

## President's Report to Shareholders – First Quarter 2011

For the first quarter of fiscal 2011 the Company had net earnings of \$5.1 million, or \$0.21 per share, compared to a net loss of \$3.3 million, or \$0.14 per share, recorded for the first quarter of fiscal 2010. Total revenue this quarter was \$109.5 million, up 75% from the \$62.5 million recorded last year. Cash flow generated from operations during the quarter was \$12.1 million, an increase of 59% over the same quarter last year.

Margins for the quarter were 24.2%, up from the 23.0% recorded in the fourth quarter of fiscal 2010. Margins were impacted by training, mobilization and additional consumable purchases to support increased demand. As we continued to prepare more rigs for the field, high repair costs also had an impact. Going forward, margins should continue to gradually improve as we put those ramp-up costs behind us and pricing improves.

Activity levels continue to improve in every region. Canada, Chile and Argentina sustained their strong recovery, while we also saw good growth in Mexico, U.S. and Mongolia this quarter. The 75% increase in revenue, despite an unfavorable foreign currency translation impact of \$6 million, came mainly from improved utilization, as pricing remains competitive, although we are starting to see improvements in certain areas.

Net capital expenditures for the quarter were \$8.9 million as we purchased 11 rigs while retiring 11 rigs through our modernization program. In the two weeks following quarter-end, the Company took delivery of an additional 3 rigs. During the quarter, we also added a significant amount of support vehicles and other support equipment to meet changing patterns of demand and our safety standards. These additions will help us to further improve rig utilization and reliability.

As previously announced, we are very pleased to welcome North Star Drilling and its employees into the Major Drilling group. North Star, in combination with the rest of our recently formed environmental drilling division, provides an excellent platform for growth in that sector. The Company continues to seek acquisitions that complement our specialized drilling strategy, increase our diversification, or expand our geographic footprint.

Looking at the rest of fiscal 2011, if customers move forward with their stated plans, we expect continued growth. Our global utilization rates are expected to continue to improve as each month goes by. Some of our regions have now reached high levels of utilization, which has begun to lead to a more positive pricing environment.

The Company remains in excellent financial shape, with no net debt. **Given the Company's continuing ability to generate cash and the improving outlook, the Board of Directors has recently approved the payment of a semi-annual dividend in the amount of \$5.2 million (\$0.22 per share), which represents a 10% increase from previous dividends.** This dividend is payable on November 1, 2010 to shareholders of record as of October 8, 2010, and is designated as an "eligible dividend" for Canadian tax purposes.

I would like to thank John Schiavi and David Hope, who have retired as Directors. Mr. Schiavi was a Director of the Company for more than 15 years, joining the Board prior to its initial public offering in 1995, and Mr. Hope was a Director of the Company since 2005.

As always, we value the continued support of our customers, employees, and shareholders.

Francis P. McGuire  
President & CEO

Groupe Forage

***MAJOR***

Drilling Group International Inc.

## **Management's Discussion and Analysis**

### **First Quarter Fiscal 2011**

# **MAJOR DRILLING GROUP INTERNATIONAL INC.**

## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

### **FIRST QUARTER FISCAL 2011**

This Management's Discussion and Analysis ("MD&A") relates to the results of operations, financial condition and cash flows of Major Drilling Group International Inc. ("Major Drilling" or the "Company") as at and for the three-month period ended July 31, 2010. This MD&A is based on financial statements prepared in accordance with Canadian generally accepted accounting principles (Canadian GAAP). All amounts in this MD&A are in Canadian dollars, except where otherwise noted. These interim unaudited consolidated financial statements were prepared using accounting policies and methods consistent with those used in the preparation of the Company's audited consolidated financial statements for the year ended April 30, 2010.

This MD&A is a review of activities and results for the quarter ended July 31, 2010 as compared to the corresponding period in the previous year. Comments relate to, and should be read in conjunction with, the comparative unaudited consolidated interim financial statements as at and for the three months ended July 31, 2010, and also in conjunction with the audited consolidated financial statements and Management's Discussion and Analysis contained in the Company's annual report for the fiscal year ended April 30, 2010.

This MD&A is dated August 31, 2010. Disclosure contained in this document is current to that date, unless otherwise stated.

### **FORWARD-LOOKING STATEMENTS**

Securities laws encourage companies to disclose forward-looking information in order for investors to have a better understanding of a company's future prospects and make informed investment decisions.

This MD&A contains forward-looking statements about the Company's objectives, strategies, financial condition, results of operations, cash flows and businesses. These statements are "forward-looking" because they are based on current expectations, estimates, assumptions, risks and uncertainties. Such statements include, but are not limited to: worldwide demand for gold and base metals and overall commodity prices, the level of activity in the minerals and metals industry and the demand for the Company's services, the Canadian and international economic environments, the Company's ability to attract and retain customers and to manage its assets and operating costs, sources of funding for its clients, particularly for junior mining companies, competitive pressures, currency movements, which can affect the Company's revenue in Canadian dollars, the geographic distribution of the Company's operations, the impact of operational changes, changes in jurisdictions in which the Company operates (including changes in regulation), failure by counterparties to fulfill contractual obligations, and other factors set forth from time to time in the Company's Annual Information Form, as such factors may be amended or updated in subsequent MD&As.

These factors and other risk factors, as described under "General Risks and Uncertainties" of the Company's Annual Information Form, represent risks the Company believes are material. Actual results could be materially different from expectations if known or unknown risks affect the business, or if estimates or assumptions turn out to be inaccurate. The Company does not guarantee that any forward-looking statement will materialize and, accordingly, the reader is cautioned not to place reliance on these forward-looking statements.

The Company disclaims any intention and assumes no obligation to update any forward-looking statement, even if new information becomes available, as a result of future events or for any other reasons, except in accordance with applicable securities laws. Risks that could cause the Company's actual results to materially differ from its current expectations are discussed in this MD&A.

Additional information relating to the Company, including the Company's Annual Information Form for the most recently completed financial year, can be found on SEDAR at [www.sedar.com](http://www.sedar.com).

## **CORPORATE OVERVIEW**

Major Drilling Group International Inc. is one of the world's largest drilling service companies primarily serving the mining industry. To support its customers' varied exploration drilling requirements, Major Drilling maintains field operations and offices in Canada, the United States, South and Central America, Australia, Asia and Africa. Major Drilling provides all types of drilling services including surface and underground coring, directional, reverse circulation, RAB, geotechnical, environmental, water-well and coal-bed methane and shallow gas.

## **BUSINESS STRATEGY**

Major Drilling continues to base its business premise on the following: mining companies continue to deplete the more easily accessible mineral reserves around the world and attractive deposits will be in increasingly remote locations, areas difficult to access and/or deep in the ground. For this reason, Major Drilling's strategy is to focus its services on projects that have these characteristics, calling these services "specialized drilling". Over the years, the Company has positioned itself as one of the largest specialized operators in the world by leveraging its main competitive advantages: skilled personnel, specialized equipment, long-standing relationships with the world's largest mining companies, and access to capital.

Although the Company's main focus remains specialized services, it also intends to continue to modernize its conventional fleet and expand its footprint in strategic areas while maintaining minimum debt levels and remaining best of class in safety and human resources. Also, the Company will seek to diversify by investing in energy and environmental drilling services that are complementary to its skill set.

The Company therefore categorizes its drilling services into three types: specialized drilling, conventional drilling and underground drilling.

Specialized drilling can be defined as any drilling project that, by virtue of its scope, technical complexity or location, creates significant barriers to entry for smaller drilling companies. This would include, for example, deep-hole drilling, directional drilling, and mobilizations to remote locations or high altitudes. Because significant ore bodies are getting more difficult to find, the Company expects specialized drilling services to continue to fuel future growth, and over the next two decades, we believe these skills will be in greater and greater demand.

