



## 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

Lori L. McLeod-Hill C.A.

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Chief Executive Officer

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Chief Financial Officer

March 26, 2009



**KPMG LLP**  
**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, 2008 and 2007 and the consolidated statements of earnings (loss), other comprehensive income (loss), deficit and accumulated other comprehensive income, 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, 2008 and 2007 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 26, 2009

# HSE Integrated Ltd.

## Consolidated Balance Sheets

(Stated in thousands of dollars)	December 31 2008	December 31 2007
<b>ASSETS</b>		
Current		
Cash and cash equivalents	\$ 1,114	\$ –
Accounts receivable	25,740	24,851
Inventory	222	216
Prepaid expenses and other assets	1,897	1,758
Income taxes recoverable	–	720
	<u>28,973</u>	<u>27,545</u>
Property and equipment (note 8)	36,173	41,314
Intangible assets (note 6)	<u>3,788</u>	<u>4,513</u>
	<u>\$ 68,934</u>	<u>\$ 73,372</u>
<b>LIABILITIES</b>		
Current		
Accounts payable and accrued liabilities	\$ 8,096	\$ 8,220
Bank indebtedness	–	616
Income taxes payable	363	–
Current portion of obligation under capital leases (note 10)	922	1,328
Current portion of long-term debt (note 9)	98	216
Current portion of deferred gain (note 16)	137	–
	<u>9,616</u>	<u>10,380</u>
Deferred gain (note 16)	455	–
Obligations under capital leases (note 10)	370	1,453
Long-term debt (note 9)	11,628	14,995
Future income taxes (note 11)	5,278	5,748
	<u>27,347</u>	<u>32,576</u>
<b>SHAREHOLDERS' EQUITY</b>		
Share capital (note 12)	60,040	60,036
Contributed surplus (note 13)	4,559	4,144
Deficit	(23,136)	(23,384)
Accumulated other comprehensive income	124	–
	<u>41,587</u>	<u>40,796</u>
	<u>\$ 68,934</u>	<u>\$ 73,372</u>

Commitments and contingencies (note 16 and note 19)

On behalf of the board.

(Signed) "David L. Yager"  
Director

(Signed) "James M. Hill"  
Director

See accompanying notes to the consolidated financial statements.

# HSE Integrated Ltd.

## Consolidated Statements of Earnings (Loss)

(Stated in thousands of dollars, except per share amounts)	Year Ended December 31 2008	Year Ended December 31 2007
<b>REVENUE</b>	\$ 113,763	\$ 97,342
<b>COSTS</b>		
Operating and materials	92,673	80,829
Selling, general and administrative	10,699	9,524
Amortization of property and equipment	6,490	6,844
Amortization of intangible assets	775	1,246
Stock based compensation (note 14)	408	1,131
Interest on long-term debt	988	1,167
Other interest and bank charges	128	87
Foreign exchange loss (gain)	(31)	36
Loss on disposal of property and equipment	648	939
	<u>112,778</u>	<u>101,803</u>
<b>EARNINGS (LOSS) BEFORE THE UNDERNOTED ITEMS</b>	<u>985</u>	<u>(4,461)</u>
Goodwill impairment (note 7)	(100)	(25,003)
Intangible asset impairment	-	(502)
	<u>(100)</u>	<u>(25,505)</u>
<b>EARNINGS (LOSS) BEFORE INCOME TAX</b>	<u>885</u>	<u>(29,966)</u>
Income taxes (note 11)		
Current provision (recovery)	1,107	(731)
Future reduction	(470)	(1,933)
	<u>637</u>	<u>(2,664)</u>
<b>NET EARNINGS (LOSS)</b>	<u>\$ 248</u>	<u>\$ (27,302)</u>
Earnings (loss) per share		
Basic and diluted	<u>\$ 0.01</u>	<u>\$ (0.73)</u>
Weighted average shares outstanding		
Basic	37,572	37,516
Diluted	<u>37,572</u>	<u>37,516</u>

See accompanying notes to the consolidated financial statements.

