BRI-CHEM CORP

**Bri-Chem Corp.**

# Year End Report

December 31, 2010

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# Independent auditors' report

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To the Shareholders
of Bri-Chem Corp.

We have audited the accompanying consolidated financial statements of Bri-Chem Corp., which comprise the consolidated balance sheets as at December 31, 2010 and December 31, 2009, and the consolidated statements of operations and comprehensive income (loss), retained earnings and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

## Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

## Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Grant Thornton

## Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Bri-Chem Corp. as at December 31, 2010 and December 31, 2009, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Edmonton, Canada

Grant Thornton LLP

March 23, 2011

Chartered Accountants

# Bri-Chem Corp.
## Consolidated Balance Sheets

| | December 31 2010 | December 31 2009 |
|---|---|---|
| **Assets** | | |
| Current | | |
| Accounts receivable | **$ 46,727,925** | $ 31,172,888 |
| Inventory (Note 5) | **42,441,797** | 40,179,035 |
| Prepaid expenses and deposits | **5,025,888** | 1,139,783 |
| Income taxes receivable | **-** | 1,381,443 |
| Current portion of future income tax assets (Note 15) | **8,712** | 27,427 |
| | **94,204,322** | 73,900,576 |
| Property and equipment (Note 6) | **3,705,757** | 3,676,600 |
| Intangible assets (Note 7) | **857,441** | 1,241,100 |
| Future income tax assets (Note 15) | **290,919** | 113,511 |
| | **$ 99,058,439** | $ 78,931,787 |
| **Liabilities** | | |
| Current | | |
| Bank indebtedness (Note 8) | **$ 39,552,948** | $ 27,652,949 |
| Accounts payable and accrued liabilities | **25,053,083** | 23,391,873 |
| Income taxes payable | **2,455,289** | - |
| Customer deposits | **294,638** | 525,486 |
| Current portion of promissory notes payable (Note 9) | **2,391,625** | 325,696 |
| Current portion of long-term debt (Note 10) | **866,913** | 872,045 |
| Current portion of obligations under capital lease (Note 11) | **26,722** | 177,040 |
| | **70,641,218** | 52,945,089 |
| Promissory notes payable (Note 9) | **1,994,082** | 5,200,000 |
| Long-term debt (Note 10) | **2,151,281** | 2,922,439 |
| Obligations under capital lease (Note 11) | **65,849** | 11,161 |
| Future income tax liabilities (Note 15) | **299,689** | 476,378 |
| | **75,152,119** | 61,555,067 |
| **Shareholders' Equity** | | |
| Share capital (Note 12) | **14,451,480** | 15,156,254 |
| Contributed surplus (Note 13) | **1,308,373** | 1,014,175 |
| Non-controlling interest (Note 4) | **(33,411)** | - |
| Retained earnings | **8,179,878** | 1,206,291 |
| | **23,906,320** | 17,376,720 |
| | **$ 99,058,439** | $ 78,931,787 |

Commitments and contingencies (Note 18)
Subsequent events (Note 23)

On behalf of the Board

*(signed) "Don Caron"*
Don Caron, Director

*(signed) "Eric Sauze"*
Eric Sauze, Director

# Bri-Chem Corp.
## Consolidated Statements of Operations and Comprehensive Income (Loss)

| For the years ended | | December 31 2010 | | December 31 2009 |
|---|---|---|---|---|
| **Sales** | **$** | **152,495,386** | $ | 96,479,615 |
| Cost of sales (Note 5) | | **131,877,684** | | 83,172,710 |
| | | **20,617,702** | | 13,306,905 |
| Net realizable value inventory (reversal) write down (Note 5) | | **(1,617,577)** | | 3,080,560 |
| Gross margin | | **22,235,279** | | 10,226,345 |
| Gross margin (%) | | **14.6%** | | 10.6% |
| **Expenses** | | | | |
| Salaries and benefits | | **6,110,137** | | 6,192,901 |
| Selling, general and administration (Note 17) | | **4,341,779** | | 4,543,208 |
| Interest on short-term operating debt | | **1,119,930** | | 1,164,301 |
| Amortization on property and equipment | | **480,522** | | 541,145 |
| Amortization on intangible assets | | **418,115** | | 986,082 |
| Foreign exchange gain | | **(646,365)** | | (1,001,153) |
| Interest on long-term debt | | **633,635** | | 661,157 |
| Interest on obligations under capital lease | | **6,015** | | 5,637 |
| Impairment charge (Note 7) | | **-** | | 6,884,132 |
| | | **12,463,768** | | 19,977,410 |
| Loss on sale of property and equipment | | **(8,119)** | | (18,992) |
| Earnings (loss) before income taxes | | **9,763,392** | | (9,770,057) |
| Income tax expense (recovery) (Note 15) | | | | |
| Current | | **3,158,628** | | (564,629) |
| Future | | **(335,382)** | | (758,090) |
| | | **2,823,246** | | (1,322,719) |
| Net earnings (loss) and comprehensive income (loss) | **$** | **6,940,146** | $ | (8,447,338) |
| Earnings (loss) attributable to: | | | | |
| Shareholders of the Company | **$** | **6,973,587** | $ | (8,447,338) |
| Non-controlling interest (Note 4) | **$** | **(33,441)** | $ | - |
| Earnings (loss) per share (Note 14) | | | | |
| Basic | **$** | **0.50** | $ | (0.58) |
| Diluted | **$** | **0.50** | $ | (0.58) |

# Bri-Chem Corp.
## Consolidated Statements of Retained Earnings

| For the years ended | | **December 31 2010** | | December 31 2009 |
|---|---|---|---|---|
| Retained earnings, beginning of year | **$** | **1,206,291** | $ | 9,653,629 |
| Net earnings (loss) | | **6,973,587** | | (8,447,338) |
| Retained earnings, end of year | **$** | **8,179,878** | $ | 1,206,291 |

# Bri-Chem Corp.
## Consolidated Statements of Cash Flows

| For the years ended | | **December 31 2010** | | December 31 2009 |
|---|---|---|---|---|
| Increase (decrease) in cash and cash equivalents | | | | |
| **Operating activities** | | | | |
| Net earnings (loss) | **$** | **6,940,146** | $ | (8,447,338) |
| Non-cash items: | | | | |
| Amortization on property and equipment | | **480,522** | | 541,145 |
| Amortization on intangible assets | | **418,115** | | 986,082 |
| Amortization of debt related transaction costs | | **90,512** | | 57,072 |
| Future income tax recovery | | **(335,382)** | | (758,090) |
| Impairment of intangible assets (Note 7) | | **-** | | 2,155,832 |
| Impairment of goodwill (Note 7) | | **-** | | 4,728,300 |
| Stock-based compensation | | **167,633** | | 130,014 |
| Loss on sale of property and equipment | | **8,119** | | 18,992 |
| | | **7,769,665** | | (587,991) |
| Change in non-cash operating working capital (Note 16) | | **(16,436,809)** | | 12,187,108 |
| | | **(8,667,144)** | | 11,599,117 |
| **Financing activities** | | | | |
| Advances on promissory notes payable | | **307,249** | | 315,417 |
| Advances (repayments) of operating line | | **11,899,999** | | (10,013,622) |
| Repurchase of common shares (Note 12) | | **(584,928)** | | (110,314) |
| Repayment of promissory notes payable | | **(1,447,238)** | | (132,211) |
| Repayment of long-term debt | | **(866,802)** | | (861,855) |
| Proceeds on issuance of shares (Note 12) | | **6,719** | | - |
| Repayment of obligations under capital lease | | **(190,748)** | | (155,602) |
| | | **9,124,251** | | (10,958,187) |
| **Investing activities** | | | | |
| Purchase of property and equipment | | **(508,142)** | | (679,688) |
| Purchase of intangible assets | | **(34,456)** | | (35,338) |
| Proceeds on disposal of property and equipment | | **85,491** | | 74,096 |
| | | **(457,107)** | | (640,930) |
| Net increase in cash and cash equivalents | | **-** | | - |
| Cash and cash equivalents, beginning of year | | **-** | | - |
| Cash and cash equivalents, end of year | **$** | **-** | $ | - |

Supplemental cash flow information (Note 16)

## 1. Organization and description of operations

Bri-Chem Corp.'s ("the Company") shares are publicly traded on the TSX Venture Exchange under the symbol BRY. The Company is a wholesale distributor of industrial drilling fluids, steel products and services to the energy, construction and industrial sectors.