Conventional drilling tends to be more affected by the industry cycle as the barriers to entry are not as significant as with specialized drilling. This part of the industry is highly fragmented and has numerous competitors. Because the Company offers only limited differentiation in this sector, it is not its priority for investment.

Underground drilling takes on greater importance in the latter stages of the mining cycle as clients develop underground mines.

Specialized projects tend to be more costly for customers than conventional projects. Due to the impact of the recent economic environment on many of our senior customers, some of these projects were either cancelled or very heavily cut back in the second half of fiscal 2009 and the first half of fiscal 2010. In the last quarter of fiscal 2010, as well as in the first quarter of fiscal 2011, general activity levels began to increase. However, the Company expects pricing to remain competitive until utilization rates pick up significantly, especially in conventional drilling. Over time, it is expected that many of the supply issues that face most commodities will come back into focus and that even with moderate growth in the world economy, the need to explore and develop mines will increase. It is believed that at that point, the need to develop resources in areas that are increasingly difficult to access will return, which should increase demand for specialized drilling.

## **INDUSTRY OVERVIEW**

The metals and minerals drilling industry is reliant primarily on demand from two metals groups, gold on the one hand and base metals on the other. Each commodity group is influenced by distinct market forces. In the last few years, historically high prices for all commodities drove the industry to record levels of activity with worldwide mineral exploration expenditures in calendar 2008 surpassing US\$14 billion.

The recent economic environment has impacted drilling, particularly on base metal projects with worldwide mineral exploration expenditures in calendar 2009 falling to US\$8 billion. Senior and intermediate base metal companies that were leveraged reduced their exploration spending in calendar 2009, in order to conserve cash. Many gold producers delayed exploration plans at that time due to the uncertainty in the economy. Sources of funding for junior mining companies were limited, and as such many junior projects, both in the base metals and gold sectors, were delayed or cancelled.

At the end of the most recently completed fiscal year, the bulk of the increased activity was coming from intermediate mining companies and junior mining companies with advanced properties. While senior companies increased their exploration budgets for calendar 2010, spending had not yet rebounded to their pre-financial crisis levels. Early stage exploration companies had shown little increase in activity as they were still experiencing difficulties in getting financing. In the longer-term, the fundamental drivers of the business remain positive, with worldwide supply for most metals expected to tighten due to the continuing lack of significant discoveries. The prospects for gold related drilling, which generally accounts for approximately 50 percent of the drilling market, remains positive.

### **Gold**

Drilling services for gold are always affected by overall commodity prices. However, Metals Economics Group (“MEG”) is reporting that declining gold reserves replacement via exploration, since 1997, may result in gold supply shortages in the long-term, a fact that has been echoed by several senior gold mining companies. Increased production by the major gold producers over the past decade has resulted in a greater need to add to reserves in order to maintain a life-of-production that satisfies the long-term views of investors and market analysts. Although, as a group, the major producers successfully replaced almost twice their total production over the past ten years, almost all of these reserve additions were achieved through acquisitions or by upgrading resources at existing projects and mines, and not through significant new discoveries.

One of the realities is that future gold deposits will probably have to come from areas difficult to access, either in remote, politically sensitive areas, deeper in the ground or at higher altitudes. This should improve demand for specialized services in the future.

### **Base Metals**

Drilling services for base metals are affected by overall commodity prices. Despite the recent economic environment, with the recent limited expansion of supply, and the emergence of China and India as major consumers of base metals, supply is expected to be stretched within the next several years. MEG reports that the time required to take a project from discovery through to production ensures that any new discoveries will not benefit global supply for years. During this time, definition drilling is required to establish mine plans in order to bring these discoveries into production.

## **BUSINESS ACQUISITIONS**

### *Acquisition of North Star Drilling*

Effective June 30, 2010, the Company acquired the assets of North Star Drilling, which provides contract drilling services to the fresh water and geothermal markets in certain mid-western states in the USA, and operates from its head office in Little Falls, Minnesota, as well as from satellite offices in Brainerd and Bemidji, Minnesota. The acquired business includes drilling equipment, contracts and employees. The purchase price for the transaction was USD \$2.3 million (CAD \$2.4 million), excluding customary working capital adjustments, financed with cash. There is also a contingent consideration of USD \$0.8 million to the purchase price, based on future earnings.

The Company is in the process of finalizing the valuation of assets. As at July 31, 2010, \$1.7 million of the purchase price was allocated to net tangible assets and \$0.7 million was allocated to goodwill. These values are preliminary and are subject to adjustments as additional information is obtained.

## **OVERALL PERFORMANCE**

Activity levels continue to improve in every region resulting in total revenue for the quarter of \$109.5 million. Canada, Chile and Argentina sustained their strong recovery, while we also saw good growth in Mexico, U.S. and Mongolia this quarter. The 75 percent increase in revenue compared to the prior year quarter, despite unfavourable foreign currency translation impact of \$6 million, came mainly from improved utilization. Pricing remains competitive, although we are starting to see improvements in certain geographic areas.

Margins in this quarter at 24.2 percent improved from our fourth quarter of fiscal 2010, but were still impacted by training, mobilization and additional consumable purchases to support increased demand. As we continued to prepare more rigs for the field, higher repair costs also affected margins. In Australia, we continue to work our way out of some low-margin contracts.

Net earnings were \$5.1 million (\$0.21 per share) for the quarter compared to a net loss of \$3.3 million (\$0.14 per share) for the prior year quarter.

Given the Company's ability to generate cash and the improving outlook, the Company's Board of Directors has authorized a semi-annual cash dividend of \$0.22 per share, which represents a 10 percent increase from previous dividends. This dividend is payable on November 1, 2010 to shareholders of record as of October 8, 2010. This dividend is designated as an "eligible dividend" for Canadian tax purposes.

## **RESULTS OF OPERATIONS – FIRST QUARTER ENDED JULY 31, 2010**

Total revenue for the quarter was \$109.5 million up 75 percent from the \$62.5 million recorded in the same quarter last year. Most of the Company's branches exhibited strong growth mainly coming from increased utilization. Revenue growth was affected by the strengthening Canadian dollar against the U.S. dollar as compared to the same period last year. The unfavourable foreign exchange translation impact for the year, when comparing to the effective rates for the same period last year, is estimated at over \$6 million on revenue.

Revenue for the quarter from Canada-U.S. drilling operations increased by 100 percent to \$40.5 million compared to \$20.2 million for the same period last year. Both countries contributed to this increase as utilization rates increased substantially while pricing remained relatively flat compared to the same quarter last year.

South and Central American revenue was up 120 percent to \$40.0 million for the quarter, compared to \$18.2 million posted for the prior year quarter. All regions exhibited strong growth, again driven primarily by increased rig utilization.

Australian, Asian and African operations reported revenue of \$29.0 million, up 20 percent from the \$24.1 million reported in the same period last year. Mongolia and Indonesia accounted for all of the growth in the region, offset by a decrease in activity in Australia as compared to last year. In Australia, market conditions were still difficult during the quarter given the recent concerns on mining tax. In the last month however, we have started to see early signs of a recovery.

The overall gross margin percentage for the quarter was 24.2 percent, down from 27.6 percent for the same period last year. Margins in the quarter were impacted by training costs, mobilization costs and additional consumable purchases to support increased demand.

General and administrative costs were \$9.6 million for the quarter, up 7.9 percent compared to \$8.9 million in the same period last year. The increase was due to the addition of the new environmental division and also increased costs to support the strong growth in activity levels.

Other expenses for the quarter were \$1.9 million, up from \$0.9 million in the prior year quarter, due primarily to higher incentive compensation expenses given the Company's increased profitability, and consulting work.

Foreign exchange loss in the quarter was \$0.1 million compared to a gain of \$0.7 million in the prior year quarter.

