

***MAJOR***

*Partners on the Ground*

**Management's Discussion and Analysis**

**Second Quarter Fiscal 2015**

# **MAJOR DRILLING GROUP INTERNATIONAL INC.**

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

### **SECOND QUARTER FISCAL 2015**

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 October 31, 2014. All amounts in this MD&A are in Canadian dollars, except where otherwise noted. These quarterly unaudited interim condensed consolidated financial statements were prepared in accordance with International Financial Reporting Standards ("IFRS").

This MD&A is a review of activities and results for the quarter ended October 31, 2014 as compared to the corresponding period in the previous year. Comments relate to, and should be read in conjunction with, the comparative unaudited interim condensed consolidated financial statements as at and for the three months ended October 31, 2014, 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, 2014.

This MD&A is dated November 30, 2014. Disclosure contained in this document is current to that date, unless otherwise stated.

#### **FORWARD-LOOKING STATEMENTS**

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. These forward-looking statements are typically identified by future or conditional verbs such as "outlook", "believe", "anticipate", "estimate", "project", "expect", "intend", "plan", and terms and expressions of similar import.

Such forward-looking statements are subject to a number of risks and uncertainties, which include, but are not limited to: cyclical downturn, competitive pressures, dealing with business and political systems in a variety of jurisdictions, repatriation of property in other jurisdictions, payment of taxes in various jurisdictions, exposure to currency movements, inadequate or failed internal processes, people or systems or from external events, dependence on key customers, safety performance, expansion and acquisition strategy, legal and regulatory risk, corruption, bribery and fraud by employees and agents, extreme weather conditions and the impact of natural or other disasters, specialized skills and cost of labour increases, equipment and parts availability and reputational risk. 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 also discussed in the Company's Annual Information Form.

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

## **CORPORATE OVERVIEW**

Major Drilling Group International Inc. is one of the world's largest drilling services 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, Mexico, South America, Asia, and Africa. Major Drilling provides all types of drilling services including surface and underground coring, directional, reverse circulation, sonic, geotechnical, environmental, water-well, coal-bed methane, shallow gas and underground percussive/longhole drilling.

## **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 prudent debt levels and remaining best in class in safety and human resources. The Company is also diversifying into energy and additional underground drilling services, such as percussive/longhole services, which are complementary to its skill set.

The Company categorizes its mineral 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, the Company believes 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 later stages of the mining cycle as clients develop underground mines. The Company just entered a new type of underground service with the acquisition of Taurus Drilling Services, a provider of underground percussive/longhole drilling to mining companies. Percussive/longhole drilling is more related to the production function of a mine. Offering both underground production drilling and its existing underground core drilling, the Company can now provide an even wider range of complementary services to its clients.

A key part of the Company's strategy is to maintain a strong balance sheet. The Company is in a unique position to react quickly when the industry begins to recover as its financial strength allows it to invest in safety and to maintain its equipment in excellent condition. The Company also has a variable cost structure whereby most of its direct costs, including field staff, go up or down with contract revenue, and a large part of the Company's other expenses relate to variable incentive compensation based on the Company's profitability.

## **INDUSTRY OVERVIEW**

The metals and minerals drilling industry is reliant primarily on demand from two metal groups, gold on the one hand and base metals on the other. Each commodity group is influenced by distinct market forces.

Gold has always been a significant driver in the mining industry accounting for 40 to 50% of the exploration spend carried out around the world. Exploration activity generally varies up or down with the trend in gold prices.

The demand for base metals is dependent on economic activity. In the longer-term, the fundamental drivers of base metals remain positive, with worldwide supply for most metals expected to tighten and higher demand coming from the emergence of the BRIC countries (Brazil, Russia, India and China) over the last 10 years. As these countries continue to urbanize, the requirement for base metals will continue to increase at the same time as the easily accessible reserves are being depleted.

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

In terms of customer base, the Company has two categories of customers: senior and intermediate companies with operating mines, and junior exploration companies.

The industry is currently in a cyclical downturn. At this point in time, most senior and intermediate mining companies are more cautious with their investments in exploration. Large base metal producers will eventually need to expand existing mines and develop new ones to meet the world's growth, especially in emerging markets. Activity from senior gold producers is likely to show greater volatility as gold prices vary, which will impact their exploration budgets.

Many junior mining companies continue to experience financing difficulties and thus have slowed down their exploration efforts. Junior mining companies can account for some 50% of the drilling market in cyclical upturns. While it is expected that some of the more advanced projects will be able to obtain financing as needed, it will be necessary for investors to once again support exploration projects in order for drilling activities to regain the momentum that they had at their peak.