## 2. Summary of significant accounting policies

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and reflect the following significant accounting policies:

*Principles of consolidation*

The consolidated financial statements include the assets, liabilities, results of operations and cash flows of the Company, its wholly-owned subsidiaries, Bri-Chem Supply Ltd., Sodium Solutions Inc., Bri-Chem Steel Corporation, and its 70% owned subsidiary Bri-Steel Manufacturing Inc. All inter-company transactions and balances have been appropriately eliminated. A non-controlling interest is presented as part of equity for the portion of the subsidiary's profit or loss and net assets that is not held by the Company. The Company attributes total comprehensive income or loss of subsidiaries between the owners of the Company and the non-controlling interest based on their respective ownership interests. The Company has applied uniform accounting policies throughout all consolidated entities and reporting dates of the subsidiaries are all consistent with the parent.

*Business combinations*

The assets and liabilities acquired in a business combination, contingent consideration and certain acquired contingencies are measured at their fair values as of the date of acquisition. All identifiable assets acquired and liabilities assumed are recognized, regardless of whether they have been previously recognized in the acquiree's prior financial statements. Acquisition related and restructuring costs are recognized separately from the business combination and included in the statement of operations.

Goodwill is calculated as the excess of the sum of the fair value of consideration, the recognized amount of any non-controlling interests, and the acquisition date fair value of any existing equity interest in the acquiree, over the acquisition date fair value of the identifiable net assets. If the acquisition date fair value of the identifiable net assets exceeds the sum above, the difference is recognized in net income immediately.

*Use of estimates and measurement uncertainty*

Preparing financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and the disclosures of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Principal areas where uncertainty is inherent include certain accounts receivable, the allowance for doubtful accounts, the sales return provisions, obsolete inventories, the net realizable value inventory write-downs and write-ups, the estimated useful life of property and equipment and intangible assets and the corresponding amortization rates, the valuation of future income tax assets, the impairment testing of goodwill and long-lived assets, the purchase price allocation for business acquisitions, amounts recorded as accrued liabilities and future

**2. Summary of significant accounting policies** (cont'd)

*Use of estimates and measurement uncertainty (cont'd)*

income tax liabilities and the fair value of options and warrants using the Black-Scholes Option Pricing Model. Actual results could differ materially from these estimates.

*Cash and cash equivalents*

Cash and cash equivalents consist of cash on hand, balances with bank and short-term deposits with original maturities of three months or less.

*Inventory*

Inventory is measured at the lower of cost and net realizable value. Net realizable value approximates the estimated selling price less all estimated costs of completion and necessary costs to complete the sale. Costs are assigned using the first-in, first-out (FIFO) cost method. Costs associated with freight transportation and handling fees are determined using a combination of actual rates and the weighted average cost method and are applied consistently by product line and location.

*Property and equipment*

Property and equipment are recorded at cost less accumulated amortization. Rates and bases of amortization applied to write-off the cost of property and equipment over their estimated useful lives are as follows:

| | |
|---|---|
| Buildings | 4 to 10% declining-balance |
| Motor vehicles | 30% declining-balance |
| Manufacturing and other equipment | 20 to 30% declining-balance |
| Office equipment | 20% declining-balance |
| Computer equipment | 20 to 100% declining-balance |
| Pavement and landscaping | 8% declining-balance |
| Leasehold improvements | 1 to 5 years straight-line |
| Equipment under capital lease | 3 years straight-line |

*Obligations under capital lease*

The Company accounts for leases as either operating or capital. Capital leases are those that substantially transfer the benefit and risks of ownership to the lessee. Assets acquired under capital lease are amortized over the lease term or if the lease contains terms that allow ownership to pass to the Company or a bargain purchase option, assets are amortized over their estimated useful lives consistent with other property and equipment rates determined. Obligations under capital lease are measured at the lower of the present value of future minimum lease payments and fair value. Leases not meeting the capital lease criteria are treated as operating with lease payments recorded as an expense in the period paid or accrued.

**2. Summary of significant accounting policies** (cont'd)

*Impairment of long-lived assets*

Long-lived assets are reviewed for impairment when events or circumstances raise concerns that the carrying value of an asset may not be recoverable. Recoverability is determined by comparing the carrying amount of the asset to the undiscounted future cash flows expected from the use and eventual disposition of the asset. If a write-down is warranted, the write down is measured as the amount by which the carrying amount exceeds its fair value.

*Intangible assets*

Intangible assets acquired individually or as part of a group of other assets are initially recognized and measured at fair value. The assigned values of a group of intangible assets acquired in a business combination that meet the specified criteria for recognition apart from goodwill are allocated to the individual assets acquired based on fair value.

Intangible assets with finite useful lives are amortized over their useful lives. The amortization methods and estimated useful lives of the intangible assets, which are reviewed annually, are as follows:

| | |
|---|---|
| Customer relationships | 5 years straight-line |
| Sales backlog | 6 months straight-line |
| Proprietary processes, technological expertise and proprietary blends | 3 years straight-line |
| Tradename | 5 years straight-line |
| Non-competition agreements | 3 to 5 years straight-line |
| Computer software | 7 years straight-line |

*Goodwill*

Goodwill represents the excess of the purchase price of an acquisition over the fair value of the underlying net assets acquired at the date of acquisition. Goodwill is recorded at cost and is not amortized but is tested for impairment annually, or more frequently if events or changes in circumstances indicate the asset might be impaired. Impairment is tested by comparing the carrying amount of the reporting unit, including goodwill, with its fair value. Fair value is determined using the discounted, estimated future operating cash flows of the reporting unit.

When the fair value of the reporting unit exceeds the carrying value, goodwill of the reporting unit is not considered to be impaired. When the carrying value of the reporting unit exceeds its fair value, the implied fair value of the reporting unit's goodwill, determined in the same manner as the value of goodwill is determined in a business combination, is compared with its carrying amount to measure the amount of impairment loss, if any. A reporting unit comprises business operations with similar economic characteristics and strategies, and is the level of reporting at which goodwill is tested for impairment. A reporting unit is either an operating segment or a level below and is the level at which information is available for management to make key decisions. For the purposes of goodwill impairment testing, the Company has three reporting units.

**2. Summary of significant accounting policies** (cont'd)

*Income taxes*

Income taxes have been accounted for using the liability method of tax allocation. Under this method, future income tax assets and liabilities are determined based on differences between the accounting and income tax bases of an asset or liability. These are measured based on the tax jurisdictions' substantively enacted income tax rates that will be in effect when the differences are expected to reverse. The effect on future income tax assets and liabilities of a change in rates is included in the period during which the change is considered substantially enacted. Future income tax assets are recorded in the financial statements if realization is considered more likely than not.

*Transaction costs*

Transaction costs directly associated with the issuance of long-term debt obligations are applied against the fair value of the related financial liability and are amortized to interest expense using the effective interest method.

*Revenue recognition*

Revenue from the sale of goods is recognized when title passes to customers, which is generally at the time the goods are shipped and when reasonable assurance exists regarding measurement and collection of the consideration given. The Company has an informal policy whereby they accept product returns from customers. Provisions for estimated product returns are based on historical experience and market conditions. There are instances when customers will request that the Company bill and hold their shipments until such time as the customers are prepared to receive the goods. Revenue on bill and hold arrangements is recognized when the customer is invoiced for the goods that have been purchased and made ready for shipment as the risk of ownership of the goods has been assumed by the customer. The terms and collections experienced on the related billings are consistent with all other sales.

*Stock-based compensation*

The Company has established a stock option plan for the Executive and Board of Directors, consultants, and employees as described in Note 12. The Company uses the fair value method of accounting for stock options. The fair value of the option grants is calculated on the grant date for employees and the measurement date for non-employees using the Black-Scholes Option Pricing Model and recognized as compensation expense over the vesting period of those granted options. The corresponding adjustment is recorded to contributed surplus. When the options are exercised the proceeds received by the Company, together with the related amount in contributed surplus, are added to share capital. Forfeited or expired options are put back into the pool of available stock options for future grants. No adjustment is recorded for stock options that expire unexercised. Compensation expense related to forfeited options is reversed on the forfeiture date provided the options have not vested.