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**HSE Integrated Ltd.**  
**Consolidated Statements of Other Comprehensive Income (Loss)**

(Stated in thousands of dollars)	Year Ended December 31 2008	Year Ended December 31 2007
<b>Net Earnings (Loss)</b>	\$ 248	\$ (27,302)
Other comprehensive income		
Unrealized gains on translating financial statements of self-sustaining foreign operations	124	—
<b>Other comprehensive income (loss)</b>	<u>\$ 372</u>	<u>\$ (27,302)</u>

**Consolidated Statements of Deficit and Accumulated Other Comprehensive Income**

(Stated in thousands of dollars)	Year Ended December 31 2008	Year Ended December 31 2007
<b>Retained Earnings (Deficit), beginning of year</b>	\$ (23,384)	\$ 3,918
Net Income (Loss)	248	(27,302)
<b>Deficit, end of year</b>	<u>\$ (23,136)</u>	<u>\$ (23,384)</u>
<b>Accumulated other comprehensive income, beginning of year</b>	\$ —	\$ —
Unrealized gains on translating financial statements of self-sustaining operations	124	—
<b>Accumulated other comprehensive income, end of year</b>	<u>\$ 124</u>	<u>\$ —</u>

See accompanying notes to the consolidated financial statements.

# HSE Integrated Ltd.

## Consolidated Statements of Cash Flows

(Stated in thousands of dollars)	Year Ended December 31 2008	Year Ended December 31 2007
<b>Cash provided by (used in)</b>		
<b>Operations</b>		
Net earnings (loss)	\$ 248	\$ (27,302)
Charges to income not involving cash		
Goodwill impairment	100	25,003
Intangible asset impairment	—	502
Amortization	7,265	8,090
Stock-based compensation (note 14)	408	1,131
Future income tax reduction	(470)	(1,933)
Loss on disposal of property and equipment	648	939
Change in non-cash working capital (note 17)	(117)	(4,914)
Cash provided by operations	<u>8,082</u>	<u>1,516</u>
<b>Financing</b>		
Issue (repayment) of bank indebtedness	(616)	616
Repayment of obligations under capital leases	(1,490)	(1,855)
Repayment of long-term debt	(3,485)	(1,964)
Issuance of share capital, net of costs	4	6
Cash used in financing activities	<u>(5,587)</u>	<u>(3,197)</u>
<b>Investing</b>		
Purchase of property and equipment	(3,317)	(4,108)
Acquisition (note 7)	(100)	(1,884)
Purchase of intangibles	(50)	—
Proceeds from disposal of property and equipment	2,086	1,122
Cash used in investing activities	<u>(1,381)</u>	<u>(4,870)</u>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>1,114</b>	<b>(6,551)</b>
Cash and cash equivalents, beginning of year	<u>—</u>	<u>6,551</u>
Cash and cash equivalents, end of year	<u>\$ 1,114</u>	<u>\$ —</u>
<b>Supplementary cash flow information</b>		
Interest paid	\$ 1,116	\$ 1,254
Income taxes paid	\$ 24	\$ 1,405

See accompanying notes to the consolidated financial statements.

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# HSE Integrated Ltd.

## Notes to the Consolidated Financial Statements

For the years ended December 31, 2008 and 2007  
(Stated in thousands of dollars)

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### NOTE 1 – NATURE OF BUSINESS

#### Nature of business

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

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### NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES

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

#### Basis of presentation

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

#### Measurement Uncertainty

The Company evaluates its estimates including:

- the allowance for doubtful accounts;
- the allowance for inventory obsolescence;
- the estimated useful lives of assets;
- the recoverability of property and equipment;
- the recoverability of intangible assets;
- contingencies and litigation;
- the amount and composition of income tax assets and income tax liabilities, including the amount of unrecognized tax benefits

on an ongoing basis. The 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.

#### Consolidation

These consolidated financial statements include the accounts of the Company and its subsidiaries (from the date of acquisition or formation). With the exception of the Company’s US subsidiary Boots & Coots HSE Services LLC (note 18), all subsidiaries are wholly owned. All intercompany balances and transactions have been eliminated on consolidation.

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# HSE Integrated Ltd.

## Notes to the Consolidated Financial Statements

For the years ended December 31, 2008 and 2007  
(Stated in thousands of dollars)

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### NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES (continued)

#### Cash and cash equivalents

Cash and cash equivalents include bank balances and highly liquid short term money market instruments with original maturities of three months or less. Cash and cash equivalents are classified as a liability on the balance sheet, described as “Bank indebtedness”, when the amount of the cheques written but not cleared by the bank exceeds the amount of the cash and temporary investments. Amounts drawn on the Company’s operating facility are disclosed as a separate line on the financial statements (note 9).

