# Bri-Chem Corp.
## Management Discussion and Analysis
Three and Six Months Ended June 30, 2009

**To Our Shareholders:**

We are pleased to report on the activity and results of Bri-Chem Corp. ("Bri-Chem") for the second quarter ended June 30, 2009. During the quarter, Bri-Chem's revenue was down nominally (5.1%) as compared to the same period last year while recording a diluted loss of ($0.06) per share. A complete copy of Bri-Chem's report is available on the Internet at www.sedar.com.

Consolidated revenues were $10,118,467 for the second quarter of 2009, a decrease of 5.1% when compared to $10,658,262 from the same period last year. Net loss from operations for the three months ended June 30, 2009 is $847,643 or ($0.06) diluted loss per share compared to earnings of $103,706 from the same period last year. Earnings before interest, taxes, depreciation and amortization (EBITDA) is ($296,383), a decrease of $998,845 or 142.2% compared to the same period last year.

Net earnings from operations for the six months ended June 30, 2009 are $12,340 or $0.00 diluted earnings per share a decrease of 99.0% when compared to $1,368,481 from the same period last year. Earnings before interest, taxes, depreciation and amortization for the same period are $2,110,156 a decrease of $1,168,421 or 35.6% compared to the same period last year. Consolidated revenues were $40,455,569, an increase of 23.1% when compared to $32,858,795 from the same period in 2008.

The decline in Company revenues and operating performance is the result of the dramatic decrease in oil and natural gas drilling activity and the North American overstock of steel products. During the second quarter, drilling activity, based on drilling operating days, was down 38.5% and 42.8% respectively for the three and six months ended June 30, 2009 compared to the same periods of 2008. Drilling rig utilization rates experienced a decline of 8.0% with average rig utilization of 10.7% for the three months ended June 30, 2009 compared to 18.7%for the same period of 2008. For the six months ended June 30, 2009 average rig utilization was 23.9% a decline of 13.6% compared to the same period in 2008.

**Outlook**

Bri-Chem continued to have increased sales growth for the six months ended June 30, 2009 of 23.1%, despite operating cautiously due to the current economic instability that exists. It is uncertain what the short-term impact of this instability will have on industries and the Company. With volatile commodity prices and the weakened demand for products, the Company is focused on managing inventory and controlling costs through this decline. Throughout 2009 we will remain focused on finding opportunities to maximize cash flow and continue to monitor our debt levels. The second half of the year, we anticipate sales and earnings to improve relative to the first half of the year, however given the global economic instability it will remain a challenge to achieve similar results reported in the third and fourth quarters of 2008.

I would like to thank our employees for their continued commitment and dedication, and our shareholders for their support.

On behalf of the Board of Directors,
*(Signed)* "Don Caron"
D.P. Caron, Chairman

This Management's Discussion and Analysis ("MD&A") was prepared as of August 26, 2009. It is provided to assist readers in understanding Bri-Chem Corp.'s ("Bri-Chem" or the "Company") financial performance for the three and six months ended June 30, 2009 and significant trends that may affect future performance of the Company. This MD&A should be read in conjunction with the annual audited consolidated financial statements for the year ended December 31, 2008.

The Company's financial statements are prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and are presented in Canadian dollars unless otherwise indicated. All references in this report to financial information concerning the Company refer to such information in accordance with GAAP and all dollar amounts in this report are in Canadian dollars unless otherwise indicated. This report also makes reference to certain non-GAAP measures in assessing the Company's financial performance. Non-GAAP measures do not have any standard meaning prescribed by GAAP and are therefore unlikely to be comparable to similar measures presented by other issuers. The Company includes these non-GAAP measures as a method to assist management in assessing comparative performance of the Company and management believes they are used by investors to assess the performance of the Company.

Statements throughout this report that are not historical facts may be considered "forward looking statements." Such statements are based on current expectations that involve risks and uncertainties which could cause actual results to differ from those anticipated. Important factors that can cause anticipated outcomes to differ materially from actual outcomes include the impact of general economic conditions, industry conditions, competition from other industry participants, volatility of petroleum prices, the ability to attract and retain qualified personnel, changes in laws or regulations, currency fluctuations, continued ability to access capital from available facilities and environmental risks. References in this MD&A to "Bri-Chem", the "Company", "us", "we", and "our" mean Bri-Chem Corp.

