acquired and liabilities assumed					
Non-cash working capital	\$ 284	\$ 377	\$ 108	\$ (52)	\$ 717
Property and equipment	12,984	765	1,572	267	15,588
Goodwill	11,973	1,931	1,745	689	16,338
Intangible assets	4,482	811	1,132	311	6,736
Long-term debt	(263)	(17)	(318)	(148)	(746)
Settlement of liabilities on acquisition	(3,068)	–	(250)	–	(3,318)
Capital lease obligations	(1,528)	–	–	(14)	(1,542)
Future income taxes	(3,578)	(375)	(725)	(124)	(4,802)
	<u>\$ 21,286</u>	<u>\$ 3,492</u>	<u>\$ 3,264</u>	<u>\$ 929</u>	<u>\$ 28,971</u>
Consideration paid					
Cash	\$ 11,646	\$ 3,688	\$ 1,080	\$ 789	\$ 17,203
Bank indebtedness (cash) acquired	920	(196)	(276)	(199)	249
Accrued consideration	2,000	–	–	–	2,000
Common shares	6,720	–	2,460	339	9,519
	<u>\$ 21,286</u>	<u>\$ 3,492</u>	<u>\$ 3,264</u>	<u>\$ 929</u>	<u>\$ 28,971</u>

HSE Integrated Ltd.

Notes to the Consolidated Financial Statements

For the years ended December 31, 2007 and 2006
(Stated in thousands of dollars)

NOTE 6 – PROPERTY AND EQUIPMENT

	December 31, 2007		
	Cost	Accumulated Amortization	Net Book Value
Land	\$ 356	\$ -	\$ 356
Buildings and improvements	1,619	369	1,250
Safety equipment	39,623	16,878	22,745
Vehicles	15,171	5,664	9,507
Vehicles and equipment under capital lease	5,639	1,863	3,776
Furniture and equipment	1,225	434	791
Other property and equipment	6,055	3,166	2,889
Total property and equipment	\$ 69,688	\$ 28,374	\$ 41,314

	December 31, 2006		
	Cost	Accumulated Amortization	Net Book Value
Land	\$ 356	\$ -	\$ 356
Buildings and improvements	1,410	184	1,226
Safety equipment	38,049	13,813	24,236
Vehicles	15,681	5,734	9,947
Vehicles and equipment under capital lease	6,554	1,440	5,114
Other property and equipment	6,589	2,723	3,866
Total property and equipment	\$ 68,639	\$ 23,894	\$ 44,745

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

NOTE 7 – OPERATING FACILITIES and LONG-TERM DEBT

During the second quarter, the Company entered an agreement with its current lender for credit facilities. The credit facilities include a \$25 million three year interest-only revolving facility and a \$7.5 million operating facility.

The credit facilities bear interest at the bank's prime rate (or U.S. base rate) plus up to 2.25%, or at bankers' acceptance rates with a variable stamping fee of 1.50% to 3.75%. An additional standby fee ranging between 0.20% to 0.60% per annum is also required on the unused portion of the credit facilities.

The revolving facility matures on June 25, 2010, with an ability to extend the term at the lender's option. The operating facility is renewable annually and is margined to accounts receivable. The operating facility is subject to covenants that are typical for this type of facility. The credit facilities are collateralized under a general security agreement.

Deferred financing costs associated with the new financing facilities have been shown as a reduction in the carrying value of long term debt and will be expensed over the term of the debt using the effective interest rate method.

HSE Integrated Ltd.

Notes to the Consolidated Financial Statements

For the years ended December 31, 2007 and 2006
(Stated in thousands of dollars)

NOTE 7 – OPERATING FACILITIES and LONG-TERM DEBT (continued)

During 2006 and the first quarter 2007, the Company had the following bank credit facilities:

- a) a \$20,000 non-revolving installment credit facility which amortized over five years from date of draw, bearing interest at the bank's prime rate, and was subject to an annual cash flow sweep of 25% of earnings before interest, amortization and taxes less interest paid and repayments of revolving and non-revolving principal.
- b) \$10,000 (seasonally reduced in June to November to \$8,000) operating facility bearing interest at the bank's prime rate. This facility was subject to margin requirements based on eligible accounts receivable.
- c) A \$5,000 revolving installment credit facility which amortized over five years from date of draw and bears interest at the bank's prime rate.

The credit facilities were secured by general security agreements and required maintenance of certain financial ratios and other covenants.