## **BUSINESS ACQUISITION**

### *Acquisition of Taurus Drilling Services*

Effective August 1, 2014, the Company entered into the underground percussive/longhole drilling sector with its purchase of the operations of Taurus Drilling Services ("Taurus"), based in Canada and the United States. The acquisition was accounted for using the acquisition method and the results of this operation were included in the Interim Condensed Consolidated Statements of Operations as of the closing date. Through this purchase, the Company acquired 39 percussive underground drill rigs, support equipment and inventory, existing contracts and receivables, the operation's management team, and other employees, including experienced drillers.

The purchase price for the transaction was \$29.6 million (consisting of \$20.7 million in cash, \$8.7 million in Major Drilling shares, and \$0.2 million in assumption of debt), and an additional maximum amount of \$11.5 million tied to performance. The additional payout period extends for three years, commencing on August 1, 2014, and payments are contingent on growing EBITDA run rates above current levels.

## **OVERALL PERFORMANCE**

Total revenue for the quarter was \$87.2 million, down 6% from the same quarter last year. Uncertainty around economic matters impacting the mining market continues to cause delays in customers' exploration drilling plans, and in a number of jurisdictions, uncertainty as to the policies of host governments or issues of land tenure also had an impact on quarterly results. Also, many junior customers have scaled back or suspended drilling activities due to a lack of capital.

Despite this very difficult environment, the Company has been able to increase its revenue by 29% and its EBITDA by 75% over the first quarter of fiscal 2015, with slightly more than half of the increases coming from the Taurus acquisition. The Company's existing coring business has seen increased utilization, although still at depressed prices. It should be noted that last year's revenue included some \$9 million from Australia and the Democratic Republic of Congo ("DRC"), branches where operations have since closed.

Lower levels of demand have significantly increased competitive pressures and margins continue to be affected as it is difficult to improve productivity beyond the gains the Company has been able to make over the last two years. With underground activities currently representing 26% of revenue, and depressed pricing in other operations, margins were lower at 23.8%.

Also, during the quarter the Company recorded a restructuring charge of \$2.8 million, primarily relating to the decision to close its operations in the DRC due to ongoing administrative difficulties associated with operating in that country.

Net loss was \$10.1 million or \$0.13 per share (\$0.13 per share diluted) for the quarter, compared to a net loss of \$19.1 million or \$0.24 per share (\$0.24 per share diluted) for the prior year quarter.

## **RESULTS OF OPERATIONS – SECOND QUARTER ENDED OCTOBER 31, 2014**

Total revenue for the quarter was \$87.2 million, down 6% from revenue of \$92.3 million recorded in the same quarter last year, but up 29% from the first quarter. Uncertainty around economic matters impacting the mining market continues to cause delays in customers' exploration drilling plans, and in a number of jurisdictions, uncertainty as to the policies of host governments or issues of land tenure also had an impact on quarterly results. Also, many junior customers have scaled back or suspended drilling activities due to a lack of capital.

Revenue for the quarter from Canada-U.S. drilling operations increased by 14% to \$49.8 million compared to the same period last year. Both countries continue to be affected by the slowdown in the industry, but decreased revenue in exploration drilling was more than offset by the additional revenue provided by the Taurus acquisition.

South and Central American revenue was up 33% to \$23.3 million for the quarter, compared to the same quarter last year. Mexico, Chile and Argentina, all showed increased activity levels although at lower prices. In Brazil, the Company had its first full quarter of operations, although it is expected that it will take a few months to attain an adequate volume to become profitable.

Australian, Asian and African operations reported revenue of \$14.0 million, down 55% from the same period last year. Several factors affected the region's revenue this quarter compared to last year. The Company closed its operations in Australia earlier in the year, and has also closed its operations in the DRC due to ongoing administrative difficulties associated with operating in that country. Also, Mongolia continues to be affected by political uncertainty around mining laws.

The overall gross margin percentage for the quarter was 23.8%, down from 32.5% for the same period last year. Margins continue to be affected by reduced pricing due to increased competitive pressures. As well, our customers are focusing on mine site drilling, especially underground drilling, which tends to have lower margins.

General and administrative costs were down 8% from last year at \$11.3 million for the quarter despite adding the operations of Taurus Drilling. With the decrease in activity, the Company has reduced its general and administrative costs by implementing reductions of salaried employees and restructuring certain branches.

The Company recorded a restructuring charge of \$2.8 million, primarily relating to the decision to shut down operations in the DRC. This consists primarily of a non-cash write-down of assets and close-down costs relating to severance and moving costs.

The provision for income tax for the quarter was an expense of \$2.4 million compared to \$8.7 million for the prior year period. The tax expense for the quarter was impacted by non-tax affected losses, non-deductible expenses and tax audit settlements relating to prior years.

Net loss was \$10.1 million or \$0.13 per share (\$0.13 per share diluted) for the quarter, compared to a net loss of \$19.1 million or \$0.24 per share (\$0.24 per share diluted) for the prior year quarter, as the Company recorded a goodwill impairment of \$12.1 million last year related to its Chilean operations.