#### Inventory

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

#### Property and equipment

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

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

Buildings and improvements	5 – 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 asset’s 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 an asset’s carrying value is initially tested by comparing the carrying amount of the asset group to estimated undiscounted future cash flows expected to be generated by the group. If the carrying amount of an asset exceeds its estimated future cash flows, the asset is considered to be impaired, and an impairment charge is recognized for the amount by which the carrying amount of the asset exceeds 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.

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# HSE Integrated Ltd.

## Notes to the Consolidated Financial Statements

For the years ended December 31, 2008 and 2007  
(Stated in thousands of dollars)

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### NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES (continued)

#### Revenue recognition

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

#### Income taxes

The 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 foreign operations are considered to be self sustaining. Accordingly, the Company translates assets and liabilities at year-end exchange rates and income and expense accounts at average exchange rates for the year. Adjustments resulting from these translations are reflected in the consolidated statements of other comprehensive income as unrealized foreign exchange gains or losses.

#### 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-employee's performance is complete, and recognized over the vesting period with a corresponding increase to contributed surplus. Upon the exercise of the award, consideration received, together with amounts previously recognized in contributed surplus, is recorded as an increase to share capital.

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

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# HSE Integrated Ltd.

## Notes to the Consolidated Financial Statements

For the years ended December 31, 2008 and 2007  
(Stated in thousands of dollars)

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### 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.

#### Financial instruments – recognition and measurement

The Company has estimated the fair value of its financial assets and liabilities, which include cash and cash equivalents, accounts receivable, bank indebtedness, accounts payable and accrued liabilities, income taxes payable, obligations under 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.

Equity instruments that do not have a quoted market price in an active market are measured at cost. All other financial instruments are initially recorded at carrying amount, which approximates fair value, then classified into one of five categories, based on the characteristics and purpose of the instrument: (i) held-for-trading, (ii) held-to-maturity, (iii) loans and receivables, (iv) available-for-sale, and (v) other financial liabilities. Subsequent to initial recognition, each category of financial instrument is measured based on its classification. Held-for-trading financial instruments are measured at fair value with changes in fair value recognized in earnings. Available-for-sale financial instruments are measured at fair value with changes in fair value recognized in comprehensive income until the investment is derecognized or impaired at which time the amounts would be recorded in net earnings. Held to maturity, loans and receivables, and other financial liabilities are measured at amortized cost using the effective interest rate method. Except in very limited circumstances, the classification of financial instruments is not subsequently changed.

The Company has designated accounts receivable as “loans and receivables”. Short-term investments have been designated as “held-for-trading”. Accounts payable and accrued liabilities, long-term debt and capital lease obligations are classified as “other financial liabilities”. Unamortized debt issue costs are offset against the long-term debt to which they relate. Debt issue costs are accreted to the carrying value of the long-term debt using the effective interest rate method.

#### Comparative figures

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

### NOTE 3 – CHANGE IN ACCOUNTING POLICIES AND RECENT PRONOUNCEMENTS

Effective January 1, 2008 the Company prospectively adopted new accounting standards regarding disclosure and presentation of financial instruments. These recommendations provide for incremental disclosure, particularly with respect to risks associated with both recognized and unrecognized financial instruments to which the Company is exposed during the year and at the balance sheet date, and how the Company manages those risks. These disclosures are contained in Note 4.

As well, the Company has adopted effective January 1, 2008 new accounting standards regarding the Company’s objectives, policies and processes for managing its capital structure. These are further described in Note 5.

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# HSE Integrated Ltd.

## Notes to the Consolidated Financial Statements

For the years ended December 31, 2008 and 2007  
(Stated in thousands of dollars)

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### NOTE 3 – CHANGE IN ACCOUNTING POLICIES AND RECENT PRONOUNCEMENTS (continued)

Effective January 1, 2008, the Company adopted new recommendations issued by the CICA regarding the recognition, measurement and disclosure of inventories. These changes require the reversal of any previously recorded write-downs to net realizable value when there is a subsequent increase in the value of inventories and require that, in certain circumstances, spare parts and servicing equipment be accounted for as property and equipment rather than as inventory.