	December 31 2007	December 31 2006
Equipment financing contracts bearing interest at rates averaging 3.13% (2006 – 1.44%), payable in blended monthly payments of \$19 (2006 - \$27) secured by specific equipment	\$ 391	\$ 438
Non-revolving credit facility loan as noted above, payable in quarterly principal payments of \$988 (2006 – quarterly principal payments of \$988)	–	15,805
Three year interest only revolving credit facility	<u>13,829</u>	–
	<u>14,220</u>	16,243
Accrued consideration on share purchase acquisition	<u>1,040</u>	790
	<u>15,260</u>	17,033
Less: current portion	<u>(216)</u>	(4,199)
	<u>15,044</u>	12,834
Less: unamortized debt issue costs	<u>(49)</u>	–
	<u>\$ 14,995</u>	<u>\$ 12,834</u>

Outstanding principal repayments are due as follows:

2007	\$ -	4,199
2008	216	4,898
2009	1,153	3,985
2010	13,871	3,951
2011	20	–
2012	–	–
	<u>15,260</u>	17,033
Less: current portion	<u>(216)</u>	(4,199)
	<u>\$ 15,044</u>	<u>12,834</u>

HSE Integrated Ltd.

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NOTE 8 – OBLIGATIONS UNDER CAPITAL LEASE

The amounts due under capital lease arrangements are repayable in blended monthly payments of \$125 (2006 - \$145) and bear interest at rates averaging 5.50% (2006 – 5.37%) per annum. On certain leases, the Company has options to acquire the leased assets at various times throughout term to 2012.

	December 31 2007	December 31 2006
2007	\$ -	\$ 1,710
2008	1,488	1,690
2009	1,145	1,238
2010	303	291
2011	111	94
2012	6	-
	3,053	5,023
Less: interest	(272)	(526)
	2,781	4,497
Less: current portion	(1,328)	(1,458)
	\$ 1,453	\$ 3,039

NOTE 9 – INCOME TAXES

	December 31 2007	December 31 2006
a) Provision for income taxes		
Earnings (loss) before income taxes	\$ (29,966)	\$ 5,006
Expected income tax (recovery) at 32.5% (2006 - 32.5%)	\$ (9,730)	\$ 1,625
Non-deductible/non-taxable amounts	8,562	334
Income tax rate reductions	(1,125)	(261)
Other	(371)	(153)
Income tax expense (recovery)	\$ (2,664)	\$ 1,545
	2007	2006
b) Future income tax assets and liabilities are as follows:		
Property and equipment	\$ 5,084	\$ 6,252
Intangible assets	970	1,763
Share issue and financing costs	(306)	(561)
Future income tax liability	\$ 5,748	\$ 7,454

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NOTE 10 – SHARE CAPITAL

a) **Authorized:**

Unlimited number of common shares without par value.

Unlimited number of preferred shares, issuable in series.

b) **Issued and outstanding:**

Common shares	December 31 2007		December 31 2006	
	Shares (in thousands)	Amount	Shares (in thousands)	Amount
Balance, January 1	37,462	\$ 59,862	29,915	\$ 36,559
Changes (net of share issue costs):				
Private placement	-	-	3,850	12,515
Issued on acquisition of shares	-	-	3,167	9,519
Issued on acquisition of PWS (note 5)	100	164	-	-
Issued on conversion of agent's warrants	-	-	445	1,070
Issued on conversion of warrants	-	-	38	110
Issued on exercise of options	6	10	47	89
Balance, December 31	37,568	\$ 60,036	37,462	\$ 59,862

c) **Warrants:**

Warrants	December 31 2007		December 31 2006	
	Warrants (in thousands)	Amount	Warrants (in thousands)	Amount
Balance, January 1	3,144	\$ 1,609	3,182	\$ 1,628
Converted to common shares	-	-	(38)	(19)
Expired	(3,144)	(1,609)	-	-
Balance, December 31	-	\$ -	3,144	\$ 1,609

Agent's Warrants	December 31 2007		December 31 2006	
	Warrants (in thousands)	Amount	Warrants (in thousands)	Amount
Balance, January 1	-	\$ -	445	\$ 224
Converted to common shares	-	-	(445)	(224)
Balance, December 31	-	\$ -	-	\$ -

HSE Integrated Ltd.

Notes to the Consolidated Financial Statements

For the years ended December 31, 2007 and 2006
(Stated in thousands of dollars)

NOTE 10 – SHARE CAPITAL (continued)

d) Per share amounts:

Basic per common share amounts are computed by dividing earnings by the weighted average number of common shares outstanding during the year. Diluted per common share amounts are computed by dividing earnings by the diluted weighted average number of common shares outstanding during the year.

	December 31 2007	December 31 2006
Basic weighted average number of common shares outstanding during the year	<u>37,516</u>	<u>35,807</u>
Diluted weighted average number of common shares outstanding during the year	<u>37,516</u>	<u>36,053</u>

NOTE 11 – CONTRIBUTED SURPLUS

	December 31 2007	December 31 2006
Balance, January 1	\$ 1,423	\$ 462
Stock compensation expense – employee options	1,116	977
Exercise of stock options	(4)	(16)
Warrants – expired	1,609	-
Balance, December 31	\$ <u>4,144</u>	\$ <u>1,423</u>

NOTE 12 - STOCK-BASED COMPENSATION PLANS

Incentive stock option plan

The weighted average fair value of options granted for the years ended December 31, 2007 and 2006 are \$2.14 and \$2.24 per option, respectively. The fair value of each option granted was estimated on the date of grant using the Modified Black-Scholes option-pricing model with the following assumptions:

	December 31 2007	December 31 2006
Vesting period (years)	<u>3</u>	<u>3</u>
Risk-free interest rate	3.94 – 4.11%	3.89 – 4.08%
Expected life (years)	5	5
Price volatility	<u>135.24%</u>	<u>55.46 – 96.00%</u>

HSE Integrated Ltd.