**2. Summary of significant accounting policies** (cont'd)

*Financial instruments*

All financial instruments and certain non-financial derivatives are initially measured at fair value. Subsequent measurement will depend on an instrument's initial classification. Held-for-trading financial instruments are measured at fair value and changes in fair value are recognized in net earnings. Available-for-sale financial instruments are measured at fair value with changes in fair value recorded in other comprehensive income until the instrument is derecognized or impaired and the effect is to reduce other comprehensive income and increase comprehensive income. Held-to-maturity investments, loans and receivables and other financial liabilities are subsequently measured at amortized cost using the effective interest method.

The Company classified the relevant financial assets and liabilities in accordance with the provisions as follows:

<u>Loans and receivables</u>

Accounts receivable

<u>Held for trading</u>

Foreign currency forward contracts

<u>Other financial liabilities</u>

Bank indebtedness
Accounts payable and accrued liabilities
Long-term debt
Promissory notes payable

The Company did not have any embedded derivatives or other non-financial contracts.

The Company categorizes its fair value measurements according to a three level hierarchy which prioritizes the inputs used in the Company's valuation techniques. A level is assigned to each fair value measurement based on the lowest level input significant to the overall fair value measurement. The three levels of the fair value hierarchy based on the reliability of inputs are as follows:

Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities;
Level 2 fair value measurements are those derived from inputs other than quoted prices included within level 1, that are observable for the asset or liability, either directly (i.e. prices) or indirectly (i.e. derived from prices); and
Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data.

**2. Summary of significant accounting policies** (cont'd)

*Foreign currency translation*

Monetary items denominated in foreign currencies are translated to Canadian dollars at the rate of exchange in effect at the balance sheet date. All revenue and expenses denominated in foreign currencies are translated at the monthly average rate in effect at the time of the transaction to approximate the rate on the transaction date. Gains or losses on translation are included in earnings.

*Earnings (loss) per share*

The computation of basic earnings (loss) per share has been calculated using the weighted average number of common shares outstanding during each reporting period. Diluted earnings (loss) per share reflect the potential dilution that would occur if stock options and warrants were exercised. The Company uses the treasury method for outstanding options and warrants which assumes that all outstanding stock options and warrants with an exercise price below the average market prices in the period are exercised and assumes proceeds are used to purchase the Company's common shares at the average market price during the reporting period. The net number of shares issued and purchased is added to the denominator figure used for basic earnings (loss) per share when calculating diluted earnings (loss) per share.

*Derivative financial instruments*

Derivative financial instruments are utilized by the Company in the management of its foreign currency exposure on certain committed and anticipated transactions. The Company does not designate its foreign exchange forward contracts as a hedge of underlying assets, liabilities, firm commitments or anticipated transactions in accordance with CICA Handbook Section 3865, *Hedges*, and accordingly does not use hedge accounting. As a result of this, foreign exchange forward contracts are recorded at fair value in receivables when the contracts are in a gain position and in accrued liabilities when the contracts are in a loss position. The difference between nominal value and fair value is recorded in foreign exchange expense in the period. The Company purchases foreign exchange forward contracts to mitigate the exposure to purchases and the related payable to suppliers denominated in U.S. dollars.

**3. Seasonality of operations**

Weather conditions can affect the sale of the Company's products and services. The ability to move heavy equipment in the Canadian oil and natural gas fields is dependent on weather conditions. As a result, spring months in Western Canada and the duration of the spring break-up has a direct impact on the Company's activity levels. In addition, many exploration and production areas in the northern Western Canadian Sedimentary Basis ("WCSB") are accessible only in winter months when the ground is frozen hard enough to support the weight of heavy equipment. The timing of freeze-up and spring break-up affects the ability to move equipment in and out of these areas. As a result, late March through May is traditionally the Company's slowest period.

## 4. Non-controlling interest

On October 13, 2010, the Company acquired 70 common shares of Bri-Steel Manufacturing Inc. ("Manufacturing") upon incorporation for $1 per share. The jointly established new operating company is a result of an agreement ratified with Wuxi Huayou Special Steel Co., Ltd, ("Wuxi") of the People's Republic of China, and will provide value-added manufacturing of large diameter seamless steel pipe located in Edmonton, Alberta, Canada. Manufacturing is 70% owned by the Company, which did not arise as a result of a business combination, and 30% owned by Wuxi, who acquired their 30 common shares on October 13, 2010. Non-controlling interests have been recorded for Wuxi's share of Manufacturing's net operations for the year.

| Non-controlling interest | | December 31 2010 | | December 31 2009 |
|---|---|---|---|---|
| Balance, beginning of year | $ | - | $ | - |
| Purchase of common share ownership | | 30 | $ | - |
| Net loss and comprehensive loss | | (33,441) | | - |
| Balance, end of year | $ | (33,411) | $ | - |

## 5. Inventory

The cost of inventory expensed in cost of sales for the year ended December 31, 2010 was $129,461,571 (December 31, 2009 - $80,240,321). Due to the improvement in overall economic conditions this year from 2009, inventory balances are presented net of a write-up of $1,617,577 on previously written down inventory from December 31, 2009 totaling $3,080,560. All inventory held is finished goods.

## 6. Property and equipment

| | December 31, 2010 | | | | | |
|---|---|---|---|---|---|---|
| | | **Cost** | | **Accumulated Amortization** | | **Net Book Value** |
| Land | $ | **402,792** | $ | **-** | $ | **402,792** |
| Buildings | | **1,759,152** | | **461,778** | | **1,297,374** |
| Motor vehicles | | **894,845** | | **212,498** | | **682,347** |
| Manufacturing and other equipment | | **1,528,495** | | **1,035,429** | | **493,066** |
| Office equipment | | **309,311** | | **195,684** | | **113,627** |
| Computer equipment | | **481,426** | | **299,467** | | **181,959** |
| Pavement and landscaping | | **174,663** | | **35,183** | | **139,480** |
| Leasehold improvements | | **761,194** | | **470,082** | | **291,112** |
| Equipment under capital lease | | **104,000** | | **-** | | **104,000** |
| | **$** | **6,415,878** | **$** | **2,710,121** | **$** | **3,705,757** |

Included in the above are manufacturing and other equipment of $12,666, leasehold improvements of $186,163, and equipment under capital lease of $104,000 which have not been amortized as they are not yet ready for use.

**6. Property and equipment** (cont'd)

The Company noted no indicators of potential impairment of property and equipment for the year ended December 31, 2010.

| | December 31, 2009 | | |
|---|---|---|---|
| | Cost | Accumulated Amortization | Net Book Value |
| Land | $ 402,792 | $ - | $ 402,792 |
| Buildings | 1,680,409 | 426,431 | 1,253,978 |
| Motor vehicles | 494,195 | 153,517 | 340,678 |
| Manufacturing and other equipment | 1,572,602 | 892,659 | 679,943 |
| Office equipment | 235,914 | 134,078 | 101,836 |
| Computer equipment | 438,872 | 237,955 | 200,917 |
| Pavement and landscaping | 147,465 | 24,842 | 122,623 |
| Leasehold improvements | 575,031 | 422,569 | 152,462 |
| Equipment under capital lease | 489,137 | 67,766 | 421,371 |
| | $ 6,036,417 | $ 2,359,817 | $ 3,676,600 |

The Company noted indicators of potential impairment of property and equipment for the year ended December 31, 2009, but no impairment was recorded.

**7. Goodwill and intangible assets**

In 2009, the Company performed its annual assessment of the fair value of its goodwill and intangible assets. Due to the deterioration in overall economic conditions, reduced activity levels within the oil and gas industry and changes in the market, the Company concluded that the carrying value of goodwill and intangible assets were impaired and recorded an impairment charge of $6,884,132, which was allocated to goodwill and intangible assets in the amounts of $4,728,300 and $2,155,832 respectively. This also decreased the related future income tax liability for the difference between tax and book amortization of the intangible assets by $527,495 during the year. The goodwill impairment was allocated to the fluids and steel operating segments in the amounts of $1,081,445 and $3,646,855 respectively. The impairment of intangible assets were recognized in the fluids and steel operating segments in the amounts of $327,232 and $1,828,600 respectively. The impairment charge for intangible assets comprises an impairment of customer relationships ($1,291,366), proprietary products ($16,667), non-compete agreements ($401,399) and trade names ($446,400).