Additional information relating to the Company is available on the System for Electronic Document Analysis and Retrieval ("SEDAR") at www.sedar.com.

## OVERVIEW OF BUSINESS

Bri-Chem is a leading Canadian based wholesale distributor of drilling fluids, steel products and services to the resource, industrial and construction industries in North America. The Company is headquartered in Acheson, Alberta located 20 kilometers west of Edmonton, Alberta. Bri-Chem owns a 100% interest in Bri-Chem Supply Ltd. ("Bri-Chem Supply"), 100% interest in Sodium Solutions Inc. ("Sodium") and 100% interest in Weifang Steel Canada Ltd. ("Weifang"), which changed its name to Bri-Chem Steel Corporation ("Bri-Chem Steel"). Bri-Chem continues to concentrate on expanding its market presence in the wholesale distribution market with the focus being on the following four divisions:

### OIL AND GAS FLUIDS DIVISION

*Western Canadian Sedimentary Basin (WCSB)*

Bri-Chem is one of Canada's largest wholesale distributors of drilling fluid supplies to the oil and gas industry in the WCSB. Bri-Chem sells over 150 different products in a wide variety of weights and clays, lost circulation materials, chemicals and oil mud products to mud engineering companies who sell directly to drilling firms engaged by the oil companies. Much of Bri-Chem's success is attributed to their comprehensive network of 17 strategically placed and fully stocked warehouses throughout Alberta, Saskatchewan and British Columbia as mud engineering companies and drilling companies prefer to use one wholesaler for all of their projects. The drilling fluid supply business experiences some seasonality with the late spring generally being the slowest period, as customers in the natural resource sectors experience a slowdown in their activity. The peak season is in the late fall and winter when customers are not constrained by environmental forces to perform their activities.

*Chemical Supplies and Packaging*

The fluids market in the WCSB also includes completion fluids, cementing, acidizing and fracturing fluids. The addressable size of these markets is significant and Bri-Chem continues to grow its business presence in each of these end use applications. Bri-Chem has the ability to mix and blend products to grow and adapt to the changing environment and needs of their clients. The distribution of chemical supplies and packaging is operated through Bri-Chem's blending and packaging facilities located in Camrose and Acheson, Alberta and its principal activity is to offer an extensive product line in both packaged and truckload quantities. Bri-Chem continues to target different industries including agriculture and construction for product and industry diversification.

*United States (US)*

The US market is significantly larger than the WCSB and more geographically dispersed. Bri-Chem has established a US based warehouse and distribution facility in Williston, ND. Due to the economic recession a number of Bri-Chem's fluid customers have moved out of the US due to decreased drilling activity. Bri-Chem is currently evaluating the feasibility of maintaining a US stock point for fluid products.

## INDUSTRIAL FLUIDS DIVISION

Performance Industrial Products ("Performance") is a division of Bri-Chem Supply Ltd. that distributes technologically advanced industrial fluids to the non-oilfield sector. Performance offers chemicals to a diverse number of markets including mining exploration, water well drilling, geothermal and geotechnical drilling, seismic and construction projects.

## SPECIALTY FLUIDS DIVISION

With a laboratory in Calgary, Alberta, Bri-Chem serves its customers throughout the WCSB with testing equipment, quality assurance, training, and research and analysis of critical fluids.

## STEEL PRODUCTS DIVISION

Bri-Chem is also in the wholesale distribution market for steel pipe, fittings, flanges, tubular products and casing. The division primarily services the resource, construction, mechanical and industrial markets in Western Canada and Eastern United States. Bri-Chem sells various diameters of carbon steel welded pipe, carbon steel seamless pipe, stainless steel pipe, drill pipe, tubing and casing, sucker rods as well as fittings and flanges. The Company's superior vendor relationships have provided access to hard to find products and increased market share in a competitive industry.