Short-term interest expense was \$0.1 million compared to revenue of \$0.1 million in the prior year quarter, while interest expense on long-term debt was down to \$0.2 million compared to \$0.3 million for the same quarter last year due to lower levels of debt and reduced interest rates.

Amortization expense was \$7.4 million for the quarter compared to \$7.7 million for the same quarter last year.

In last year's quarter, the Company recorded a restructuring charge of \$1.2 million to account for retrenchment and closedown costs, primarily in Australia. The Company also recorded a net non-cash goodwill impairment charge of \$2.0 million relating to the Paragon del Ecuador S.A. acquisition.

Income tax expense was \$2.3 million in the quarter compared to \$0.2 million for the prior year quarter.

Net earnings were \$5.1 million or \$0.21 per share (\$0.21 per share diluted) for the quarter compared to a net loss of \$3.3 million or \$0.14 per share (\$0.14 per share diluted) for the prior year quarter.

## SUMMARY OF QUARTERLY RESULTS

(in \$000 CAD, except per share)	Fiscal 2009			Fiscal 2010				Fiscal 2011
	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Revenue	\$ 191,010	\$ 87,361	\$ 66,400	\$ 62,489	\$ 75,528	\$ 72,471	\$ 97,368	\$ 109,480
Gross profit	70,438	24,086	17,806	17,230	22,792	11,979	22,372	26,532
Gross margin	36.9%	27.6%	26.8%	27.6%	30.2%	16.5%	23.0%	24.2%
Net earnings (loss)	29,276	(5,070)	(4,601)	(3,296)	4,060	(4,453)	3,225	5,053
Per share - basic	1.23	(0.21)	(0.19)	(0.14)	0.17	(0.19)	0.14	0.21
Per share - diluted	1.22	(0.21)	(0.19)	(0.14)	0.17	(0.19)	0.13	0.21

Historically, the Company's fourth quarter has been its strongest, followed by its second and first quarters. The third quarter (November to January) is normally the Company's weakest quarter due to the shutdown of mining and exploration activities, often for extended periods over the holiday season, particularly in South and Central America. With the exception of the third quarter, the Company has, over the past several years, exhibited comparatively less seasonality in quarterly revenue, since a relatively higher proportion of drilling revenue was generated in regions with more temperate or tropical climates that were not impacted by winter weather conditions. Additionally, strong cyclical growth had tended to mute normal seasonal patterns. Coming out of the recent economic and industry downturn, it is not yet clear whether or not the Company's revenue will return to more historical seasonal patterns, or whether a recent lack of seasonality will continue.

## **LIQUIDITY AND CAPITAL RESOURCES**

### ***Operating Activities***

Operating cash flow from continuing operations (before changes in non-cash working capital) was \$12.1 million for the quarter compared to \$7.6 million generated in the same period last year.

The change in non-cash operating working capital items was an outflow of \$0.2 million in the quarter compared to an outflow of \$0.5 million for the same quarter last year.

### ***Financing Activities***

In the first quarter of the current fiscal year, the Company borrowed 5,375 million Chilean pesos (CAD \$10.4 million), secured by a USD \$10 million stand-by letter of credit drawn from the Company's demand credit facility, carrying interest at an annual rate of 5.18 percent and maturing in May 2011.

Total long-term debt decreased by \$2.2 million during the quarter from \$23.9 million at April 30, 2010 to \$21.7 million at July 31, 2010. The decrease is due to debt repayments of \$2.2 million during the quarter.

Under the terms of certain of the Company's debt agreements, the Company must satisfy certain financial covenants. Such agreements also limit, among other things, the Company's ability to incur additional indebtedness, create liens, engage in mergers or acquisitions and make dividend and other payments. During the period, the Company was, and continues to be, in compliance with all covenants and other conditions imposed by its debt agreements.

The credit facilities related to operations total \$26.4 million (\$25.0 million from a Canadian chartered bank and \$1.4 million in credit facilities in Chile and Australia) and are primarily secured by corporate guarantees of companies within the group. The Company has a credit facility of \$0.7 million for credit cards for which interest rate and repayment are as per cardholder agreements. At July 31, 2010, the Company had utilized \$11.2 million of these lines for stand-by letters of credit.

The Company has a \$45.0 million facility for financing the cost of equipment purchases or acquisition costs of related businesses. At July 31, 2010, the Company had utilized \$19.0 million of this line. Draws on this line can be amortized over five years.

The Company also has other various loans and capital lease facilities related to equipment purchases that totaled \$9.6 million at July 31, 2010, of which \$2.7 million was utilized and mature through 2011.

The Company believes that it will be able to generate sufficient cash flow to meet its current and future working capital, capital expenditure and debt obligations. As at July 31, 2010, the Company had unused borrowing capacity under its credit facilities of \$48.1 million and cash of \$35.2 million, for a total of \$83.3 million in available funds.

During the first quarter, the Company paid a semi-annual dividend of \$4.8 million.

### ***Investing Activities***

Capital expenditures were \$8.9 million for the quarter ended July 31, 2010 compared to \$3.3 million for the same period last year.

During the quarter, the Company added 11 drill rigs through its capital expenditure program and 8 drill rigs through a business acquisition while retiring or disposing of 11 drill rigs through its modernization program. This brings the total drill rig count to 533 at quarter-end.

The Company expects to spend approximately \$50 million in capital expenditures in fiscal 2011, with the intent to purchase 50 rigs that are much better tailored for the current market. It is expected that 30 of the rigs will replace older rigs that had very low utilization rates. The Company also intends to add support vehicles and equipment to the operations to meet the changing patterns of demand and its continually rising safety standards. Through this, the Company plans to continue its efforts to improve rig utilization and reliability.

## **OUTLOOK**

Activity levels continue to improve in every region. The bulk of the increased activity is coming from intermediate mining companies and junior mining companies with advanced properties, as early stage exploration companies are still experiencing difficulties in getting financing.

Looking at the rest of fiscal 2011, if customers move forward with their stated plans, we expect to see continuing growth. Our global utilization rates are expected to continue to improve as each month goes by. Some of our regions have now reached high levels of utilization, which has begun to lead to a more positive pricing environment.

Going forward, margins should continue to gradually improve as we put training, repair and mobilization ramp-up costs behind us and pricing improves, although a shortage of experienced crews will put some pressure on productivity.

## **FOREIGN EXCHANGE**

Year-over-year revenue comparisons continue to be affected by the variations of the Canadian dollar against the U.S. dollar. The unfavourable impact of U.S. dollar exchange translation, for the quarter, when comparing to the effective rates for the same period last year, is estimated at \$6 million on revenue but negligible on net earnings.

## **OTHER COMPREHENSIVE EARNINGS (LOSS)**

The consolidated statements of comprehensive earnings (loss) for the quarter include \$5.6 million in unrealized gains on translating the financial statements of our self-sustaining foreign operations compared to a loss of \$24.4 million for the same period last year. The change relates to translating the net assets of our foreign operations using the current rate method, given that the subsidiaries are considered self-sustaining for Canadian GAAP purposes. During the current quarter, the U.S. dollar strengthened 2.7 percent against the Canadian dollar increasing the net value of our net asset position in these subsidiaries in Canadian dollar terms.

## **GENERAL RISKS AND UNCERTAINTIES**

The risks described below and elsewhere in this MD&A do not include all possible risks, and there may be other risks of which management is currently not aware.