The Company noted no indicators of potential impairment of intangible assets for the year ended December 31, 2010.

| **Goodwill** | **December 31 2010** | December 31 2009 |
|---|---|---|
| Balance, beginning of year | **$ -** | $ 4,728,300 |
| Impairment charge | **-** | (4,728,300) |
| | **$ -** | $ - |

**7. Goodwill and intangible assets** (cont'd)

Intangible assets having finite lives consist of the following:

| **Intangible assets** | **December 31, 2010** | | | |
|---|---|---|---|---|
| | **Cost** | **Accumulated Amortization** | **Impairment Charge** | **Net Book Value** |
| Customer relationships | **$ 1,923,985** | **$ 1,545,108** | **$ -** | **$ 378,877** |
| Non-compete agreement | **707,222** | **417,390** | **-** | **289,832** |
| Computer software | **280,504** | **91,772** | **-** | **188,732** |
| | **$ 2,911,711** | **$ 2,054,270** | **$ -** | **$ 857,441** |

| | December 31, 2009 | | | |
|---|---|---|---|---|
| | Cost | Accumulated Amortization | Impairment Charge | Net Book Value |
| Customer relationships | $ 3,215,351 | $ 1,280,455 | $ 1,291,366 | $ 643,530 |
| Sales backlog | 410,000 | 410,000 | - | - |
| Proprietary processes, technological expertise and proprietary blends | 150,000 | 133,333 | 16,667 | - |
| Tradename | 558,000 | 111,600 | 446,400 | - |
| Non-compete agreement | 1,108,621 | 296,032 | 401,399 | 411,190 |
| Computer software | 243,796 | 57,416 | - | 186,380 |
| | $ 5,685,768 | $ 2,288,836 | $ 2,155,832 | $ 1,241,100 |

**8. Bank indebtedness**

Effective December 31, 2010, the Company amended its credit facility, which resulted in an increase in its line of credit from a maximum of $40,000,000 with a $5,000,000 bulge between December 1, 2009 and April 30, 2010, to a maximum of $50,000,000 with no bulge. The credit facility includes a sub-limit of $10,000,000 (December 31, 2009 - $10,000,000) on a US demand overdraft, $1,000,000 (December 31, 2009 - $100,000) on a bank guarantee and $10,000,000 (December 31, 2009 - $250,000) on an import line. The bank operating line of credit bears interest ranging from prime plus 0.75% to prime plus 1.75% per annum (December 31, 2009 – prime plus 0.75% to prime plus 1.50%) and is due on demand. The US demand overdraft bears interest ranging from US base rate plus 0.75% to US base rate plus 1.75% per annum (December 31, 2009 – US base rate plus 0.75% to US base rate plus 1.50%) and is due on demand.

In addition, the HSBC Bank Canada ("HSBC") committed non-revolving loan was amended with an increase to $2,500,000 (December 31, 2009 - $1,742,584) available subject to property appraisals, at an interest rate of prime plus 1.75% and maturing on June 30, 2012. The Company was also granted a $1,000,000 evergreen credit facility to finance potential future purchases of equipment, at a rate of prime plus 1.75% per annum. As at December 31, 2010, no additional amounts were drawn on the HSBC committed non-revolving loan or on the evergreen credit facility. At December 31, 2010, the prime rate was 3.00% and the US base rate was 3.25%.

**8. Bank indebtedness** (cont'd)

The collateral security lodged by the Company to support all debt held with HSBC Bank Canada (Note 10) is a general security agreement creating a first priority security interest in all present and after acquired personal property of the Company and its subsidiaries, a floating charge over all of the Company and its subsidiaries' present and after acquired real property, a demand collateral land mortgage and assignment of rents in the amount of $2,000,000 from the Company creating a first fixed and specific mortgage charge over all of the lands and premises, $5,000,000 guarantee of HSBC Capital Canada Inc., assignment of all risk insurance on the Company's real and personal property and guarantees of related parties. At December 31, 2010, the Company was on-side with all covenant requirements (Note 19).

**9. Promissory notes payable**

| | **December 31 2010** | December 31 2009 |
|---|---|---|
| Promissory notes payable, bearing interest at 6% per annum, repayable in installments as follows: $1,000,000 plus interest on October 29, 2009, $1,000,000 plus interest on October 29, 2010, and $1,000,000 plus interest on October 29, 2011, secured by a general security agreement covering all the assets of the Company. | **$ 3,180,000** | $ 3,244,356 |
| Promissory note payable, bearing interest at 6% per annum, repayable in installments as follows: $11,000,000 plus interest on completion of the amalgamation, $1,000,000 plus interest on May 19, 2008, $1,000,000 plus interest on May 20, 2009, and $1,200,000 plus interest on May 20, 2010, secured by a general security agreement covering all the assets of the Company. | **1,205,707** | 2,281,340 |
| | **4,385,707** | 5,525,696 |
| Less: current portion | **2,391,625** | 325,696 |
| | **$ 1,994,082** | $ 5,200,000 |

The $1,000,000 promissory note principal due in October 2009, the $1,000,000 promissory note principal due in October 2010, and the $1,000,000 promissory note principal due in October 2011 have been postponed at the request of the Company's lender. The $1,000,000 promissory note principal due in May 2009, previously postponed at the request of the Company's lender, was paid out in December 2010. The $1,000,000 promissory note principal due in October 2009, and the $1,200,000 promissory note principal due in May 2010 are expected to be paid out in 2011 and have therefore been reclassified as current. All other amounts remaining outstanding are classified as long-term as these amounts are not expected to be paid out within the next year. The interest on the promissory notes will be paid within the next year and has been recorded as a current liability.

### 9. **Promissory notes payable** (cont'd)

Expected principal repayments over the next three years are as follows:

| | |
|---|---|
| 2011 | $ 2,391,625 |
| 2012 | 994,082 |
| 2013 | 1,000,000 |
| | $ 4,385,707 |

### 10. Long-term debt

| | **December 31 2010** | December 31 2009 |
|---|---|---|
| HSBC Capital subordinated debenture, bearing interest at prime, repayable monthly from February 2007 to January 2009 interest only, February 2009 to December 2011 monthly installments of $60,000 plus interest with the remaining balance of $900,000 due January 31, 2012. In addition, the Company pays 1% on a monthly basis for total of 12% per annum to guarantor of this debt. The loan security is described below. | **$ 1,620,000** | $ 2,340,000 |
| HSBC committed non-revolving loan, payable in monthly installments of $18,000 including interest at prime plus 1.75% per annum, maturing June 30, 2012 (December 31, 2009- maturing June 30, 2011). The loan is secured by the same security as the bank indebtedness (see Note 8). | **1,520,658** | 1,667,461 |
| | **3,140,658** | 4,007,461 |
| Less: transaction costs | **122,464** | 212,977 |
| | **3,018,194** | 3,794,484 |
| Less: current portion | **866,913** | 872,045 |
| | **$ 2,151,281** | $ 2,922,439 |

**10. Long-term debt** (cont'd)

The HSBC subordinated debenture is secured by the following: a general security agreement creating a fixed and floating charge over all assets of the Borrower subordinated only to a prior charge in favor of the Bank; an unlimited corporate guarantee supported by a general security agreement from Bri-Chem Supply Ltd. and Sodium Solutions Inc. and from all other material entities within the group determined by the Lender subordinated only to a prior charge from the Bank; second demand collateral land mortgage and assignment of rents from Bri-Chem Corp. creating a second fixed and specific mortgage charge over all lands and premises located at 15, 53016 Highway 60, Acheson, Alberta and 4420 – 37th Street in Camrose, Alberta; assignment by Bri-Chem Corp. to HSBC of all risk insurance in amounts and from an insurer acceptable to HSBC, on all Bri-Chem Corp. real and personal property, without limitation, lands, buildings, equipment and inventory owned by Bri-Chem Corp., showing HSBC as first loss payee, including business interruption and public liability insurance; and assignment and postponement by Alan Campbell, Brian Campbell, Roy Rasmussen, Neil Rasmussen and Roger Boisvert of all present and future amounts outstanding to them by Bri-Chem Corp.

