

Groupe Forage

***MAJOR***

Drilling Group International Inc.

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

### **First Quarter Fiscal 2010**

## **MAJOR DRILLING GROUP INTERNATIONAL INC.**

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

#### **FIRST QUARTER FISCAL 2010**

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, 2009. 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, 2009, except for the adoption of new accounting policies as disclosed in Note 2 of the Notes to Interim Unaudited Consolidated Financial Statements.

This MD&A is a review of activities and results for the quarter ended July 31, 2009 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, 2009, 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, 2009.

This MD&A is dated August 31, 2009. 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. 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, Indonesia, Mongolia, 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 the class in safety and human resources.

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 is much 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. While growth in underground drilling is relatively flat, conventional drilling grows parallel with the industry cycle, while specialized drilling grows structurally.

Specialized projects tend to be more costly for customers than conventional projects. Due to the impact of the current 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. Subsequent to the quarter, general activity levels have begun to increase. However, we expect pricing to remain competitive until utilization rates pick up significantly, especially in conventional drilling. Over time, we expect 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 metal groups, gold on the one hand and base metals on the other. Each commodity group is influenced by distinct market forces. In a positive commodity pricing regime, either one of these metal groups can, by itself, stimulate significant demand for drilling services. In the last few years, historically high commodity prices in all commodities drove the industry to record levels of activity with worldwide mineral exploration expenditures in calendar 2008 surpassing US\$14 billion.

The current economic environment has impacted, and will continue to impact, drilling in the short to medium-term, particularly on base metal projects. Senior and intermediate base metal companies that are leveraged have also

reduced their exploration spending for 2009, in order to conserve cash. Many gold producers have delayed exploration plans due to the uncertainty in the economy. Sources of funding for junior mining companies are limited, and as such many junior projects, both in the base metals and gold sectors, have been delayed or cancelled.

In the longer-term, the fundamental drivers of our 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 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. Especially evident from their analysis is that the number of recently discovered large deposits of more than 2.5 million oz. (a size senior mining companies would consider developing) is not adequate to replace the seniors’ gold production. The discovery rate of major gold deposits has declined in each of the last 10 years. Historically, only about half of feasibility-stage projects reach production within 10 years.

## **Base Metals**

Drilling services for base metals are affected by overall commodity prices. Despite the current economic environment, with low levels of exploration in the recent past limiting the 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.

## **OUTLOOK**

The current economic environment continues to impact drilling in the short to medium-term. While we expect continued improvements as the year goes on, calendar 2009 will remain difficult. If customers move forward with their stated plans, we should see gradual gains as each month goes by. Despite the upward movement in commodity prices and the fund raising activity that occurred in the last few months, customers, especially the large mining companies, remain very hesitant to invest in exploration. Most of these companies are not expected to reset their budgets until next calendar year and will remain focused on cash management. Although improved, the capital markets remain challenging for junior mining companies.

Subsequent to the quarter, general activity levels have begun to increase. However, we expect pricing to remain competitive until utilization rates pick up significantly, especially in conventional drilling. Over time, we expect many of the supply issues that face most commodities to come back into focus and that even with moderate growth in the world economy, the need to explore and develop mines will increase. We believe 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.

## **OVERALL PERFORMANCE**

During the quarter, activity levels were flat relative to the fourth quarter but due to the weakening U.S. dollar, the Company posted lower revenue in Canadian dollars. Market conditions during the quarter continued to be difficult and operations were still affected by ongoing delays and program cancellations. With the liquidity crisis, a large number of specialized projects, which tend to be more costly for customers than conventional projects, and where the Company has historically placed its main focus, have either been cancelled or very heavily cut back.

In terms of regional performance, Latin America and Canada are holding up relatively well. The Company continues to explore new opportunities to expand its geographic footprint. For instance, during the quarter, the Company started operations in Colombia. On the other hand, market conditions are much more difficult in Australia, the U.S. and Africa. During the quarter, the Company took further actions in Australia to restructure its operations by closing down two offices and reducing personnel. As such, the Company recorded a further restructuring charge of \$1.2 million during the quarter. Australia was also affected by adverse weather conditions. Queensland, where the

Company concentrates its operations, suffered its worst floods since 1974. The restructuring combined with better weather conditions should improve performance in that region going forward.