## RESULTS OF OPERATIONS – YEAR-TO-DATE ENDED OCTOBER 31, 2014

Revenue for the six months ended October 31, 2014 decreased 23% to \$154.7 million from \$200.5 million for the corresponding period last year.

Revenue from Canada-U.S. drilling operations decreased by 11% to \$86.2 million compared to the same period last year as both countries were affected by the slowdown in the industry, which was somewhat offset by the additional revenue provided by the Taurus acquisition.

South and Central American revenue was down 5% to \$37.4 million compared to the same period last year.

Australian, Asian and African operations reported revenue of \$31.1 million, down 52% from the same period last year. Four main factors affected the region's revenue: 1) Australia, where the Company has shut down operations, 2) Mongolia, which is affected by political uncertainty around mining laws, 3) DRC where the Company has closed its operation due to ongoing administrative difficulties associated with operating in that country, and 4) Mozambique, where the cancellation of one large project had a significant impact on that operation.

Gross margin for the year-to-date was 24.2% compared to 32.5% last year. Margins were affected by reduced pricing due to increased competitive pressures. As well, margins were affected by higher than normal repair costs this quarter, as the Company continued to prepare rigs in order to be able to respond rapidly to any customer requests.

General and administrative expenses decreased by \$3.1 million or 12% to \$22.2 million compared to the prior year. With the decrease in activity, the Company has reduced its general and administrative costs by implementing reductions of salaried employees and restructuring certain branches.

The Company recorded a restructuring charge of \$3.4 million, primarily relating to the decision to shut down operations in the DRC. This consists primarily of a non-cash write-down of assets and close-down costs relating to severance and moving costs. Last year's restructuring charge of \$2.7 million consisted primarily of retrenchment costs following additional staff reduction initiatives implemented across the Company.

Net loss was \$17.5 million or \$0.22 per share (\$0.22 per share diluted) compared to a loss of \$17.6 million or \$0.22 per share (\$0.22 per share diluted) last year.

## SUMMARY OF QUARTERLY RESULTS

(in \$000 CAD, except per share)	Fiscal 2013		Fiscal 2014				Fiscal 2015	
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Revenue	\$ 123,189	\$ 135,537	\$ 108,211	\$ 92,268	\$ 71,830	\$ 82,637	\$ 67,551	\$ 87,192
Gross profit	29,275	43,087	35,122	30,011	17,770	21,524	16,667	20,736
Gross margin	23.8%	31.8%	32.5%	32.5%	24.7%	26.0%	24.7%	23.8%
Net (loss) earnings	(4,288)	2,174	1,522	(19,100)	(12,797)	(24,935)	(7,331)	(10,148)
Per share - basic	(0.05)	0.03	0.02	(0.24)	(0.16)	(0.31)	(0.09)	(0.13)
Per share - diluted	(0.05)	0.03	0.02	(0.24)	(0.16)	(0.31)	(0.09)	(0.13)

With the exception of the third quarter, the Company exhibits comparatively less seasonality in quarterly revenue than in the past. 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.

## LIQUIDITY AND CAPITAL RESOURCES

### *Operating Activities*

Cash flow from operations (before changes in non-cash operating working capital items, finance costs and income taxes) was \$5.8 million for the quarter compared to \$15.7 million generated in the same period last year.

The change in non-cash operating working capital items was an inflow of \$3.6 million for the quarter compared to an inflow of \$9.7 million for the same period last year. The inflow in non-cash operating working capital in the quarter ended October 31, 2014 was primarily impacted by:

- An increase in accounts receivable of \$6.0 million due to increased activity in the second quarter;
- A decrease in inventory of \$4.8 million;
- A decrease in prepaid expenses of \$1.4 million; and
- An increase in accounts payable of \$4.1 million (net of dividend payable of \$8.0 million).

### *Financing Activities*

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 quarter, the Company entered into an amending agreement amending the current credit agreement with its lenders. As a result, the Company is in compliance with all covenants and other conditions imposed in this credit agreement.

### Operating Credit Facilities

The credit facilities related to operations total \$33.2 million (\$25.0 million from a Canadian chartered bank, \$3.9 million for a Chilean pesos facility and \$4.3 million in various credit facilities) and are primarily secured by corporate guarantees of companies within the group. At October 31, 2014, the Company had utilized \$7.4 million of these lines mainly for stand-by letters of credit. The Company also has a credit facility of \$3.1 million for credit cards for which interest rate and repayment are as per cardholder agreements.

### Long-Term Debt

Total long-term debt decreased by \$4.5 million during the quarter to \$17.6 million at October 31, 2014. Debt repayments were \$4.8 million during the quarter.