Principal repayments over the next two years are as follows:

| | |
|---|---|
| 2011 | $ 866,913 |
| 2012 | 2,273,745 |
| | $ 3,140,658 |

The long-term debt contains financial covenants including, but not limited to, a minimum debt service coverage ratio among others that are calculated on a quarterly basis. As at December 31, 2010, the Company was in compliance all covenants. On December 20, 2010, HSBC Capital amended its agreement to eliminate the funded debt to normalized EBITDA (earnings before interest, taxes, depreciation, amortization, and other non-cash transactions) financial covenant for a one year period ended January 1, 2012.

## 11. Obligations under capital lease

| | December 31 2010 | December 31 2009 |
|---|---|---|
| De Lage Landen capital lease bearing interest at 6.6% per annum, repayable at blended monthly installments of $2,666, maturing December 29, 2013, secured by specific equipment with a net book value of $104,000 (net of accumulated amortization of $nil). | **$ 92,571** | $ - |
| Scotiabank capital lease bearing interest at bankers acceptance plus 2%, repayable in blended monthly installments of $3,702, maturing November 16, 2010, secured by specific equipment with a net book value of $130,505 (net of accumulated amortization of $22,697). | **-** | 71,411 |
| Scotiabank capital lease bearing interest at bankers acceptance plus 2%, repayable in blended monthly installments of $3,233, maturing November 15, 2010, secured by specific equipment with a net book value of $111,433 (net of accumulated amortization of $19,687). | **-** | 62,378 |
| John Deere capital lease bearing interest at 0.90% per annum, repayable in blended monthly installments of $5,218, maturing August 22, 2010, secured by specific equipment with a net book value of $141,909 (net of accumulated amortization of $23,406). | **-** | 36,417 |
| De Lage Landen capital lease bearing interest at 6.8% per annum, repayable at blended monthly installments of $654, maturing July 8, 2012, secured by specific equipment with a net book value $37,525, (net of accumulated amortization of $1,975). This lease was paid out during 2010. | **-** | 17,995 |
| | **92,571** | 188,201 |
| Less: current portion | **26,722** | 177,040 |
| | **$ 65,849** | $ 11,161 |

## 11. Obligations under capital lease (cont'd)

Future minimum lease payments required over the next three years for all obligations under capital lease are as follows:

| | | |
|---|---|---|
| 2011 | $ | 31,997 |
| 2012 | | 31,997 |
| 2013 | | 38,984 |
| | | 102,978 |
| Less: interest | | (10,407) |
| | $ | 92,571 |

The Company has signed capital lease agreements relating to new equipment totalling $353,400 which has not yet been received and for which payments have not yet commenced as of December 31, 2010.

## 12. Share capital

Authorized

Unlimited number of voting common shares
Unlimited number of preferred shares, issued in series

| **Issued and outstanding** | **Number** | | **Amount** |
|---|---|---|---|
| **Common Shares** | | | |
| Balance, January 1, 2009 | **14,514,186** | **$** | **15,295,274** |
| Shares repurchased and cancelled | **(132,400)** | | **(139,020)** |
| Balance, December 31, 2009 | **14,381,786** | **$** | **15,156,254** |
| Shares issued under stock options | **6,000** | | **12,270** |
| Shares repurchased and cancelled | **(682,900)** | | **(717,044)** |
| Balance, December 31, 2010 | **13,704,886** | **$** | **14,451,480** |

a) On August 29, 2008, the Company issued 1,304,348 shares with a fair value of $2,260,000 for the purchase of shares of Bri-Chem Steel Corporation. The following resale restrictions exist on the following shares:

434,782 common shares with resale restrictions expiring August 30, 2011

b) On December 17, 2009, the Company renewed its Normal Course Issuer Bid ("NCIB"), whereby the Company was permitted to repurchase, for cancellation, up to 807,000 of its outstanding common shares. The NCIB terminated on December 17, 2010. At termination date of the NCIB, a total of 682,900 shares had been repurchased for cash consideration of $584,928 under the renewed NCIB and have been cancelled. The excess of the carrying amount over the repurchase price has been credited to contributed surplus.

**12. Share capital** (cont'd)

**Stock option plan**

The Company's Stock Option Plan (the "Plan") provides for the granting of stock options to directors, officers, consultants and employees of the Company and its affiliates. The expiry date and price payable upon the exercise of any option granted are fixed by the Board of Directors at the time of grant, subject to regulatory requirements. Options granted under the plan are vested under such times as determined by the Board of Directors, subject to regulatory requirements. As at December 31, 2010, the Plan permits the authorization to grant stock options up to a maximum of 1,400,000 common shares of the Company.

A summary of transactions during the years are outlined below:

**Options to employees and directors**

| **December 31, 2010** | **Number of options** | **Weighted average exercise price** | **Weighted average contractual life (years)** |
|---|---|---|---|
| Outstanding, January 1, 2010 | **1,286,000** | $ 1.97 | 4.00 |
| Granted | **30,000** | 1.30 | 4.65 |
| Exercised | **(6,000)** | 1.12 | 1.00 |
| Forfeited | **(22,000)** | 1.83 | 4.00 |
| Outstanding, December 31, 2010 | **1,288,000** | $ 1.96 | 3.15 |
| Options exercisable, December 31, 2010 | **1,240,000** | $ 1.96 | 3.00 |

| December 31, 2009 | **Number of options** | **Weighted average exercise price** | **Weighted average contractual life (years)** |
|---|---|---|---|
| Outstanding, January 1, 2009 | **1,353,000** | $ 1.99 | 3.63 |
| Granted | **30,000** | 0.75 | 4.00 |
| Exercised | **-** | - | - |
| Forfeited | **(97,000)** | 1.99 | 4.00 |
| Outstanding, December 31, 2009 | **1,286,000** | $ 1.97 | 4.00 |
| Options exercisable, December 31, 2009 | **839,160** | $ 1.99 | 4.00 |

Effective July 2, 2010, the Company repriced 335,000 outstanding employee stock options having exercise prices between $1.50 and $2.10 to $1.12. The related expense of $76,661 was recorded in salaries and benefits expense with a corresponding increase to contributed surplus.

The fair value of the employee and directors options granted is estimated on the date of grant using the Black-Scholes option pricing model based on the following weighted average assumptions:

| | **2010** | 2009 |
|---|---|---|
| Expected life | **5 years** | 4 years |
| Risk-free rate | **2.29%** | 2.52% |
| Expected volatility | **154.57%** | 77.50% |
| Expected dividend yield | **0.00%** | 0.00% |

**12. Share capital** (cont'd)

**Options to employees and directors** (cont'd)

During the year, 6,000 options were exercised (December 31, 2009 – nil) under the Plan at a total fair value of $12,920 (December 31, 2009 - $nil). A total of 1,288,000 options, net of forfeitures, have been issued under the Plan.

**Options to consultants**

| **December 31, 2010** | **Number of options** | **Weighted average exercise price** | **Weighted average contractual life (years)** |
|---|---|---|---|
| Outstanding December 31, 2009 | **-** | $ - | - |
| Outstanding, January 1, 2010 | **-** | $ - | - |
| Granted | **25,000** | 2.05 | 2.00 |
| Outstanding, December 31, 2010 | **25,000** | $ 2.05 | 1.59 |
| Options exercisable, December 31, 2010 | **8,330** | $ 2.05 | 1.59 |

The fair value of the employee and directors options granted is estimated on the date of grant using the Black-Scholes option pricing model based on the following weighted average assumptions:

| | **2010** |
|---|---|
| Expected life | **2 years** |
| Risk-free rate | **1.45%** |
| Expected volatility | **77.61%** |
| Expected dividend yield | **0.00%** |

During the year, 25,000 options were issued (December 31, 2009 – nil) to consultants under the Plan at a total fair value of $9,439 (December 31, 2009 – $nil).

**Warrants**

a) As part of the consideration given for the acquisition of Spirit Mountain Holdings Ltd., the Company issued 100,000 share purchase warrants with a fair value of $46,344. Each share purchase warrant entitles the holder to purchase one common share of the Company at a price of $2.10 per common share, as negotiated between the parties to the transaction from July 17, 2007, expiring July 17, 2010.

   In July 2010, the Company extended the 100,000 share purchase warrants for an additional two years, expiring July 16, 2012. The warrants were extended at an exercise price of $2.10 with an incremental increase in the fair value of the warrants as a result of the extension of $41,900.