#### Other Recent Pronouncements

International Financial Reporting Standards (“IFRS”) will be adopted as Canadian GAAP for publicly accountable entities in Canada for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The Company has started an IFRS conversion project and is assessing the impact of the change to IFRS on the results of our operations, financial position and disclosures.

In February 2008, new accounting standards were issued with regard to goodwill and intangible assets to clarify the criteria for recognition of assets, intangible assets and internally developed intangible assets. These changes are effective for fiscal years beginning on or after October 1, 2008. The Company does not expect these recommendations to have a material effect on our financial position or the results of our operations.

In January 2009, the CICA issued new recommendations regarding business combinations, consolidated financial statements and non-controlling interests. These recommendations provide standards equivalent to the current equivalent IFRS requirements. While the standards are effective January 1, 2011 in conjunction with the changeover to IFRS, early adoption of these standards is permitted provided that all three standards are adopted simultaneously. The Company is currently reviewing the changes required by the standards and assessing when to adopt the new standards.

### NOTE 4 – FINANCIAL RISK MANAGEMENT

#### Overview

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

- credit risk
- liquidity risk
- market risk

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

#### Credit risk

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

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# HSE Integrated Ltd.

## Notes to the Consolidated Financial Statements

For the years ended December 31, 2008 and 2007  
(Stated in thousands of dollars)

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### NOTE 4 – FINANCIAL RISK MANAGEMENT (continued)

The Company's accounts receivable are due from customers in a variety of industries including a significant proportion with customers operating in the energy and manufacturing industries. The ability of customers within the energy industry to pay us is partially affected by fluctuations in the price they receive for various hydrocarbon products. Customers in both these industries may also face particular challenges in their ability to secure debt and equity financing. The maximum credit exposure associated with trade accounts receivable is the carrying value.

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

Trade accounts receivable are recorded at the invoiced amount and do not bear interest. The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in the Company's existing accounts receivable. The Company determines the allowance by reviewing individual accounts past due for collectability, historical write-off experience, and overall account aging. The Company reviews its allowance for doubtful accounts on an ongoing basis, but at least monthly.

	<u>December 31, 2008</u>	December 31, 2007
Trade accounts receivable	\$ 27,145	26,006
Allowance for doubtful accounts	(1,405)	(1,155)
Total trade accounts receivable	<u>\$ 25,740</u>	<u>24,851</u>

The aging of trade receivables is as follows:

		<u>December 31, 2008</u>		December 31, 2007	
		Gross	Allowance	Gross	Allowance
Current (0 – 30 days from invoice date)	\$	13,465	-	15,886	-
Past due 1-30 days		6,633	-	5,772	-
Past due 31-90 days		5,949	481	3,473	280
More than 90 days		1,098	924	875	875
Total	\$	<u>27,145</u>	<u>1,405</u>	<u>26,006</u>	<u>1,155</u>

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

		<u>2008</u>	2007
Balance, January 1	\$	1,155	427
Bad debt provision		252	982
Write-offs net of recoveries		(2)	(254)
Balance, December 31	\$	<u>1,405</u>	<u>1,155</u>

### Liquidity risk

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

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# HSE Integrated Ltd.

## Notes to the Consolidated Financial Statements

For the years ended December 31, 2008 and 2007  
(Stated in thousands of dollars)

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### NOTE 4 – FINANCIAL RISK MANAGEMENT (continued)

The Company's contractual financial liabilities include interest payments, trade and other payables, bank indebtedness, secured equipment loans, an operating line of credit margined by accounts receivable, a revolving credit facility and capital leases for equipment (notes 9 and 10).

The Company's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and distressed conditions, without unacceptable losses or risking damage to the Company's reputation. The Company generally relies on operating cash flow to provide liquidity to meet its financial obligations. As well, the Company has access to operating lines of credit and a revolving credit facility (see note 9). At December 31, 2008 the Company had cash on hand of \$1,114 and undrawn operating lines of credit totalling \$7,500. In addition, the Company has access to \$14,171 of the unused revolving credit facility with its current lender available to fund capital expenditures and acquisitions. The operating facility is renewable annually, while the revolving facility matures on June 25, 2010.