### ***Cyclical Downturn***

The most significant operating risk affecting the Company is a downturn in demand for its services due to a decrease in activity in the minerals and metals industry. In attempting to mitigate this risk, the Company is exploiting its competitive advantage in specialized drilling and continues to explore opportunities to diversify and to rationalize its regional infrastructures. In previous cyclical market downturns the Company realized that specialized services were not as affected by decreases in metal and mineral prices compared to its traditional services. Consequently, the Company's addition of rigs and acquisitions of businesses have generally been focused on specialized drilling services. The impact on the Company of a severe and persistent downturn in the minerals and metals industry (a possible outcome of the recent global economic conditions) may not be fully mitigated by the foregoing measures.

While receivables from senior and larger intermediate mining exploration companies remain a significant component of total receivables, accounts receivable from junior mining companies also have a tendency to increase during a cyclical downturn. In many cases, capital markets are the only source of funds available to these juniors and any change in the outlook for the sector or the lack of success of a specific exploration program can quickly impair the ability of these juniors to raise capital to pay for their drilling programs. Credit and capital markets financing continue to be challenging for many mining companies, which could adversely impact exploration programs.

Levels of inventory typically increase as a result of increased activity levels. In addition to direct volume related increases however, inventory levels also increase due to an expansion of activity in remote locations at the end of long supply chains where it is necessary to increase inventory to ensure an acceptable level of continuing service, which is part of the Company's competitive advantage. In the event of a sudden downturn of activities related either

to a specific project or to the sector as a whole, it is more difficult and costly to redeploy this remote inventory to other regions where it can be consumed.

### ***Competitive Pressures***

Pressures from competitors could result in decreased contract prices and put a strain on current growth rates. There can be no assurance that the Company's competitors will not be successful in capturing a share of the Company's present or potential customer base.

### ***Country Risk***

Major Drilling is committed to utilizing its expertise and technology in exploration areas around the world. With this comes the risk of dealing with business and political systems in a variety of jurisdictions. Unanticipated economic, political, tax related, regulatory or legal changes (or changes in interpretation) could have a material negative impact on operations and assets. The risks include, but are not limited to, military repression, extreme fluctuations in currency exchange rates and high rates of inflation, and changes in mining or investment policies or shifts in political attitude that may adversely affect the business. There has been an emergence of a trend by some governments to increase their participation in the benefits of rising commodity prices, most notably in South America and Mongolia, through increased taxation, expropriation, or otherwise. This could negatively impact the level of foreign investment in mining and exploration activities and thus drilling demand in these regions. Such events could result in reductions in revenue and transition costs as equipment is shifted to other locations.

### ***Repatriation of Funds or Property***

There is no assurance that any of the countries in which the Company operates or may operate in the future will not impose restrictions on the repatriation of funds or property to other jurisdictions.

### ***Taxes***

The Company is subject to many different forms of taxation in various jurisdictions throughout the world, including but not limited to, income tax, withholding tax, commodity tax and social security and other payroll related taxes, which may lead to disagreements with tax authorities regarding the application of tax law.

Tax law and administration is extremely complex and often requires us to make subjective determinations. The computation of income, payroll and other taxes involves many factors, including the interpretation of tax legislation in various jurisdictions in which we are subject to ongoing tax assessments. Our estimate of tax related assets, liabilities, recoveries and expenses incorporates significant assumptions. These assumptions include, but are not limited to, the tax rates in various jurisdictions, the effect of tax treaties between jurisdictions and taxable income projections. To the extent that such assumptions differ from actual results, we may have to record additional tax expenses and liabilities, including interest and penalties.

### ***Foreign Currency***

The Company conducts a significant proportion of its business outside of Canada and consequently has exposure to currency movements, principally in U.S. dollars, Chilean pesos and Australian dollars. In order to reduce its exposure to foreign exchange risks associated with currencies of developing countries, where a substantial portion of the Company's business is conducted, the Company has adopted a policy of contracting in U.S. dollars, where practical and legally permitted.

Foreign exchange translations can have a great impact on year-to-year comparisons because of the geographic distribution of the Company's activities. Year-over-year revenue comparisons have been affected by the fluctuation in the Canadian dollar against the U.S. dollar. Margin performance however is less affected by currency fluctuations as a large proportion of costs are typically in the same currency as revenue. In future periods, year-to-year comparisons of revenue could be significantly affected by changes in foreign exchange rates.

### ***Operational Risk***

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and/or systems or from external events. Operational risk is present in all of the Company's business activities, and incorporates exposure relating to fiduciary breaches, regulatory compliance failures, legal disputes, business disruption, pandemics, technology failures, processing errors, business integration, theft and fraud, damage to physical assets and employee safety and insurance coverage.

### ***Dependence on Key Customers***

From time to time, the Company may be dependent on a small number of customers for a significant portion of overall revenue and net income. Should one or more such customers terminate contracts with the Company, there can be no guarantee that the Company will obtain sufficient replacement contracts to maintain the existing revenue and income levels. Consequently, the Company continues to work to expand its client base and geographic field of operations to mitigate its exposure to any single client, commodity or mining region.

### ***Safety***

Failure to maintain a record of acceptable safety performance may have an adverse impact on the Company's ability to attract and retain customers. Most of the Company's customers consider safety and reliability two primary attributes when selecting a provider of drilling services. The Company continues to invest in training to improve skills, abilities and safety awareness.

### ***Expansion and Acquisition Strategy***

The Company intends to remain vigilant with regard to potentially strategic future acquisitions and internal expansion. It is not possible to ensure that future acquisition opportunities will exist on acceptable terms, or that newly acquired or developed entities will be successfully integrated into the Company's operations. Additionally, the Company cannot give assurances that it will be able to secure the necessary financing on acceptable terms to pursue this strategy.

### ***Legal and Regulatory Risk***

Regulatory risk incorporates exposure relating to the risk of non-compliance with applicable legislation and regulatory directives. Legal risk incorporates non-compliance with legal requirements, including the effectiveness of preventing or handling litigation. Local management is responsible for managing day-to-day regulatory risk. In meeting this responsibility, local management receives advice and assistance from such corporate oversight functions as legal, compliance and internal audit. Compliance and internal audit test the extent to which operations meet regulatory requirements, as well as the effectiveness of internal controls.

### ***Extreme Weather Conditions and the Impact of Natural or Other Disasters***

The Company operates in a variety of locations, some of which are prone to extreme weather conditions. From time to time these conditions, as well as natural or other disasters, could have an adverse financial impact on operations located in the regions where these conditions occur.

### ***Specialized Skills and Cost of Labour Increases***

Generally speaking, drilling activity related to metals and minerals is broadly linked to price trends in the metals and minerals sector. During periods of increased activity, such as that occurring as the industry last transitioned from a cyclical downturn to a cyclical upturn, a limiting factor in this industry was a shortage of qualified drillers. The Company addresses this issue by attempting to become the "employer of choice" for drillers in the industry, as well as hiring and training more locally-based drillers. Historically, most of the Company's drillers have been Australian or Canadian. Development of local drillers has already had a positive impact in South American, African, Mongolian and Indonesian operations, and is expected to continue to play an important role.

The Company also relies on an experienced management team across the Company to carry on its business. A departure of several members of the management team at one time could have an adverse financial impact on operations.

A material increase in the cost of labour could materially affect gross margins and therefore the Company's financial performance.

#### ***Equipment and Parts Availability***

The Company's ability to provide reliable service is dependent upon timely delivery of equipment and replacement parts from fabricators and suppliers. Any factor that substantially increases the order time on equipment and increases uncertainty surrounding final delivery dates may constrain future growth, existing operations, and the financial performance of the Company.

#### ***Reputational Risk***

Negative publicity, whether true or not, regarding practices, actions or inactions, could cause a decline in the Company's value, liquidity, or customer base.

### **CRITICAL ACCOUNTING ESTIMATES**

The Company's financial statements are prepared in accordance with Canadian generally accepted accounting principles. A comprehensive discussion of the Company's significant accounting policies is contained in Note 2 to the audited financial statements for the year ended April 30, 2010. The Company's significant accounting policies are subject to estimates and key judgments about future events, many of which are beyond management's control.