**12. Share capital** (cont'd)

**Warrants** (cont'd)

b) Pursuant to the terms of the loan agreement with HSBC Capital, the Company issued 250,000 share purchase warrants with a fair value of $141,706 to the lender. Each share purchase warrant entitles the lender to purchase one common share of the Company at a price of $2.00 per common share from January 30, 2007, expiring January 30, 2010. In December 2009, the Company extended the 250,000 share purchase warrants for an additional two years. The warrants were extended at an exercise price of $2.00 with an immaterial change in the fair value of the warrants as a result of the extension.

The following is a summary of the warrant activities during the year:

| | Number of warrants | Weighted average exercise price | Weighted average contractual life |
|---|---|---|---|
| Outstanding, January 1, 2009 | | | |
| Granted | **350,000** | $ 2.03 | 2.56 |
| Exercised | **-** | - | - |
| Expired | **-** | - | - |
| Outstanding, December 31, 2009 | **350,000** | 2.03 | 2.56 |
| Outstanding, December 31, 2010 | **350,000** | $ 2.03 | 1.21 |
| Exercisable, December 31, 2010 | **350,000** | $ 2.03 | 1.21 |

The fair value of the warrants extension during the year of $41,900 (2009 - $nil) is estimated on the date of modification using the Black-Scholes Option Pricing Model based on the following weighted average assumptions:

| | |
|---|---|
| Expected life | 2 years |
| Risk-free rate | 1.46% |
| Expected volatility | 75.75% |
| Expected dividend yield | 0.00% |

**13. Contributed surplus**

| | **December 31 2010** | December 31 2009 |
|---|---|---|
| Balance, beginning of year | **$ 1,014,175** | $ 855,454 |
| Fair value of stock options granted | **49,072** | 130,014 |
| Fair value of stock option repriced (Note 12) | **76,661** | |
| Fair value of stock options exercised | **(5,551)** | - |
| Fair value of warrant extension granted (Note 12) | **41,900** | - |
| Repurchase of common shares (Note 12) | **132,116** | 28,707 |
| Balance, end of year | **$ 1,308,373** | $ 1,014,175 |

## 14. Earnings (loss) per share

| | | December 31 2010 | December 31 2009 |
|---|---|---|---|
| Net earnings (loss) | $ | **6,940,146** | $ (8,447,338) |
| Basic weighted average number of common shares | | **13,874,990** | 14,485,860 |
| Weighted average dilutive stock options | | **74,600** | - |
| Diluted weighted average number of common shares | | **13,949,590** | 14,485,860 |
| Basic earnings (loss) per share | $ | **0.50** | $ (0.58) |
| Diluted earnings (loss) per share | $ | **0.50** | $ (0.58) |

## 15. Income taxes

Income tax expense differs from the amount computed by applying the statutory provincial and federal income tax rates to the respective years' earnings before income taxes. These differences result from the following items:

| | | December 31 2010 | December 31 2009 |
|---|---|---|---|
| Expected income tax rate at 28.00% (December 2009 - 29.00%) | $ | **2,733,750** | $ (2,833,317) |
| Increase (decrease) resulting from: | | | |
| Tax rate differential | | **13,289** | 53,916 |
| Non-deductible expenses | | **75,732** | 80,073 |
| Goodwill writedown | | **-** | 1,371,207 |
| Other | | **475** | 5,402 |
| | $ | **2,823,246** | $ (1,322,719) |

**15. Income taxes** (cont'd)

**Temporary differences**

The tax effects of temporary differences and loss carryforwards that give rise to the Company's future income tax assets (liabilities) are as follows:

| | **December 31 2010** | December 31 2009 |
|---|---|---|
| Future income tax assets: | | |
| Capital assets - excess of undepreciated capital cost compared to net book value | **$ 12,009** | $ 25,776 |
| Inventory valuation allowance | **-** | 27,427 |
| Share issue costs | **13,707** | 71,366 |
| Capital lease obligations | **23,544** | 49,931 |
| Intangibles - excess tax basis over book value | **15,103** | 16,368 |
| Free rent period | **25,403** | - |
| Non-capital loss carryforwards | **333,664** | - |
| Capital loss carryforwards | **23,750** | 23,750 |
| Less: valuation allowance | **(23,750)** | (23,750) |
| | **$ 423,430** | $ 190,868 |
| Future income tax liabilities: | | |
| Capital assets - excess of net book value over undepreciated capital cost | **$ 206,839** | $ 195,674 |
| Intangibles - excess of net book value over tax basis | **216,649** | 330,634 |
| | **$ 423,488** | $ 526,308 |
| Net future tax asset (liability) | **$ (58)** | $ (335,440) |
| Reported in the financial statements as follows: | | |
| Future income tax asset | **$ 299,631** | $ 140,938 |
| Future income tax liability | **(299,689)** | (476,378) |
| | **$ (58)** | $ (335,440) |

A valuation allowance is recognized to the extent the recoverability of future income tax assets is not considered more likely than not. The Company has non-capital losses of $1,169,486 (2009 - $nil) available to reduce future taxable income which expire in 2030.

### 16. Supplemental cash flow information

| | | December 31 2010 | | December 31 2009 |
|---|---|---|---|---|
| Accounts receivable | $ | **(15,555,037)** | $ | 12,002,921 |
| Inventory | | **(2,262,762)** | | (236,122) |
| Prepaids and deposits | | **(3,886,105)** | | 3,830,859 |
| Accounts payable and accrued liabilities | | **1,661,210** | | (1,262,013) |
| Income taxes payable | | **3,836,732** | | (2,674,023) |
| Customer deposits | | **(230,847)** | | 525,486 |
| | $ | **(16,436,809)** | $ | 12,187,108 |
| Interest paid | $ | **1,887,114** | $ | 1,647,890 |
| Income tax paid | | **703,338** | | 1,543,380 |
| Income tax received | | **1,381,442** | | - |
| Non-cash transactions: | | | | |
| Share capital issued (Note 12) | | **5,550** | | - |
| Equipment purchased under capital lease | | **95,118** | | 39,500 |

### 17. Related party transactions

The related party transactions are conducted on the terms and conditions agreed to by the related parties and are recorded at their exchange amounts. Interest on the promissory notes payable is recorded at the exchange amount.

During the year ended December 31, 2010, the Company incurred selling, general and administration expenses in the normal course of operations with affiliated companies, which certain directors have significant influence, and are as follows:

a) Management and other advisory services of $120,000 (December 31, 2009 – $120,000) were paid to a company over which a director has significant influence.

b) Accounting, administrative and corporate expenses of $18,312 (December 31, 2009 – $39,095) were paid to a company over which a director has significant influence.

The Company paid directors fees of $57,000 (December 31, 2009 – $39,750) to three of the Company's directors.

The Company expensed interest of $127,460 (December 31, 2009 - $132,000) on promissory notes payable which are held by two of the Company's directors, senior management and significant shareholders. Of this amount, $5,918 (December 31, 2009 - $81,340) is included in promissory notes payable at year end. In addition, the Company expensed $180,000 (December 31, 2009 – $183,206) on promissory notes payable issued on the acquisition of Bri-Chem Steel which are held by three of the former owners of Bri-Chem Steel. The expense has been included in interest on long term debt and added to the balance of the promissory notes payable.

## 18. Commitments and contingencies

a) The Company has committed to numerous operating lease arrangements for property and equipment. The minimum lease payments under the leases are as follows:

| | |
|---|---|
| 2011 | $ 1,691,511 |
| 2012 | 1,575,675 |
| 2013 | 1,575,675 |
| 2014 | 1,035,012 |
| 2015 | 926,880 |
| | $ 6,804,753 |

b) In the normal course of business, the Company enters into agreements that include indemnities in favour of third parties, such as engagement letters with advisors and consultants. The Company has also agreed to indemnify its directors and officers in accordance with the Company's corporate bylaws. Certain agreements do not contain any limits on the Company's liability and therefore it is not possible to estimate the Company's potential liability under these circumstances. In certain cases, the Company has recourse against third parties with respect to these indemnities. The Company maintains insurance policies that may provide coverage against certain claims under these indemnities.

## 19. Capital risk management

Management's objectives when managing capital are to safeguard the Company's ability to continue as a going concern, to provide an adequate return to shareholders, to meet external capital requirements on the Company's debt and credit facilities and preserve financial flexibility in order to benefit from potential opportunities that may arise.