Revenue for the quarter was down 64.9 percent at \$62.5 million compared to \$178.2 million recorded for the prior year period. Cancellations or delays of drilling programs, combined with price reductions, significantly affected revenue in all three regions.

The overall gross margin percentage for the quarter was down at 27.6 percent as compared to 35.5 percent for the same period last year. Reduced pricing due to increased competitive pressures and delays significantly impacted margins. Pricing dropped by more than 20 percent overall since October 2008 but the Company has been able to recapture some of this loss through productivity gains and cost cutting. Finally, weather issues in Australia impacted margins, especially in the energy sector.

During the quarter, the Company recorded a restructuring charge of \$1.2 million to account for retrenchment and closedown costs primarily in Australia. Also, the Company recorded a net non-cash goodwill impairment charge of \$2.0 million on its Ecuador acquisition.

Net loss for the quarter was \$3.3 million or \$0.14 per share (\$0.14 per share diluted) compared to net earnings of \$26.3 million or \$1.11 per share (\$1.10 per share diluted) in the prior year period.

Given the Company's ability to generate cash even in these most difficult times, its Board of Directors declared its third semi-annual cash dividend of \$0.20 per common share payable on November 2, 2009 to shareholders of record as of October 9, 2009. This dividend is designated as an "eligible dividend" for Canadian tax purposes.

## **RESULTS OF OPERATIONS – FIRST QUARTER ENDED JULY 31, 2009**

Total revenue for the quarter was \$62.5 million down 64.9 percent from the \$178.2 million recorded in the same quarter last year. Cancellations or delays of drilling programs, combined with price reductions, significantly affected revenue in all three regions.

Revenue for the quarter from Canada-U.S. drilling operations decreased by 63.7 percent to \$20.2 million compared to \$55.6 million for the same period last year. Cancellations and decreased pricing impacted both countries.

South and Central American revenue was at \$18.2 million for the quarter, down 67.1 percent from the \$55.3 million posted for the prior year quarter. During the quarter, the Company started operations in Colombia. In Ecuador operations are still on hold due to delays related to mining law implementation.

Australian, Asian and African operations reported revenue of \$24.1 million, down some 64.2 percent from the \$67.4 million reported in the same period last year. Cancellation of drilling programs and severe weather issues impacted revenue in Australia. Indonesia was affected by a reduction in drilling programs and pricing while Mongolian revenue continued to be down compared to last year as the mining industry awaited the final passage of that country's mining laws.

The overall gross margin percentage for the quarter was 27.6 percent, down from 35.5 percent for the same period last year. Reduced pricing due to increased competitive pressures and delays significantly impacted margins. Pricing dropped by more than 20 percent overall since October 2008 but the Company has been able to recapture some of this loss through productivity gains and cost cutting. Finally, weather issues in Australia impacted margins, especially in the energy sector.

General and administrative costs were \$8.9 million for the quarter, down 33.6 percent compared to \$13.4 million in the same period last year. The decrease was due to cost cutting initiatives implemented in November and February.

Other expenses for the quarter were \$0.9 million, down from \$3.8 million in the prior year quarter, due primarily to lower incentive compensation expenses given the Company's decreased profitability in the current year.

Foreign exchange gain in the quarter was \$0.7 million compared to a loss of \$0.2 million in the prior year quarter.

Short-term interest revenue was flat at \$0.1 million compared to the same quarter last year, while interest expense on long-term debt was down to \$0.3 million compared to \$0.6 million for the same quarter last year due to lower levels of debt and reduced interest rates.

Amortization expense was \$7.7 million for the quarter compared to \$7.6 million for the same quarter last year, as a result of the increased direct investment in equipment.

During the quarter, the Company recorded a restructuring charge of \$1.2 million to account for retrenchment and closedown costs primarily in Australia. Also, the Company recorded a net non-cash goodwill impairment charge of \$2.0 million. This eliminated goodwill of \$3.7 million recorded on the Paragon del Ecuador S.A. acquisition, offset by a reduction of a holdback of \$1.7 million, which was a contingent consideration to the purchase price and dependant on the political situation in Ecuador. The goodwill impairment charge resulted from political issues and uncertainty still affecting the mining industry in Ecuador.