### **OFF BALANCE SHEET ARRANGEMENTS**

Except for operating leases discussed in the annual MD&A for the year ended April 30, 2010, where there were no significant changes, the Company does not have any other off balance sheet arrangements.

### **INTERNAL CONTROLS OVER FINANCIAL REPORTING**

The company's Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO") are responsible for designing internal controls over financial reporting ("ICFR") and disclosure controls and procedures ("DC&P") or causing them to be designed under their supervision. The Company's ICFR are designed to provide reasonable assurance regarding the reliability of the Company's financial reporting and its preparations of financial statements for external purposes in accordance with Canadian generally accepted accounting principles. The Company's DC&P are designed to provide reasonable assurance that all relevant information required to be disclosed in documents filed with securities regulatory authorities is recorded, processed, summarized and reported on a timely basis, and is accumulated and communicated to the Company's management, including the CEO and CFO, as appropriate, to allow timely decisions regarding financial disclosure.

As discussed above, the inherent limitations in all control systems are such that they can provide only reasonable, not absolute, assurance that all control issues and instances of fraud or error, if any, within the Company have been detected. Therefore, no matter how well designed, ICFR and DC&P have inherent limitations and may not prevent or detect all misstatements.

For the three months ended July 31, 2010, there have been no significant changes to the ICFR and no change in the assessment of the effectiveness of the Company's ICFR and DC&P. Accordingly, the CEO and CFO have concluded that the design and operation were effective at a reasonable assurance level as of the end of the period covered by this report.

## **TRANSITION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS**

In February 2008, the Accounting Standards Board (“AcSB”) confirmed that Canadian reporting issuers will be required to report under International Financial Reporting Standards (“IFRS”) effective January 1, 2011. Reporting issuers will be required to provide IFRS comparative information for the previous year. The Company will begin issuing interim and annual financial statements under IFRS for the fiscal year beginning May 1, 2011. The transition date of May 1, 2011 will require the restatement for comparative purposes of amounts reported by the Company for the year ended April 30, 2011.

IFRS uses a conceptual framework similar to Canadian GAAP, but there are significant differences on recognition, measurement and disclosures. The Company expects the transition to IFRS to impact financial reporting, business processes and information systems.

The Company launched its conversion project in 2008. The Company is following the key events timeline proposed by the AcSB to obtain training and thorough knowledge of IFRS, finalize assessment of accounting policies with reference to IFRS and plan for conversion to be ready for the 2011 changeover.

The conversion project consists of four primary phases:

1. The scoping and planning phase, which involves establishing a project management team, mobilizing organizational support for the conversion plan, obtaining stakeholder support for the project, identifying major areas affected and developing a project charter, developing an implementation plan and communication strategy, was completed in mid 2009 and served as the basis for the planning of future phases.
2. We are near completion of the detailed assessment phase, which will result in accounting policies and transitional exemption decisions, quantification of financial statement impact, preparation of shell financial statements and identification of business processes and resources impacted. The Company will continue to monitor changes in IFRS throughout the duration of the implementation process and assess their impacts on the Company and its reporting.
3. The operations implementation phase has started and includes the design of business, reporting and system processes to support the compilation of IFRS compliant financial data for the opening balance sheet at May 1, 2010, fiscal 2011 and thereafter. This phase also includes ongoing training, testing of the internal control environment and updated processes for disclosure controls and procedures.
4. Post implementation phase will include sustainable IFRS compliant financial data and processes for fiscal 2011 and beyond.

The Company has engaged and will continue to engage in dialogue with the Company’s independent auditors in all phases of the conversion project.

In light of the IFRS requirements, the Company has implemented the majority of the systems that will support the compilation of the IFRS compliant financial data for the opening balance sheet as at May 1, 2010, fiscal 2011 and thereafter. These systems include new functionalities in the consolidation system, a uniform fixed assets module and a stock-based compensation plan management system. Other enhancements to our current systems have also been implemented to ensure future compliance. The implementation phase also includes ongoing training for key personnel, identification and documentation of impact and required changes to, and ensuring the effectiveness of, the Company’s internal control environment and disclosure controls and procedures. This stage of phase 3 will be conducted throughout fiscal 2011. The post implementation phase will include sustainable IFRS compliant financial data and processes for fiscal 2012 and beyond.

The Company is in the process of quantifying the impacts expected on its consolidated financial statements. The following is a discussion of some of the general issues facing the Company related to the accounting standards identified as most likely to have a significant financial statement impact.

### ***IFRS 1 – First-Time Adoption of IFRS***

Most adjustments required on transition to IFRS will be made, retrospectively, against opening retained earnings as of May 1, 2010, the date of the first comparative balance sheet presented under IFRS. However, IFRS 1 provides entities adopting IFRS for the first time a number of optional exemptions and mandatory exemptions, in certain areas, to the general requirement for full retrospective application of IFRS on the date of transition.

The following are the optional exemptions that the Company is considering:

- Business combination election – This election allows the Company to adopt IFRS 3(R) prospectively from the date of transition.
- Share-based payments election – This election enables the Company to adopt IFRS 2, share-based payments, from the date of transition to IFRS.
- Foreign currency translation adjustment (CTA) – This election allows the Company on its date of transition to record its CTA from all its foreign operations to retained earnings and reset the CTA balance to nil.

The remaining optional exemptions are not expected to be significant to the Company's adoption of IFRS.

### ***IFRS 2 – Share Based Payments***

The Company's policy under Canadian GAAP is to use the straight-line method to account for options that vest over time. Under IFRS, for graded-vesting features, IFRS requires each instalment to be treated as a separate share option grant, because each instalment has a different vesting period, and hence the fair value of each instalment will differ.

In addition, Canadian GAAP permits companies to either estimate the forfeitures at the grant date or record the entire expense as if all share-based payments vest and then record forfeitures as they occur. IFRS requires that forfeitures be estimated at the time of grant to eliminate distortion of remuneration expense recognized during the vesting period. The estimate should be revised if subsequent information indicates that actual forfeitures are likely to differ from previous estimates.

### ***IAS 12 – Income Taxes***

While the overall methodology for recording deferred taxes is consistent between Canadian GAAP and IFRS, there are several differences that may have an impact on the Company's financial statements.

### ***IAS 16 – Property, Plant and Equipment***

Under Canadian GAAP, costs incurred for plant and equipment on initial recognition are allocated to significant components when practicable. Under IFRS, costs incurred for plant and equipment on initial recognition are allocated to significant components, capitalized and depreciated separately over the estimated useful lives of each component. Practicability of allocating to significant components is not considered under IFRS. Costs incurred subsequent to the initial purchase of property, plant and equipment are capitalized when it is probable that future economic benefits will flow to the Company over a period and the costs can be measured reliably. Upon capitalization, the carrying amount of components replaced, if any, are written off.

### ***IAS 21 – Effects of Changes in Foreign Exchange Rates***

The underlying concepts of functional currency and reporting currency are broadly consistent between Canadian GAAP and IFRS. However, IFRS rules differ in the determination of functional currency. Under IFRS, the functional currencies of some subsidiaries may change.

*IAS 36 – Impairment of Assets*

Canadian GAAP generally uses a two-step approach to impairment testing while IFRS uses a one-step approach for both testing for and measurement of impairment. This may potentially result in more write-downs where carrying values of assets were previously supported under Canadian GAAP on an undiscounted cash flow basis, but would not be supported on a discounted cash flow basis.

In addition, IFRS requires the reversal of any previous impairment losses where circumstances leading to the original impairment have changed. Canadian GAAP prohibits reversal of impairment losses.