Notes to the Consolidated Financial Statements

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NOTE 12 - STOCK-BASED COMPENSATION PLANS (continued)

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

Information about outstanding stock options is as follows:

	December 31 2007		December 31 2006	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
Outstanding, beginning of period	1,924,501	\$ 2.24	1,022,333	\$ 1.74
Granted	667,500	1.71	1,053,000	2.83
Exercised	(5,333)	1.06	(47,332)	1.36
Forfeited	(206,670)	2.12	(103,500)	2.69
Outstanding, end of period	2,379,998	\$ 2.15	1,924,501	\$ 2.24
Exercisable at end of period	996,143	\$ 2.06	445,442	\$ 1.69

The following table summarizes information about stock options outstanding at December 31, 2007:

Options outstanding	Exercise prices \$	Weighted average remaining life	Number exercisable
28,000	0.50-1.05	1.15	28,000
276,999	1.06-1.60	2.09	214,322
1,238,333	1.61-2.15	3.46	397,167
330,000	2.16-2.70	3.04	186,663
506,666	2.71-4.50	3.26	169,991
2,379,998	2.15	3.17	996,143

Deferred share unit plan

Effective November 13, 2006, the Company adopted a deferred share unit ("DSU") plan for non-executive directors. Under the terms of the plan, DSUs awarded will vest immediately and will be settled with cash in the amount equal to the closing price of the Company's common shares on the redemption date specified by the Director upon tendering their resignation from the Board. The redemption date must be after the date on which the notice of redemption is filed with the Company and before December 15 of the first calendar year commencing after the Director's termination date. On January 16, 2007, 15,000 deferred share units were granted to non-executive directors. The units were revalued at December 31, 2007 and the expense for 2007 was \$15 (2006 - \$nil).

HSE Integrated Ltd.

Notes to the Consolidated Financial Statements

For the years ended December 31, 2007 and 2006
(Stated in thousands of dollars)

NOTE 13 – RELATED PARTY TRANSACTIONS

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

- Included in accounts receivable is a promissory note of \$49 (2006 – \$49) which is due from an officer and Director of the Company. This note is payable on demand. In 2007, the Company paid rent and property taxes to a corporation related to this same Officer and Director of the Company in the amount of \$284 (2006 – \$285). The rent is for a regional office.
 - In 2007, the Company also paid rent and property taxes of \$64 (2006 – \$41), and \$371 (2006 – \$342) for regional offices to two different corporations. In 2007, the Company also paid rent of \$21 (2006 - \$nil) for a regional office to a corporation and received \$3 (2006 - \$nil) on the sale of miscellaneous small tools from the same corporation. Different members of senior management of the Company control each corporation.
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NOTE 14 - COMMITMENTS

The Company leases certain shop and office space and vehicles and equipment under operating leases for periods ending between 2008 and 2012. Future minimum lease payments under these leases in each of the next five years are as follows:

	Rental facilities	Operating leases	Total
2008	\$ 2,514	\$ 1,717	\$ 4,231
2009	2,093	1,389	3,482
2010	1,641	1,300	2,941
2011	833	692	1,525
2012	417	18	435

NOTE 15 - SUPPLEMENTARY CASH FLOW INFORMATION

	December 31 2007	December 31 2006
Increase (decrease) in non-cash working capital from operations		
Short term investments	\$ 802	\$ -
Accounts receivable	(1,730)	3,431
Inventory	40	358
Prepaid expenses and other assets	229	267
Accounts payable and accrued liabilities	(1,918)	(8,498)
Income tax payable	(2,337)	729
Net decrease in non-cash working capital	\$ (4,914)	\$ (3,713)

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Notes to the Consolidated Financial Statements

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NOTE 16 – SEGMENT INFORMATION

Management has determined that the Company operates in a single industry segment, which involves the provision of industrial health, safety and environmental monitoring services. Substantially all of the Company's operations, assets, revenues, and employees are in Canada. For the periods ended December 31, 2007 and 2006, the Company had no customer representing more than 10% of revenue.

Revenue by customer group is as follows:

	December 31		December 31
	2007		2006
Oilfield	\$ 43,473	\$	66,794
Industrial	41,618		23,459
Environment	12,251		10,286
Total Revenue	<u>\$ 97,342</u>	\$	<u>100,539</u>

As a % of Revenue:

Oilfield	44.7%		66.5%
Industrial	42.7%		23.3%
Environment	12.6%		10.2%
Total Revenue	<u>100.0%</u>		<u>100.0%</u>

NOTE 17 – CONTINGENCIES

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

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