Income tax expense was \$0.2 million in the quarter compared to \$11.5 million for the prior year quarter. Tax expense for the quarter was impacted by the non-recognition or reversal of tax losses in Ecuador and losses in Tanzania.

Net loss for the quarter was \$3.3 million or \$0.14 per share (\$0.14 per share diluted) compared to net earnings of \$26.3 million or \$1.11 per share (\$1.10 per share diluted) in the prior year period.

## SUMMARY OF QUARTERLY RESULTS

(in \$000 CDN, except per share)	Fiscal 2008			Fiscal 2009				Fiscal 2010
	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Revenue	\$ 156,136	\$ 120,758	\$ 169,995	\$ 178,215	\$ 191,010	\$ 87,361	\$ 66,400	\$ 62,489
Gross profit	54,665	33,712	59,420	63,304	70,438	24,086	17,806	17,230
Gross margin	35.0%	27.9%	35.0%	35.5%	36.9%	27.6%	26.8%	27.6%
Earnings (loss) from continuing operations	22,815	7,670	25,286	26,330	29,276	(5,070)	(4,601)	(3,296)
Per share - basic	0.97	0.32	1.07	1.11	1.23	(0.21)	(0.19)	(0.14)
Per share - diluted	0.95	0.32	1.05	1.10	1.22	(0.21)	(0.19)	(0.14)
Net earnings (loss)	22,563	7,236	25,361	26,330	29,276	(5,070)	(4,601)	(3,296)
Per share - basic	0.96	0.31	1.07	1.11	1.23	(0.21)	(0.19)	(0.14)
Per share - diluted	0.94	0.30	1.05	1.10	1.22	(0.21)	(0.19)	(0.14)

The geographic distribution of the Company's operations, as well as the timing of the current economic downturn, has impacted its historical seasonal revenue patterns. Historically, the Company's fourth quarter was 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. With the current economic and industry downturn ongoing, 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 \$7.6 million for the quarter compared to \$36.5 million generated in the same period last year.

The change in non-cash operating working capital items was an outflow of \$0.5 million in the quarter compared to an outflow of \$18.4 million for the same quarter last year.

### ***Financing Activities***

Total long-term debt decreased by \$5.6 million during the quarter from \$38.6 million at April 30, 2009 to \$33.0 million at July 31, 2009. The decrease is primarily due to debt repayments of \$3.1 million and a reduction of a holdback of \$1.7 million which was a contingent consideration and dependant on the political situation in Ecuador.

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 \$31.1 million (\$30.0 million from a Canadian chartered bank and \$1.1 million in credit facilities in Chile and Australia) and are secured by fixed and floating charges on selected Canadian capital assets, a general assignment of book debts, inventories and corporate guarantees of companies within the group. The Company has a credit facility of \$1.7 million for credit cards for which interest rate and repayment are as per cardholder agreements. At July 31, 2009, the Company had utilized \$0.7 million of these lines for stand-by letters of credit.

The Company has a \$65.0 million facility for financing the cost of equipment purchases or acquisition costs of related businesses. At July 31, 2009, the Company had utilized \$25.4 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 \$12.8 million at July 31, 2009, of which \$7.6 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, 2009, the Company had unused borrowing capacity under its credit facilities of \$75.2 million and cash of \$52.2 million, for a total of \$127.4 million in available funds.

### ***Investing Activities***

Capital expenditures were \$3.3 million for the quarter ended July 31, 2009 compared to \$19.0 million (\$18.9 million net of financing) for the same period last year. As the difficulty in accessing ore bodies continues to increase, the Company continues to see opportunities to invest in specialized drilling, but in the current economic climate, will do so at a slower pace. While acquisitions remain a possibility, we are increasingly focused on building our cash reserves. It is expected that capital expenditures will be reduced to \$25 million in fiscal 2010 as the Company focuses on cash accumulation.