**OUTSTANDING SHARE DATA**

As of August 31, 2010, there were 23,791,806 common shares issued and outstanding in the Company. This represents an increase of 2,000 issued and outstanding shares as compared to the number reported in our annual MD&A (reported as of June 30, 2010).

**Major Drilling Group International Inc.**  
**Consolidated Statements of Operations**  
(in thousands of Canadian dollars, except per share information)  
(unaudited)

	Three months ended July 31	
	<u>2010</u>	<u>2009</u>
<b>TOTAL REVENUE</b>	<b>\$ 109,480</b>	\$ 62,489
<b>DIRECT COSTS</b>	<b>82,948</b>	45,259
<b>GROSS PROFIT</b>	<u><b>26,532</b></u>	<u>17,230</u>
<b>OPERATING EXPENSES</b>		
General and administrative	9,556	8,872
Other expenses	1,891	885
Foreign exchange loss (gain)	92	(680)
Interest expense (revenue)	86	(69)
Interest expense on long-term debt	200	303
Amortization	7,355	7,727
Restructuring charge (note 5)	-	1,220
Goodwill impairment (note 6)	-	2,032
	<u><b>19,180</b></u>	<u>20,290</u>
<b>EARNINGS (LOSS) BEFORE INCOME TAX</b>	<u><b>7,352</b></u>	<u>(3,060)</u>
<b>INCOME TAX - PROVISION (RECOVERY)</b>		
Current	2,943	(285)
Future	(644)	521
	<u><b>2,299</b></u>	<u>236</u>
<b>NET EARNINGS (LOSS)</b>	<u><b>\$ 5,053</b></u>	<u>\$ (3,296)</u>
<b><u>EARNINGS (LOSS) PER SHARE</u></b>		
<b>Basic *</b>	<u><b>\$ 0.21</b></u>	<u>\$ (0.14)</u>
<b>Diluted **</b>	<u><b>\$ 0.21</b></u>	<u>\$ (0.14)</u>

\*Based on 23,784,913 and 23,716,073 daily weighted average shares outstanding for the fiscal year to date 2011 and 2010, respectively. The total number of shares outstanding on July 31, 2010 was 23,789,806.

\*\*Based on 23,916,473 and 23,861,826 daily weighted average shares outstanding for the fiscal year to date 2011 and 2010, respectively.

For the quarter ended July 31, 2009 the exercise of stock options would have been anti-dilutive.

**Major Drilling Group International Inc.**  
**Consolidated Statements of Comprehensive Earnings (Loss)**

(in thousands of Canadian dollars)  
(unaudited)

	Three months ended July 31	
	<u>2010</u>	<u>2009</u>
<b>NET EARNINGS (LOSS)</b>	<b>\$ 5,053</b>	<b>\$ (3,296)</b>
<b>OTHER COMPREHENSIVE EARNINGS (LOSS)</b>		
Unrealized gains (losses) on translating financial statements of self-sustaining foreign operations	<u>5,637</u>	<u>(24,428)</u>
<b>COMPREHENSIVE EARNINGS (LOSS)</b>	<u><b>\$ 10,690</b></u>	<u><b>\$ (27,724)</b></u>

**Consolidated Statements of Retained Earnings**

(in thousands of Canadian dollars)  
(unaudited)

	Three months ended July 31	
	<u>2010</u>	<u>2009</u>
<b>RETAINED EARNINGS, BEGINNING OF THE PERIOD</b>	<b>\$ 209,025</b>	<b>\$ 218,983</b>
Net earnings (loss)	<u>5,053</u>	<u>(3,296)</u>
<b>RETAINED EARNINGS, END OF THE PERIOD</b>	<u><b>\$ 214,078</b></u>	<u><b>\$ 215,687</b></u>

**Consolidated Statements of Accumulated Other  
Comprehensive Loss**

(in thousands of Canadian dollars)  
(unaudited)

	Three months ended July 31	
	<u>2010</u>	<u>2009</u>
<b>ACCUMULATED OTHER COMPREHENSIVE LOSS, BEGINNING OF THE PERIOD</b>	<b>\$ (44,333)</b>	<b>\$ (5,079)</b>
Unrealized gains (losses) on translating financial statements of self-sustaining foreign operations	<u>5,637</u>	<u>(24,428)</u>
<b>ACCUMULATED OTHER COMPREHENSIVE LOSS, END OF THE PERIOD</b>	<u><b>\$ (38,696)</b></u>	<u><b>\$ (29,507)</b></u>

**Major Drilling Group International Inc.**  
**Consolidated Statements of Cash Flows**

(in thousands of Canadian dollars)  
(unaudited)

	Three months ended July 31	
	<u>2010</u>	<u>2009</u>
<b>OPERATING ACTIVITIES</b>		
Net earnings (loss)	\$ 5,053	\$ (3,296)
Operating items not involving cash		
Amortization	7,355	7,727
(Gain) loss on disposal of property, plant and equipment	(112)	67
Future income tax (recovery)	(644)	521
Stock-based compensation	447	505
Goodwill impairment (note 6)	-	2,032
	<u>12,099</u>	<u>7,556</u>
Changes in non-cash operating working capital items	(217)	(538)
Cash flow from operating activities	<u>11,882</u>	<u>7,018</u>
<b>FINANCING ACTIVITIES</b>		
Repayment of long-term debt	(2,281)	(3,076)
Acquisition of short-term debt (note 10)	10,400	-
Issuance of common shares	134	-
Dividend paid	(4,750)	(4,743)
Cash flow from (used in) financing activities	<u>3,503</u>	<u>(7,819)</u>
<b>INVESTING ACTIVITIES</b>		
Business acquisition (note 7)	(2,352)	-
Acquisition of property, plant and equipment	(8,919)	(3,304)
Proceeds from disposal of property, plant and equipment	540	895
Cash flow used in investing activities	<u>(10,731)</u>	<u>(2,409)</u>
<b>OTHER ACTIVITIES</b>		
Foreign exchange translation adjustment	332	(2,673)
<b>INCREASE (DECREASE) IN CASH</b>	<b>4,986</b>	<b>(5,883)</b>
<b>CASH POSITION, BEGINNING OF THE PERIOD</b>	<b><u>30,232</u></b>	<b><u>58,035</u></b>
<b>CASH POSITION, END OF THE PERIOD</b>	<b><u>\$ 35,218</u></b>	<b><u>\$ 52,152</u></b>

**Major Drilling Group International Inc.**  
**Consolidated Balance Sheets**

As at July 31, 2010 and April 30, 2010

(in thousands of Canadian dollars)

(unaudited)

<b>ASSETS</b>	<b>July</b>	<b>April</b>
	<b>2010</b>	<b>2010</b>
<b>CURRENT ASSETS</b>		
Cash	\$ 35,218	\$ 30,232
Accounts receivable	69,923	62,128
Income tax receivable	8,045	10,053
Inventories	63,491	63,170
Prepaid expenses	9,523	4,813
Future income tax assets	287	793
	<u>186,487</u>	<u>171,189</u>
<b>PROPERTY, PLANT AND EQUIPMENT</b>	<b>216,773</b>	<b>210,812</b>
<b>FUTURE INCOME TAX ASSETS</b>	<b>8,777</b>	<b>8,117</b>
<b>GOODWILL AND INTANGIBLE ASSETS (note 9)</b>	<b>26,434</b>	<b>25,538</b>
	<u>\$ 438,471</u>	<u>\$ 415,656</u>
 <b>LIABILITIES</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable and accrued charges	\$ 56,350	\$ 54,027
Income tax payable	3,872	2,830
Short-term debt (note 10)	10,624	-
Current portion of long-term debt	8,383	8,887
Future income tax liabilities	350	819
	<u>79,579</u>	<u>66,563</u>
<b>LONG-TERM DEBT</b>	<b>13,360</b>	<b>15,041</b>
<b>FUTURE INCOME TAX LIABILITIES</b>	<b>15,992</b>	<b>15,783</b>
	<u>108,931</u>	<u>97,387</u>
<b>SHAREHOLDERS' EQUITY</b>		
Share capital	142,569	142,435
Contributed surplus	11,589	11,142
Retained earnings	214,078	209,025
Accumulated other comprehensive loss	(38,696)	(44,333)
	<u>329,540</u>	<u>318,269</u>
	<u>\$ 438,471</u>	<u>\$ 415,656</u>

**MAJOR DRILLING GROUP INTERNATIONAL INC.**  
**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**  
**FOR THE PERIODS ENDED JULY 31, 2010 AND 2009**  
**(in thousands of Canadian dollars)**

**1. BASIS OF PRESENTATION**

These interim consolidated financial statements were prepared using accounting policies and methods consistent with those used in the preparation of the Company's audited consolidated financial statements for the year ended April 30, 2010. These interim consolidated financial statements conform in all respects to the requirements of Canadian generally accepted accounting principles for annual financial statements, with the exception of certain note disclosures. As a result, these interim consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and notes for the year ended April 30, 2010 contained in the Company's 2010 annual report.