The Company the following in the definition of capital:

| | **2010** | 2009 |
|---|---|---|
| Bank indebtedness | **$ 39,552,948** | $ 27,652,949 |
| Long-term debt | **3,018,194** | 3,794,484 |
| Promissory notes payable | **4,385,707** | 5,525,696 |
| Obligations under capital lease | **92,571** | 188,201 |
| Shareholders' equity | **23,906,320** | 17,376,720 |
| | **$ 70,955,740** | $ 54,538,050 |

The Company uses a combination of debt and equity financings to help it achieve its objectives. The percentage levels of each capital component may change as the entity attempts to take advantage of prevailing market conditions. The Company is not subject to capital requirements imposed by a regulator.

## 19. Capital risk management (cont'd)

The bank indebtedness and long-term debt require the Company to maintain certain financial covenants. The Company monitors these requirements on a monthly basis. Changes in certain key ratios are as follows:

| | December 31 2010 | December 31 2009 |
|---|---|---|
| Current ratio | 1.33 | 1.40 |
| Debt service ratio | 2.09 | 1.35 |
| Total debt to tangible net worth | 2.78 | 2.11 |

For the year ended December 31, 2010, the Company was in compliance with all financial convenants. On December 20, 2010, HSBC Capital amended its agreement to eliminate the funded debt to normalized EBITDA financial covenant for a one year period ended January 1, 2012. On December 31, 2010, HSBC amended its agreement for the debt to tangible net worth covenant not to exceed 3.00 to 1.0, reducing to 2.75 to 1.00 on December 31, 2011.

Current ratio is defined as current assets divided by current liabilities.

Debt service ratio is defined as the ratio of normalized EBITDA less cash income taxes and unfunded capital expenditures for the trailing four quarters divided by the principal, interest and other fixed obligations, including EBITDA bonuses and any payments owed under promissory notes payable for the same trailing four quarters. Normalized Earnings Before Interest, Taxes, Depreciation and Amortization ("EBITDA") plus non-cash items is a measure that does not have any standardized meaning prescribed by GAAP and therefore may not be comparable to similar measures by other companies.

Total debt to tangible net worth ratio is defined as the ratio of total liabilities of the Company less postponement of long term portion of the promissory notes payable and long term portion of subordinated debt divided by total equity of the Company less intangible assets and goodwill plus any postponement of promissory notes payable and long term portion of subordinated debt.

## 20. Financial instruments

The Company's financial instruments consist of recorded amounts of accounts receivable, as well as, bank indebtedness, accounts payable and accrued liabilities, forward foreign exchange contracts, promissory notes payable, long-term debt, and obligations under capital lease.

*Credit risk*

Credit risk arises from the possibility that the entities to which the Company provides services may experience financial difficulty and be unable to fulfill their obligations. Concentrations of credit risk on trade accounts receivable are with customers in the oil and gas industry. Revenue from the Company's largest three customers accounted for approximately 19%, 12% and 11% respectively (December 31, 2009 – 14%, 9%, 7%) of total revenue during the year ended December 31, 2010 and 26%, 16% and 12% respectively (December 31, 2009 – 19%, 13%, 11%) of total accounts receivable at December 31, 2010.

## 20. Financial instruments (cont'd)

The Company manages its credit risk through the credit application process and through an extensive collections process. The Company maintains an allowance for estimated credit losses on accounts receivable. The estimate is based on the best assessment of the collectability of the related receivable balances based, in part, on the age of the outstanding accounts receivable and on the Company's historical collection and loss experience and other economic information.

The aging of accounts receivable was as follows:

| **2010** | **Gross accounts receivable** | **Allowance for doubtful accounts** | **Net accounts receivable** |
|---|---|---|---|
| Current | $ 15,520,997 | $ - | $ 15,520,997 |
| 31 to 60 days | 13,587,845 | - | 13,587,845 |
| 61 to 90 days | 12,708,104 | - | 12,708,104 |
| 91 to 120 days | 4,199,489 | - | 4,199,489 |
| Over 120 days | 803,490 | 92,000 | 711,490 |
| Total | $ 46,819,925 | $ 92,000 | $ 46,727,925 |

| **2009** | **Gross accounts receivable** | **Allowance for doubtful accounts** | **Net accounts receivable** |
|---|---|---|---|
| Current | $ 10,620,233 | $ - | $ 10,620,233 |
| 31 to 60 days | 9,080,357 | - | 9,080,357 |
| 61 to 90 days | 6,679,747 | - | 6,679,747 |
| 91 to 120 days | 4,282,864 | - | 4,282,864 |
| Over 120 days | 679,178 | 169,491 | 509,687 |
| Total | $ 31,342,379 | $ 169,491 | $ 31,172,888 |

The changes in allowance for doubtful accounts were as follows:

| | **2010** | 2009 |
|---|---|---|
| Balance, beginning of year | **$ 169,491** | $ 3,435 |
| Bad debt expense | **202,456** | 316,171 |
| Receivables written off | **(223,173)** | (119,468) |
| Recovery of receivables | **(56,774)** | (30,647) |
| Balance, end of year | **$ 92,000** | $ 169,491 |

The Company held $294,638 (2009 - $525,486) of customer deposits for the purpose of mitigating the credit risk associated with accounts receivable. The maximum amount of credit risk exposure is limited to the carrying amount of the balance in the financial statements.

*Interest rate risk*

Long-term debt and bank indebtedness are subject to interest rate cash flow risk as the required cash flow to service the debt will fluctuate as a result of the changing prime interest rate. It is management's opinion that interest rate risk is not significant.

**20. Financial instruments** (cont'd)

*Interest rate risk (cont'd)*

The effective interest rate on the bank indebtedness at December 31, 2010 was Canadian bank prime interest rate plus 150 basis points (4.50%). The HSBC committed non-revolving loan bears interest at bank prime plus a fixed increment. As at December 31, 2010, other variables unchanged, an increase or decrease of 25 basis points in the prime interest rate would impact the Company's net earnings by approximately $73,935 (2009 – $56,593).

*Currency risk*

The Company is subject to foreign currency risk due to its accounts receivable, accounts payable and accrued liabilities denominated in foreign currencies. Therefore, there is a risk of earnings fluctuations arising from changes in and the degree of volatility of foreign exchange rates arising on foreign monetary assets and liabilities. Although the majority of the Company's operations are in Canada, the Company has operations outside Canada, which increases its exposure to foreign currency risk. Accounts receivable in foreign currency was $2,799,698 as at December 31, 2010 (December 31, 2009 - $1,580,209) and accounts payable in foreign currency outstanding as at December 31, 2010 is $5,969,389 (December 31, 2009 - $8,281,171). The Company realized a foreign exchange gain of $646,365 (December 31, 2009 - $1,001,153) during the year ended December 31, 2010. Based on the monetary assets and liabilities held in the United States ("US") at December 31, 2010, a 5% increase or decrease in exchange rates would impact the Company's net earnings by approximately $108,113 (December 31, 2009 – $239,781). The Company uses forward foreign exchange contracts to reduce its currency risk. A derivative of $169,790 (2009 - $nil) loss has been accrued and expensed to foreign exchange on the US dollar purchase contracts held at December 31, 2010.

*Liquidity risk*

Liquidity risk is the risk that the Company may not have cash available to satisfy financial liabilities as they become due. The Company actively monitors its financing obligations, as well as its cash and cash equivalents to ensure that it has sufficient available funds to meet current and foreseeable future financial requirements at a reasonable cost. Global financial markets and economic conditions have been disrupted and volatile. The debt and equity markets have been distressed. These factors, together with the repricing of credit risk and the current weak economic conditions have made, and will likely continue to make it difficult to obtain financing. In addition, the cost of obtaining money from the credit market has generally increased as many lenders have increased interest rates, enacted tighter lending standards, and are not refinancing existing debt at maturity on terms similar to current debt and, in some cases, ceased to provide funding. Due to these factors, the Company cannot be certain that financing will be available when needed and to the extent required, on acceptable terms. If financing is not available when needed, or is available only on unfavorable terms, the Company may be unable to implement its business plans, or take advantage of business opportunities, or respond to competitive pressures, all of which could have a material adverse effect on the Company's financial conditions, results of operations, and cash flows.