As of October 31, 2014, the Company had the following long-term debt facilities:

- \$9.6 million non-revolving facility for financing the acquisition of Bradley Group. This facility is amortized over five years ending in September 2016.
- \$50.0 million revolving facility for financing the cost of equipment purchases or acquisition costs of related businesses. At October 31, 2014, this facility had not been utilized.
- \$6.8 million non-revolving facility. This facility carries a fixed interest rate of 5.9% and is amortized over ten years ending in August 2021.
- The Company also has various other loans and capital lease facilities related to equipment purchases that totaled \$1.2 million at October 31, 2014, which were fully drawn and mature through 2017.

The Company believes that it will be able to generate sufficient cash flow to meet its current and future debt obligations and appropriate levels of working capital, capital expenditures, and dividends. As at October 31, 2014, the Company had unused borrowing capacity under its credit facilities of \$75.8 million and cash of \$51.1 million, for a total of \$126.9 million in available funds.

### ***Investing Activities***

Capital expenditures were \$2.9 million for the quarter ended October 31, 2014 compared to \$6.0 million for the same period last year.

The disposal of equipment generated proceeds of \$5.2 million during the quarter compared to \$1.1 million for the same period last year.

During the quarter, the Company added 39 drill rigs through its Taurus acquisition while retiring or disposing of 9 drill rigs through its modernization program. This brings the total drill rig count to 720 at quarter-end.

## **OUTLOOK**

Due to the uncertainty around economic matters impacting the mining market, it is very difficult to forecast customer demand over the next twelve months, as senior customers are still very cautious about investing in future projects. In the immediate future, however, the Company is adding revenue from the Taurus acquisition, which has allowed the Company to provide an even wider range of complementary services, adding underground production drilling to existing underground core drilling. Also, the Company is in a unique position to react quickly when the industry begins to recover as the Company's financial strength has allowed it to invest in safety and to maintain its equipment in excellent condition.

It is important to note that the Company is now in its third quarter, traditionally the weakest quarter of its fiscal year, as mining and exploration companies shut down, often for extended periods over the holiday season. At this time, most senior and intermediate companies are still working through their budget process and have yet to decide on post-holiday start-up dates. As usual, due to the time it takes to mobilize once contracts are awarded, a slow pace of start-ups is expected in January, which will impact overall third quarter revenue. Pricing is expected to remain competitive until utilization rates pick up significantly, especially in conventional drilling. Therefore, as the Company has experienced in some past years, it expects to generate a seasonal loss in the upcoming third quarter. As the outlook for 2015 becomes clearer, the Company will continue to evaluate each of its operations and continue to review the appropriate levels for its dividend.

## **FOREIGN EXCHANGE**

Year-over-year revenue comparisons continue to be affected by the variations of the Canadian dollar against the U.S. dollar and other functional reporting currencies. The favourable impact of foreign exchange translation, for the quarter, when comparing to the effective rates for the same period last year, is estimated at \$2 million on revenue but negligible on net earnings. The favourable impact of foreign exchange translation, for the six-month period ended October 31, 2014, is estimated at \$4 million on revenue but negligible on net earnings.

## **COMPREHENSIVE EARNINGS**

The consolidated statements of other comprehensive earnings for the quarter include \$8.8 million in unrealized gain on translating the financial statements of the Company's foreign operations compared to a gain of \$9.7 million for the same period last year. The change relates to translating the net assets of the Company's foreign operations, which have a functional currency other than the Canadian dollar, to the Company's Canadian dollar currency presentation.

## **GENERAL RISKS AND UNCERTAINTIES**

A complete discussion of general risks and uncertainties may be found in the Company's Annual Information Form for the fiscal year ended April 30, 2014, which can be found on the SEDAR website at [www.sedar.com](http://www.sedar.com), and which continue to apply to the business of the Company. The Company is not aware of any significant changes to risk factors from those disclosed at that time.

## **OFF BALANCE SHEET ARRANGEMENTS**

Except for operating leases discussed in the annual MD&A for the year ended April 30, 2014, where there were no significant changes, the Company does not have any other off balance sheet arrangements.



## **DISCLOSURE CONTROLS AND INTERNAL CONTROLS OVER FINANCIAL REPORTING**

There have been no changes in the Company's disclosure and internal controls over financial reporting during the period beginning on May 1, 2014 and ending on October 31, 2014 that have materially affected, or are reasonably likely to materially affect, its internal controls over financial reporting.

## **OUTSTANDING SHARE DATA**

As of November 30, 2014, there were 80,135,883 common shares issued and outstanding in the Company. This is the same number as reported in our first quarter MD&A (reported as of August 29, 2014).

## **ADDITIONAL INFORMATION**

Additional information relating to the Company, including the Company's Annual Information Form, is available on SEDAR at [www.sedar.com](http://www.sedar.com).