#### Market risk

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

HSE is exposed to currency risk on US dollar denominated financial assets and liabilities. The Company adjusts the reported amounts of foreign currency denominated financial assets and liabilities to their Canadian dollar equivalent at each balance sheet date. For amounts held directly by the Company, any related foreign exchange gains and/or losses are recognized in the consolidated statement of earnings. For amounts held by the Company's self-sustaining foreign operations, the amount is included in other comprehensive income. At December 31, 2008 the extent of this exposure was not material.

HSE is exposed to interest rate risk on its prime based operating facility and revolving credit facility. Based on amounts outstanding at December 31, 2008, a 1% increase in the average prime interest rate for the year would cost the Company \$108 in additional interest expense.

### NOTE 5 – CAPITAL MANAGEMENT

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

To ensure that the Company maintains an appropriate balance between long-term debt and shareholders' equity, we monitor the ratio of long-term debt to total capital. As at December 31, 2008 and 2007, these ratios were:

	<u>December 31, 2008</u>	<u>December 31, 2007</u>
Long-term debt	\$ 11,726	15,211
Shareholders' equity	41,587	40,796
Total capitalization	<u>\$ 53,313</u>	<u>56,007</u>
Long-term debt to total capitalization	<u>0.22</u>	<u>0.27</u>

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# HSE Integrated Ltd.

## Notes to the Consolidated Financial Statements

For the years ended December 31, 2008 and 2007  
(Stated in thousands of dollars)

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### NOTE 5 – CAPITAL MANAGEMENT (continued)

The Company is subject to various financial covenants (note 9) associated with its existing debt facilities. These covenants are monitored on a regular basis and controls are in place to maintain ongoing compliance with these covenants. The Company complied with all externally imposed debt covenants at December 31, 2008.

### NOTE 6 – INTANGIBLE ASSETS

December 31, 2008					
	Cost	Acquired	Accumulated Amortization	Impairment	Net Book Value
Marketing license	\$ 100	–	100	–	\$ –
Customer relationships	5,529	50	1,864	–	3,715
Non-compete agreements	1,798	–	1,798	–	–
Technological knowledge	104	–	31	–	73
	<u>\$ 7,531</u>	<u>50</u>	<u>3,793</u>	<u>–</u>	<u>\$ 3,788</u>

  

December 31, 2007					
	Cost	Acquired	Accumulated Amortization	Impairment	Net Book Value
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
	<u>\$ 7,378</u>	<u>152</u>	<u>2,515</u>	<u>502</u>	<u>\$ 4,513</u>

In 2007, the Company reviewed for impairment its purchased intangible assets subject to amortization and determined an intangible asset impairment of \$502 on non-competition agreements. During the current year the Company reviewed its purchased intangibles for impairment and concluded that impairment did not exist at year end and therefore no write-down was required.

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### NOTE 7 – ACQUISITION

On July 1, 2007, the Company acquired the shares of Prairie Wide Safety Ltd. (“PWS”) of Weyburn, Saskatchewan in a business combination accounted for using the purchase method. 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. Consideration and acquisition costs were originally comprised of 100,000 common shares of the Company valued at \$1.64 per share, \$1,884 cash and the assumption of debt.

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# HSE Integrated Ltd.

## Notes to the Consolidated Financial Statements

For the years ended December 31, 2008 and 2007  
(Stated in thousands of dollars)

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### NOTE 7 – ACQUISITION (continued)

On July 1, 2008, additional consideration of \$100, which was contingent upon performance measures based upon the first year after acquisition, was paid to the vendor. The amount has been reflected in the following table as an increase in cash consideration and an increase in goodwill, which has been recorded as goodwill impairment in the current period.