**20. Financial instruments** (cont'd)

Contractual obligations related to financial liabilities at December 31, 2010 are as follows:

| | Bank credit facility | Accounts payable | Long-term debt * | Promissory notes payable * | Capital leases* | Total |
|---|---|---|---|---|---|---|
| 2011 | $ 39,552,948 | $ 25,053,083 | $ 1,056,297 | $ 2,391,625 | $ 31,997 | $ 68,085,950 |
| 2012 | - | - | 2,305,404 | 1,994,082 | 31,997 | 4,331,483 |
| 2013 | - | - | - | - | 38,864 | 38,864 |
| 2014 | - | - | - | - | - | - |
| 2015 | - | - | - | - | - | - |
| Total | $ 39,552,948 | $ 25,053,083 | $ 3,361,701 | $ 4,385,707 | $ 102,858 | $ 72,456,297 |

* includes interest calculated to be paid

Contractual obligations related to financial liabilities at December 31, 2009 are as follows:

| | Bank credit facility | Accounts payable | Long-term debt * | Promissory notes payable * | Capital leases* | Total |
|---|---|---|---|---|---|---|
| 2010 | $ 27,652,949 | $ 23,917,359 | $ 936,000 | $ 641,436 | $ 195,653 | $ 53,343,397 |
| 2011 | - | - | 2,235,416 | 2,434,401 | 7,848 | 4,677,665 |
| 2012 | - | - | 900,000 | 1,173,495 | 4,578 | 2,078,073 |
| 2013 | - | - | - | 1,163,424 | - | 1,163,424 |
| 2014 | - | - | - | 1,150,915 | - | 1,150,915 |
| Total | $ 27,652,949 | $ 23,917,359 | $ 4,071,416 | $ 6,563,671 | $ 208,079 | $ 62,413,474 |

* includes interest calculated to be paid

*Fair value of financial instruments*

The estimated fair value of the Company's financial instruments approximates the amount for which the financial instruments could currently be exchanged in an arm's length transaction between willing parties who are under no compulsion to act. The carrying value of accounts receivable, bank indebtedness, and accounts payable and accrued liabilities approximate their fair value because of the near term to maturity of these instruments. The fair value of long-term debt and obligations under capital lease approximate the carrying values as the interest rates are similar to the current market rate for similar debt, while the fair value of promissory notes payable reflects the incremental cost of borrowing given current market risks and interest rates for similar debt.

The carrying amount of the Company's other financial liabilities, including long-term debt, promissory notes payable, and obligations under capital lease approximates the fair value, except for promissory notes payable where fair value is $4,287,750 (2009 - $5,353,135). The fair value of the forward exchange forward contracts using Level 2 fair value measurements is a loss of $169,790 (2009 - $nil) as at December 31, 2010.

### 21. Segmented information

Operating segments are defined as components of the Company for which separate financial information is available that is evaluated regularly by the chief decision makers in allocating resources and assessing performance. The Company operates in two business segments based on type of products sold. The fluids segment includes the sale of fluids and chemical additives to the resource and industrial markets. The steel product segment includes the sale of tubular steel products to the resource, industrial and construction industries.

Accounting policies for each of these business segments are the same as those disclosed in the Company's annual consolidated financial statements. General and administrative expenses directly related to the operating segments are included as operating expenses for those segments. There are no significant inter-segment revenues.

Selected financial information by reportable segment is disclosed as follows:

| **December 31, 2010** | **Fluids** | **Steel** | **Corporate** | **Consolidated** |
|---|---|---|---|---|
| Revenue | $ 118,088,431 | $ 34,406,955 | $ - | **$ 152,495,386** |
| Amortization | 633,857 | 242,585 | 22,195 | **898,637** |
| Interest expense (income) | 2,748,434 | 353,393 | (1,342,247) | **1,759,580** |
| Income tax expense (recovery) | 2,956,241 | (318,411) | 185,416 | **2,823,246** |
| Segment profit (loss) before adjustments | $ 7,178,806 | $ (2,579,225) | $ 722,988 | **$ 5,322,569** |
| Inventory write-down (reversal) | - | (1,617,577) | - | **(1,617,577)** |
| Segment profit (loss) | $ 7,178,806 | $ (961,648) | $ 722,988 | **$ 6,940,146** |
| Intangible assets | $ 580,618 | $ 276,823 | $ - | $ 857,441 |
| Total assets | 78,335,167 | 19,694,391 | 1,028,881 | 99,058,439 |
| Capital expenditures (excluding business acquisitions) | 262,291 | 245,851 | - | 508,142 |

## 21. Segmented information (cont'd)

| December 31, 2009 | Fluids | Steel | Corporate | Consolidated |
|---|---|---|---|---|
| Revenue | $ 62,051,728 | $ 34,427,887 | $ - | **$ 96,479,615** |
| Amortization | 749,010 | 749,429 | 28,788 | **1,527,227** |
| Interest expense (income) | 2,319,891 | 1,060,915 | (1,549,711) | **1,831,095** |
| Income taxes | 366,146 | (1,264,768) | (424,097) | **(1,322,719)** |
| Segment profit (loss) before adjustments | $ 744,972 | $ (953,423) | $ 1,725,805 | **$ 1,517,354** |
| Impairment charge | 1,408,677 | 5,475,455 | - | **6,884,132** |
| Inventory write-down | 347,259 | 2,733,301 | - | **3,080,560** |
| Segment (loss) profit | $ (1,010,964) | $ (9,162,179) | $ 1,725,805 | **$ (8,447,338)** |
| Intangible assets | $ 877,873 | $ 363,227 | $ - | $ 1,241,100 |
| Total assets | 54,788,136 | 23,250,643 | 893,008 | 78,931,787 |
| Capital expenditures (excluding business acquisitions) | 344,970 | 334,718 | - | 679,688 |

The Company's operations are conducted in the following geographic locations:

| | **December 31 2010** | December 31 2009 |
|---|---|---|
| Revenue | | |
| Canada and International | **$ 144,847,036** | $ 88,118,737 |
| United States | **7,648,350** | 8,360,878 |
| | **$ 152,495,386** | $ 96,479,615 |

Total assets, property and equipment, intangibles and goodwill related to the United States operations were not significant and therefore have been included in Canadian operations.

## 22. Comparative figures

Certain of the prior period's figures have been reclassified to conform to the current period consolidated financial statement presentation.

**23. Subsequent events**

a) On January 10, 2011, the Company announced it had commenced operations of Manufacturing, which will provide value-added manufacturing of large diameter seamless steel pipe location in Edmonton, Alberta, Canada. The Company has agreed to advance approximately $1,000,000 of working capital and support initial inventory financing as required, and to provide sales and marketing personnel. Wuxi will contribute all the necessary equipment, training, installation and engineering. The equipment contribution by Wuxi will be in exchange for $2,100,000 non-voting preferred shares to be issued.

b) On January 19, 2011, the Company announced an equity financing of up to 2,000,000 common shares of the Company at a price of $3.00 per share. The financing was completed February 22, 2011 with 2,000,000 common shares issued for gross proceeds of $6,000,000. In consideration for services related to the offering, the Company has agreed to pay Macquarie Private Wealth Inc. (“the Agent”) and any designated sub-agents, a fee equal to 6% of the gross proceeds of the offering, totaling an aggregate commission of $360,000, plus a corporate finance fee of $30,000 plus tax. The Agent also received non-transferrable agent options equal to 7% of the number of shares sold under the offering. Upon closing of the offering, 124,002 non-transferrable agent options were issued to the Agent, and 15,998 non-transferrable agent options were issued to a designated sub-agent, entitling them to purchase one Bri-Chem common share per option at a price of $3.00 per share, with an expiry date of August 22, 2012. The value of the options issued at February 22, 2011 was $178,089, which was recorded against share capital at that date. The funds will be used to repay $1,000,000 of outstanding promissory notes payable, and well as added to working capital to fund future acquisitions.

c) On March 23, 2011, the Company entered into a letter of intent to acquire the net assets and business operations of Stryker Ltd., a Denver-based full-service drilling fluids wholesaler, and Stryker Transportation Ltd., its transportation division. The total purchase price of US$2,500,000 consists of US$1,000,000 cash payable on closing, US$350,000 payable twelve months from closing, approximately US$550,000 by way of assumption of existing bank debt and capital lease obligations and US$600,000 by way of the issuance of approximately 171,428 common shares of the Company at a price of $3.50 per share.