**2. FUTURE ACCOUNTING CHANGES**

***International Financial Reporting Standards ("IFRS")***

In February 2008, the Accounting Standards Board ("AcSB") confirmed that the use of IFRS will be required in 2011 for publicly accountable enterprises in Canada. In April 2008, the AcSB issued an IFRS Omnibus Exposure draft proposing that publicly accountable enterprises be required to apply IFRS, in full and without modification, on January 1, 2011 for companies with a calendar year end, therefore the transition date for the Company is May 1, 2011. This will require the restatement, for comparative purposes, of amounts reported by the Company for its year ended April 30, 2011, and of the opening balance sheet as at May 1, 2010. The Company is currently in the process of developing a conversion and implementation plan and assessing the impacts of the conversion on the consolidated financial statements and disclosures of the Company.

**3. SEASONALITY OF OPERATIONS**

The Company's operations tended to exhibit a seasonal pattern whereby its fourth quarter (February to April) was its strongest. With the exception of the third quarter, the Company has, over the past several years, exhibited comparatively less seasonality in quarterly revenue. The third quarter (November to January) is normally the Company's weakest quarter due to the shutdown of mining and exploration activities, often for extended periods over the holiday season, particularly in South and Central America. Coming out of the recent economic and industry downturn, it is not yet clear whether or not the Company's revenue will return to more historical seasonal patterns, or whether a recent lack of seasonality will continue.

**4. FUNCTIONAL CURRENCY**

Effective May 1, 2010, the Company's operation in Chile changed its functional currency from the U.S. dollar to the Chilean peso. Factors considered when changing the functional currency included contract revenue being determined in local currency, the currency of operating costs and local regulations requiring invoicing and settlement of these being performed in the local currency. This change has been done in accordance with CICA Handbook Section 1651, Foreign Currency Translation, and consequently applied prospectively. All items were translated to the new functional currency using the exchange rate at the date of the change.

**MAJOR DRILLING GROUP INTERNATIONAL INC.**  
**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**  
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**(in thousands of Canadian dollars)**

**5. RESTRUCTURING CHARGE**

In the last year's first quarter, the Company recorded a restructuring charge of \$1,220 to account for retrenchment and closedown costs, primarily in Australia.

**6. GOODWILL IMPAIRMENT**

In the previous year's first quarter, the Company recorded a net non-cash goodwill impairment charge of \$2,032 relating to the Paragon del Ecuador S.A. acquisition.

**7. BUSINESS ACQUISITIONS**

***North Star Drilling***

Effective June 30, 2010, the Company acquired the assets of North Star Drilling, which provides contract drilling services to the fresh water and geothermal markets in certain mid-western states in the USA, and operates from its head office in Little Falls, Minnesota, as well as from satellite offices in Brainerd and Bemidji, Minnesota. The acquired business includes drilling equipment, contracts and employees. The purchase price for the transaction was USD \$2,250 (CAD \$2,352), excluding customary working capital adjustments, financed with cash. There is also a contingent consideration of USD \$750 to the purchase price, based on future earnings.

The Company is in the process of finalizing the valuation of assets. As at July 31, 2010, \$1,664 of the purchase price was allocated to net tangible assets and \$688 was allocated to goodwill. These values are preliminary and are subject to adjustments as additional information is obtained.

The estimated net assets acquired at fair market value at acquisition are as follows:

**Assets acquired and liabilities assumed**

Accounts receivable	\$	874
Inventories		530
Prepaid expenses		31
Property, plant and equipment		1,075
Goodwill		688
Accounts payable		(846)
<b>Net assets</b>	<b>\$</b>	<b><u>2,352</u></b>

**Consideration**

Cash	<b>\$</b>	<b><u>2,352</u></b>
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***SMD Services***

Effective February 26, 2010, the Company acquired SMD Services based in Huntsville, Alabama. Through this purchase, Major Drilling entered the environmental drilling sector and acquired a small fleet of sonic, probe and auger drill rigs, as well as a skilled management team and personnel. The purchase price for the transaction was USD \$1,953 (CAD \$2,064), including customary working capital adjustments, financed with cash. There is also a contingent consideration of USD \$2,000 to the purchase price, based on future earnings.

**MAJOR DRILLING GROUP INTERNATIONAL INC.**  
**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**  
**FOR THE PERIODS ENDED JULY 31, 2010 AND 2009**  
(in thousands of Canadian dollars)

**7. BUSINESS ACQUISITIONS (Continued)**

The net assets acquired at fair market value at acquisition are as follows:

<b>Assets acquired and liabilities assumed</b>	
Cash	\$ 90
Accounts receivable	234
Prepaid expenses	46
Property, plant and equipment	1,605
Intangible assets	249
Accounts payable	(160)
<b>Net assets</b>	<b><u>\$ 2,064</u></b>

**Consideration**

Cash	<b><u>\$ 2,064</u></b>
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**8. INVENTORY**

The cost of inventory recognized as an expense and included in direct costs for the three months ended July 31, 2010 was \$18,718. During the period, there were no significant write-downs of inventory as a result of net realizable value being lower than cost and no inventory write-downs recognized in previous years were reversed.

**9. GOODWILL AND INTANGIBLE ASSETS**

	<u>July 2010</u>	<u>April 2010</u>
Goodwill	\$ 25,249	\$ 24,464
Intangible assets	1,185	1,074
	<b><u>\$ 26,434</u></b>	<b><u>\$ 25,538</u></b>

Intangible assets include the carrying value of customer relationships and a non-compete agreement, which are amortized on a straight-line basis between a three and five year period.

Changes in the goodwill and intangible assets balance were as follows for the three months ending July 31, 2010 and 2009:

	<u>2011 YTD</u>	<u>2010 YTD</u>
Balance at beginning of the period	\$ 25,538	\$ 32,072
Goodwill and intangible assets acquired	688	-
Amortization of intangible assets	(132)	(132)
Goodwill adjustment	-	(1,690)
Goodwill impairment (note 6)	-	(2,032)
Effect of foreign currency exchange rate changes	340	(1,526)
	<b><u>\$ 26,434</u></b>	<b><u>\$ 26,692</u></b>

**MAJOR DRILLING GROUP INTERNATIONAL INC.**  
**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**  
**FOR THE PERIODS ENDED JULY 31, 2010 AND 2009**  
(in thousands of Canadian dollars)

**10. SHORT-TERM DEBT**

In the first quarter of the current fiscal year, the Company borrowed 5,375 million Chilean pesos (CAD \$10.4 million), secured by a USD \$10 million stand-by letter of credit drawn from the Company's demand credit facility, carrying interest at an annual rate of 5.18% and maturing in May 2011.