	Prairie Wide Safety Ltd.
<hr/> Net assets acquired and liabilities assumed <hr/>	
Non-cash working capital	46
Property and equipment	1,365
Intangible assets	152
Goodwill	1,462
Bank indebtedness	(119)
Long-term debt	(392)
Capital lease obligations	(139)
Future income taxes	(227)
	<hr/> 2,148 <hr/>
<hr/> Consideration paid <hr/>	
Cash	1,984
Issuance of Common shares	164
	<hr/> 2,148 <hr/>

### NOTE 8 – PROPERTY AND EQUIPMENT

	December 31, 2008		
	Cost	Accumulated Amortization	Net Book Value
Land	\$ –	\$ –	\$ –
Buildings and improvements	1,105	478	627
Safety equipment	40,998	20,019	20,979
Vehicles	14,986	6,552	8,434
Vehicles and equipment under capital lease	4,825	2,197	2,628
Furniture and equipment	1,291	534	757
Other property and equipment	6,626	3,878	2,748
Total property and equipment	<hr/> \$ 69,831	<hr/> \$ 33,658	<hr/> \$ 36,173 <hr/>

	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	<hr/> \$ 69,688	<hr/> \$ 28,374	<hr/> \$ 41,314 <hr/>

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# HSE Integrated Ltd.

## Notes to the Consolidated Financial Statements

For the years ended December 31, 2008 and 2007  
(Stated in thousands of dollars)

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### NOTE 9 – OPERATING FACILITIES and LONG-TERM DEBT

During the second quarter of 2007, 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 a margin varying between 0.25 percent and 1.50 percent, or at bankers' acceptance rates with a variable stamping fee of 1.75 to 3.00 percent. An additional standby fee ranging from 0.35 to 0.65 percent per annum is also required on any unused portion of the credit facilities. The applicable margin is dependent on the Company's consolidated debt to trailing 12 month cash flows ratio (as defined in the agreement). For each quarter, interest is paid based on the ratio at the immediately preceding quarter end. At December 31, 2008 the applicable margin for interest to be paid during the first quarter of 2009 is 75 basis points.

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. Both the operating facility and the revolving facility are subject to certain covenants including a covenant regarding the ratio of senior debt to cash flows (as defined in the agreement), a current ratio covenant, an interest coverage covenant and certain other positive and negative covenants that are typical for these types of facilities. The credit facilities are collateralized under a general security agreement.

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

	<b>December 31 2008</b>	December 31 2007
Equipment financing contracts bearing interest at rates averaging 2.93% (2007 – 3.13%), payable in blended monthly payments of \$12 (2007 - \$19) secured by specific equipment.	\$ 131	\$ 391
Three year interest only revolving credit facility	<b>10,829</b>	13,829
	<b>10,960</b>	14,220
Accrued consideration on share purchase acquisition	<b>810</b>	1,040
	<b>11,770</b>	15,260
Less current portion	<b>(98)</b>	(216)
	<b>11,672</b>	15,044
Less unamortized debt issue costs	<b>(44)</b>	(49)
	<b>\$ 11,628</b>	<b>\$ 14,995</b>
Outstanding principal repayments are due as follows:		
2008	\$ –	216
2009	<b>98</b>	1,153
2010	<b>10,854</b>	13,871
2011	<b>818</b>	20
	<b>11,770</b>	15,260
Less: current portion	<b>(98)</b>	(216)
	<b>\$ 11,672</b>	<b>15,044</b>

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# HSE Integrated Ltd.

## Notes to the Consolidated Financial Statements

For the years ended December 31, 2008 and 2007  
(Stated in thousands of dollars)

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### NOTE 10 – OBLIGATIONS UNDER CAPITAL LEASE

Amounts due under capital lease arrangements are repayable in blended monthly payments of \$105 (2007 - \$125) and bear interest at rates averaging 5.45% (2007 – 5.50%) per annum. On certain leases, the Company has options to acquire the leased assets at various times throughout term to 2012.

	December 31 2008	December 31 2007
2008	\$ –	\$ 1,488
2009	993	1,145
2010	283	303
2011	111	111
2012	6	6
	<u>1,393</u>	<u>3,053</u>
Less: interest	(101)	(272)
	<u>1,292</u>	<u>2,781</u>
Less: current portion	(922)	(1,328)
	<u>\$ 370</u>	<u>\$ 1,453</u>

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### NOTE 11 – INCOME TAXES

	December 31 2008	December 31 2007
<b>a) Provision for income taxes</b>		
Earnings (loss) before income taxes	\$ 885	\$ (29,966)
Expected income tax (recovery) at 29.8% (2007 - 32.5%)	\$ 264	\$ (9,730)
Non-deductible/non-taxable amounts	224	8,562
Income tax rate reductions	–	(1,125)
United States start-up losses	197	–
United States rate differences	(48)	–
Other	–	(371)
Income tax expense (recovery)	<u>\$ 637</u>	<u>\$ (2,664)</u>