During the quarter, the Company added 4 drill rigs through its capital expenditure program. This brings the total rig count to 539 at quarter-end.

## **FOREIGN EXCHANGE**

Year-over-year revenue comparisons continue to be affected by the variations of the Canadian dollar against the U.S. dollar and the Australian dollar. The unfavourable impact of foreign exchange translation, for the quarter, when comparing to the effective rates for the same period last year, is estimated at \$3 million on revenue but negligible on net loss.

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

The consolidated statements of comprehensive (loss) earnings for the quarter include \$24.4 million in unrealized losses on translating the financial statements of our self-sustaining foreign operations. 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 quarter, the Canadian dollar strengthened 10.3 percent against the U.S. dollar but weakened 3 percent against the Australian dollar, increasing the net value of our net asset position in these subsidiaries in Canadian dollar terms.

## **RESTRUCTURING CHARGE**

During the quarter, the Company took further actions in Australia to restructure the operations by closing down two offices and reducing personnel. As such, the Company recorded a restructuring charge of \$1.2 million during the quarter. These changes combined with better weather conditions should improve performance in that region going forward.

## **GOODWILL IMPAIRMENT**

In the current quarter, the Company recorded a net non-cash goodwill impairment charge of \$2.0 million. This charge eliminates the goodwill of \$3.7 million recorded on the Paragon del Ecuador S.A. acquisition offset by a reduction of a holdback of \$1.7 million which was a contingent consideration and dependant on the political situation in Ecuador.

The goodwill impairment charge resulted from political issues and uncertainty still affecting the mining industry in Ecuador and therefore the inability of this region to generate the expected revenue.

## **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 the continuing or further 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 rationalize its regional infrastructures. In the last cyclical market downturn, 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 current 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. Also, both credit and capital markets financing have become generally scarce under current global economic conditions, which could adversely impact the exploration programs of all mining exploration companies, irrespective of size.



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 existing competitors, in particular in current global economic conditions, could intensify and impose 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. 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, which occurred as the industry last transitioned from a cyclical downturn to a cyclical upturn, a limiting factor in this industry is 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.

### **CHANGES IN ACCOUNTING POLICIES**

#### ***Goodwill and Intangible Assets***

Effective May 1, 2009 the Company adopted the new CICA Handbook Section 3064, Goodwill and Intangible Assets, which establishes standards for recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets. Standards concerning goodwill are unchanged from the standards included in the previous CICA Handbook Section 3062. The adoption of this new standard did not have a material impact on the Company's consolidated financial statements.

### **CRITICAL ACCOUNTING ESTIMATES**

In light of the current economic conditions, the Company has re-examined its significant management estimates. Except for goodwill impairment, there have been no material changes in this quarter to these estimates, as presented in the Company's annual MD&A for the year ended April 30, 2009.

Particular attention was given to impairment testing of the company's long-lived assets, goodwill and intangible assets. These assets are assessed for potential impairment at least annually or when events or changes in circumstances exist such that the carrying amount may not be recoverable. Such an assessment requires a comparison of the fair value of the respective reporting unit to its carrying value. The estimate of fair value of a reporting unit is based on cash flows, growth projections, terminal values, discount rates and industry data. Any change in the estimates used could have a material impact on the calculation of fair value and the resulting impairment charge. Sensitivity analysis is performed when testing for impairment. Significant changes in the estimates and assumptions used in impairment testing will not impact cash flows generated from our operations.

### **OFF BALANCE SHEET ARRANGEMENTS**

Except for operating leases discussed in the annual MD&A for the year ended April 30, 2009, 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 CEO and 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 Chief Executive Officer ("CEO") and the Chief Financial Officer ("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, 2009, 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.

## **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 implementation plan and assessing the impacts of the conversion on the consolidated financial statements and disclosures of the Company. At this point, the Company is not able to reasonably estimate the financial reporting impact of the conversion to IFRS.

## **OUTSTANDING SHARE DATA**

As of August 31, 2009, there were 23,716,073 common shares issued and outstanding in the Company. This is the same number of issued and outstanding shares as reported in our annual MD&A (reported as of June 30, 2009).