**11. CAPITAL MANAGEMENT**

The Company includes shareholders' equity (excluding accumulated other comprehensive loss), short and long-term borrowings and demand credit facility net of cash in the definition of capital.

Total managed capital was as follows:

	<u>July 2010</u>	<u>April 2010</u>
Short-term debt	\$ 10,624	\$ -
Long-term debt	21,743	23,928
Share capital	142,569	142,435
Contributed surplus	11,589	11,142
Retained earnings	214,078	209,025
Cash	<u>(35,218)</u>	<u>(30,232)</u>
	<u>\$ 365,385</u>	<u>\$ 356,298</u>

The Company's objective when managing its capital structure is to maintain financial flexibility in order to: i) preserve access to capital markets; ii) meet financial obligations; and iii) finance internally generated growth and potential new acquisitions. To manage its capital structure, the Company may adjust spending, issue new shares, issue new debt or repay existing debt.

Under the terms of certain of the Company's debt agreements, the Company must satisfy certain financial covenants. Such agreements also limit, among other things, the Company's ability to incur additional indebtedness, create liens, engage in mergers or acquisitions and make dividend and other payments. During the period, the Company was, and continues to be, in compliance with all covenants and other conditions imposed by its debt agreements.

In order to facilitate the management of its capital requirements, the Company prepares annual budgets that are updated as necessary, dependent on various factors.

The Company's objectives with regards to capital management remain unchanged from fiscal 2010.

**12. FINANCIAL INSTRUMENTS**

***Fair value***

The carrying values of cash, accounts receivable and accounts payable and accrued charges approximate their fair value due to the relatively short period to maturity of the instruments. Long-term debt has a carrying value of \$21,743 as at July 31, 2010 (April 30, 2010 - \$23,928) which also approximates its fair value.

**MAJOR DRILLING GROUP INTERNATIONAL INC.**  
**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**  
**FOR THE PERIODS ENDED JULY 31, 2010 AND 2009**  
**(in thousands of Canadian dollars)**

**12. FINANCIAL INSTRUMENTS (Continued)**

***Risk management***

The Company is exposed to various risks related to its financial assets and liabilities. There have been no substantive changes in the Company's exposure to financial instrument risks, its objectives, policies and processes for managing those risks, or the methods used to measure them, from previous periods, unless otherwise stated in this note.

***Credit risk***

The Company is exposed to credit risk from its accounts receivable. The Company has adopted a policy of dealing only with creditworthy counterparties and obtaining sufficient collateral where appropriate, as a means of mitigating the risk of financial loss from defaults. It carries out, on a continuing basis, credit checks on its customers and maintains provisions for contingent credit losses. The Company also diversifies its credit risk by dealing with a large number of customers in various countries. Demand for the Company's drilling services depends upon the level of mineral exploration and development activities conducted by mining companies, particularly with respect to gold, nickel and copper. The Company's five largest customers account for 28 percent (34 percent in 2010) of total quarterly revenue, with no one customer representing more than 10 percent of its revenue for 2011 or 2010.

The carrying amounts for accounts receivable are net of allowances for doubtful accounts, which are estimated based on aged analyses of receivables, past experience, specific risks associated with the customer and other relevant information. The maximum exposure to credit risk is the carrying value of the financial assets.

As at July 31, 2010, 69 percent of the Company's trade receivables were aged as current (less than 30 days) and 2.6 percent of the trade receivables were impaired.

Credit risk also arises from cash and cash equivalents and deposits with banks and financial institutions. This risk is limited because the counterparties are banks with high credit ratings assigned by international credit-rating agencies.

***Interest rate risk***

The demand loan and long-term debt of the Company bear a floating rate of interest, which exposes the Company to interest rate fluctuations.

As at July 31, 2010, the Company has estimated that a one percentage point increase in interest rates would have caused a quarterly decrease in net income of approximately \$50 and a one percentage decrease in interest rates would have caused a quarterly increase in net income of \$50.

***Foreign currency risk***

Foreign currency risk arises as the Company has operations located internationally where local operational currency is not the same as the functional currency of the Company.

A significant portion of the Company's operations are located outside of Canada. The accounting impact of foreign currency exposure is minimized since the operations are classified as self-sustaining operations. In certain developing countries, the Company mitigates its risk of large exchange rate fluctuations by conducting business primarily in U.S. dollars. U.S. dollar revenue

**MAJOR DRILLING GROUP INTERNATIONAL INC.**  
**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**  
**FOR THE PERIODS ENDED JULY 31, 2010 AND 2009**  
(in thousands of Canadian dollars)

**12. FINANCIAL INSTRUMENTS (Continued)**

exposure is partially mitigated by offsetting U.S. dollar labour and material expenses. Monetary assets denominated in foreign currencies are exposed to foreign currency fluctuations.

Based on the Company's foreign currency net monetary exposures and net assets as at July 31, 2010, and assuming that all other variables remain constant, a 10 percent rise or fall in the Canadian dollar against the other foreign currencies would have resulted in increases (decreases) in the net earnings and comprehensive earnings as follows:

	<u>Increase (decrease) in net earnings</u>	
	<u>Canadian dollar appreciates 10%</u>	<u>Canadian dollar depreciates 10%</u>
U.S. Dollar	\$ (865)	\$ 865

  

	<u>Increase (decrease) in comprehensive earnings</u>	
	<u>Canadian dollar appreciates 10%</u>	<u>Canadian dollar depreciates 10%</u>
U.S. Dollar	\$ (22,170)	\$ 22,170
Chilean Peso	(3,369)	3,369
Australian Dollar	(884)	884

***Liquidity risk***

Liquidity risk, the risk that the Company would not be able to meet its financial obligations as they become due, arises from the Company's management of working capital, finance charges and principal repayments on its debt instruments.

The Company manages liquidity risk by maintaining adequate reserves, banking facilities and reserve borrowing facilities, by continuously monitoring forecast and actual cash flows and matching the maturity profiles of financial assets and liabilities.

Total financial liabilities, by due date, as at July 31, 2010 are as follows:

	<u>Total</u>	<u>1 year</u>	<u>2-3 years</u>	<u>4-5 years</u>
Accounts payable & accrued charges	\$ 56,350	\$ 56,350	\$ -	\$ -
Long-term debt	<u>21,743</u>	<u>8,383</u>	<u>11,473</u>	<u>1,887</u>
	<u>\$ 78,093</u>	<u>\$ 64,733</u>	<u>\$ 11,473</u>	<u>\$ 1,887</u>

**MAJOR DRILLING GROUP INTERNATIONAL INC.**  
**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**  
**FOR THE PERIODS ENDED JULY 31, 2010 AND 2009**  
(in thousands of Canadian dollars)

**13. SEGMENTED INFORMATION**

	<u>2011 YTD</u>	<u>2010 YTD</u>
Revenue		
Canada - U.S.	\$ 40,451	\$ 20,188
South and Central America	40,017	18,243
Australia, Asia and Africa	29,012	24,058
	<u>\$ 109,480</u>	<u>\$ 62,489</u>
Earnings (loss) from operations		
Canada - U.S.	\$ 5,571	\$ 1,613
South and Central America	4,532	1,906
Australia, Asia and Africa	994	(704)
	<u>11,097</u>	<u>2,815</u>
Eliminations	<u>(231)</u>	<u>(324)</u>
	<u>10,866</u>	2,491
Interest expense, net	286	234
General corporate expenses	3,228	2,065
Restructuring charge	-	1,220
Goodwill impairment	-	2,032
Income tax	2,299	236
Net earnings (loss)	<u>\$ 5,053</u>	<u>\$ (3,296)</u>

Goodwill impairment relates to the South and Central American segment for the fiscal year 2010 (see Note 6 – Goodwill Impairment).