	2008	2007
<b>b) Future income tax assets and liabilities are as follows:</b>		
Canada		
Property and equipment	\$ 4,674	\$ 5,084
Intangible assets	787	970
Share issue and financing costs	(183)	(306)
	<u>5,278</u>	<u>5,748</u>
United States		
Property and equipment	(15)	–
Intangible assets	(182)	–
	<u>(197)</u>	<u>–</u>
Less: United States valuation allowance	197	–
	<u>–</u>	<u>–</u>
Future income tax liability	<u>\$ 5,278</u>	<u>\$ 5,748</u>

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# HSE Integrated Ltd.

## Notes to the Consolidated Financial Statements

For the years ended December 31, 2008 and 2007  
(Stated in thousands of dollars)

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### NOTE 12 – 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	2008		2007	
	Shares (in thousands)	Amount	Shares (in thousands)	Amount
<b>Balance, January 1</b>	<b>37,568</b>	<b>\$ 60,036</b>	37,462	\$ 59,862
Changes (net of share issue costs):				
Issued on acquisition of PWS (note 7)	–	–	100	164
Issued on exercise of options	<b>8</b>	<b>4</b>	6	10
<b>Balance, December 31</b>	<b>37,576</b>	<b>\$ 60,040</b>	37,568	\$ 60,036

c) **Warrants:**

Warrants	2008		2007	
	Warrants (in thousands)	Amount	Warrants (in thousands)	Amount
<b>Balance, January 1</b>	–	\$ –	3,144	\$ 1,609
Converted to common shares	–	–	–	–
Expired	–	–	(3,144)	(1,609)
<b>Balance, December 31</b>	–	\$ –	–	\$ –

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### NOTE 13 – CONTRIBUTED SURPLUS

	2008	2007
<b>Balance, January 1</b>	<b>\$ 4,144</b>	\$ 1,423
Stock compensation expense – employee options	<b>415</b>	1,116
Exercise of stock options	–	(4)
Warrants – expired	–	1,609
<b>Balance, December 31</b>	<b>\$ 4,559</b>	\$ 4,144

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# HSE Integrated Ltd.

## Notes to the Consolidated Financial Statements

For the years ended December 31, 2008 and 2007  
(Stated in thousands of dollars)

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### NOTE 14 - STOCK-BASED COMPENSATION PLANS

#### Incentive stock option plan

The weighted average fair value of options granted for the year ended December 31, 2008 was \$1.88 (2007 – \$2.15). The fair value of each option granted was estimated on the date of grant using the Merton Black-Scholes option-pricing model with the following assumptions:

	2008	2007
Vesting period (years)	3	3
Risk-free interest rate	2.11%	4.10%
Expected life (years)	5	5
Price volatility	89.70%	135.24%

Pursuant to the 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:

	2008		2007	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
Outstanding, beginning of year	2,379,998	\$ 2.15	1,924,501	\$ 2.24
Granted	735,000	0.99	667,500	1.71
Exercised	(8,000)	0.50	(5,333)	1.06
Forfeited	(573,499)	1.86	(206,670)	2.12
Outstanding, end of year	2,533,499	\$ 1.88	2,379,998	\$ 2.15
Exercisable at end of year	1,335,810	\$ 2.16	996,143	\$ 2.06

The following table summarizes information about stock options outstanding at December 31, 2008:

Options outstanding	Exercise prices \$	Weighted average remaining life	Number exercisable
630,000	0.50-1.05	4.27	20,000
714,833	1.06-1.69	1.76	544,497
722,000	1.70-2.50	2.61	457,987
466,666	2.51-3.50	2.25	313,326
2,533,499	1.88	2.72	1,335,810

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# HSE Integrated Ltd.

## Notes to the Consolidated Financial Statements

For the years ended December 31, 2008 and 2007  
(Stated in thousands of dollars)

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### NOTE 14 - STOCK-BASED COMPENSATION PLANS (continued)

#### Deferred share unit plan

On January 16, 2007, 15,000 deferred share units ("DSUs") were granted to non-executive directors. An additional 15,000 DSUs were granted on May 15, 2008. On December 15, 2008 3,000 of the DSUs were settled for \$1.

The units are revalued quarterly and any change in value is included as an increase or decrease in stock based compensation expense. The expense recognized for 2008 was \$8 (2007 - \$15).

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### NOTE 15 – 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:

- In 2008, the Company paid rent and property taxes for a regional office of \$273 (2007 – \$284) to a corporation related to a Director of the Company. Also in 2008, a non-interest bearing promissory note of \$49 (2007 - \$49) was forgiven.
  - In 2008, the Company also paid rent and property taxes of \$344 (2007 – \$371) for a regional office to a corporation controlled by a Senior Manager of the Company.
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### NOTE 16 - COMMITMENTS

The Company leases certain shop and office space and vehicles and equipment under operating leases for periods ending between 2009 and 2013. Future minimum lease payments under these leases in each of the next five years are as follows:

	Rental facilities	Operating leases	Total
2009	\$ 2,831	\$ 1,858	\$ 4,689
2010	2,268	1,775	4,043
2011	1,373	1,049	2,422
2012	951	45	996
2013	688	—	688

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In May 2008, the Company sold three of its buildings as part of a sale/lease back arrangement. The net proceeds on the sale were \$1.7 million, resulting in gains on sale of \$0.7 million. The resulting gains were deferred and are being amortized over the 60-month lives of the leases.

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# HSE Integrated Ltd.

## Notes to the Consolidated Financial Statements

For the years ended December 31, 2008 and 2007  
(Stated in thousands of dollars)

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### NOTE 17 - SUPPLEMENTARY CASH FLOW INFORMATION

	<b>December 31</b>	December 31
	<b>2008</b>	2007
Increase (decrease) in non-cash working capital from operations		
Short term investments	\$ -	\$ 802
Accounts receivable	<b>(889)</b>	(1,730)
Inventory	<b>(6)</b>	40
Prepaid expenses and other assets	<b>(188)</b>	229
Accounts payable and accrued liabilities	<b>(117)</b>	(1,918)
Income tax payable	<b>1,083</b>	(2,337)
	<hr/>	<hr/>
Net decrease in non-cash working capital	<b>\$ (117)</b>	<b>\$ (4,914)</b>

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### NOTE 18 - 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 based in Canada. For the periods ended December 31, 2008 and 2007, no customer provided more than 10% of the Company's revenue.

On May 7, 2008 a new company called Boots & Coots HSE Services LLC ("BCHSE") was incorporated to pursue the expansion of Oilfield safety services in the continental United States. The Company owns 100% of the shares of HSE Integrated Inc. ("INC") a Delaware corporation which in turn owns a 90% interest in BCHSE, a Delaware Limited Liability Company. Boots & Coots International Well Control Inc. owns the remaining 10%. The Company has consolidated the operations of BCHSE. A non-controlling interest has not been recorded as BCHSE continues to record losses. At December 31, 2008 US operations comprised less than 1% of revenues and 3% assets of the Company.

The Company provides services to two main groups of customer industries. "Oilfield" services are provided to customers in the conventional upstream, or "wellhead", sector of the oil and gas industry. "Industrial" services are provided to customers in a variety of other industries including: non-conventional upstream oil development and production (including oil sands extraction); oil and gas processing; petrochemicals; pulp and paper; utilities; power generation; and manufacturing. It also includes worker safety training and safety management and consulting services. The Company tracks revenues provided to each customer group as a method to predict future operating activity. Revenue by customer group is as follows:

	<b>December 31</b>	December 31
	<b>2008</b>	2007
Oilfield	\$ <b>51,264</b>	\$ 53,886
Industrial	<b>62,499</b>	43,456
Total Revenue	<b>\$ 113,763</b>	<b>\$ 97,342</b>

  

As a % of Revenue:		
Oilfield	<b>45.1%</b>	55.4%
Industrial	<b>54.9%</b>	44.6%
Total Revenue	<b>100.0%</b>	100.0%

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## **HSE Integrated Ltd.**

### **Notes to the Consolidated Financial Statements**

For the years ended December 31, 2008 and 2007

(Stated in thousands of dollars)

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#### **NOTE 19 – 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.