Bri-Chem manages its steel product inventory through one warehouse in Leduc, Alberta, which is the primary stock location for steel products in North America and also maintains three pipe yards in New Orleans, Louisiana, Chicago, Illinois, and Houston, Texas, which allows the Company to service major pipe distributors throughout the Eastern USA. Bri-Chem's broad base of steel products are primarily used in the oil and gas industry, however the Company does distribute steel products to non-oilfield related industries such as construction, industrial and mining.

**Seasonality of Operations**

Weather conditions can affect the sale of the Company's fluid chemical and steel 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 have a direct impact on the Company's activity levels. In addition, many exploration and production areas in the northern 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.

**Growth Strategy**

The Company will continue to focus on growth by expanding its market presence in the industrial wholesale distribution markets. Acquisitions may play a significant role in the Company's growth. Management recognizes that the key determinants to successfully building shareholder value from acquisitions are reaching agreement on an appropriate valuation and efficiently integrating corporate cultures. Acquisitions are intended to increase product, geographical, industry and seasonal diversification.

## FINANCIAL SUMMARY

| Consolidated statement of operations | For the three months ended June 30 2009 | 2008 | Change $ | % |
|---|---|---|---|---|
| Sales | **$ 10,118,467** | $ 10,658,262 | $ (539,795) | -5.1% |
| Gross margin | **1,869,387** | 1,969,054 | (99,667) | -5.1% |
| Gross margin % | **18.5%** | 18.5% | - | 0.0% |
| Operating expenses (1) | **2,165,770** | 1,266,592 | 899,178 | 71.0% |
| EBITDA (2) | **(296,383)** | 702,462 | (998,845) | -142.2% |
| Depreciation and amortization | **402,378** | 190,446 | 211,932 | 111.3% |
| Interest | **489,750** | 375,113 | 114,637 | 30.6% |
| Earnings (loss) before income taxes | **(1,188,511)** | 136,903 | (1,325,414) | -968.1% |
| Income tax (recovery)/expense | **(340,868)** | 33,197 | (374,065) | -1126.8% |
| Net earnings | **$ (847,643)** | $ 103,706 | $ (951,349) | -917.4% |
| **Earnings per share** | | | | |
| Basic | **$ (0.06)** | $ 0.01 | $ (0.07) | -684.4% |
| Diluted | **$ (0.06)** | $ 0.01 | $ (0.07) | -684.4% |
| **Weighted average shares outstanding** | | | | |
| Basic | **14,504,183** | 12,939,278 | n/a | n/a |
| Diluted | **14,504,183** | 12,939,278 | n/a | n/a |

(1) See page 28 for a further explanation of this non-GAAP measure.
(2) Represents earnings before interest, taxes, depreciation and amortization (see page 28 for a further explanation of this non-GAAP measure).

| Consolidated statement of operations | For the six months ended June 30 2009 | 2008 | Change $ | % |
|---|---|---|---|---|
| Sales | **$ 40,455,569** | $ 32,858,795 | $ 7,596,774 | 23.1% |
| Gross margin | **6,686,304** | 6,306,688 | 379,616 | 6.0% |
| Gross margin % | **16.5%** | 19.2% | - | -2.7% |
| Operating expenses (1) | **4,576,148** | 3,028,111 | 1,548,037 | 51.1% |
| EBITDA (2) | **2,110,156** | 3,278,577 | (1,168,421) | -35.6% |
| Depreciation and amortization | **921,247** | 405,463 | 515,784 | 127.2% |
| Interest | **1,171,651** | 851,009 | 320,642 | 37.7% |
| Earnings before income taxes | **17,258** | 2,022,105 | (2,004,847) | -99.1% |
| Income taxes | **4,918** | 653,624 | (648,706) | -99.2% |
| Net earnings | **$ 12,340** | $ 1,368,481 | $ (1,356,141) | -99.1% |
| **Earnings per share** | | | | |
| Basic | **$ 0.00** | $ 0.11 | $ (0.11) | -99.2% |
| Diluted | **$ 0.00** | $ 0.11 | $ (0.11) | -99.2% |
| **Weighted average shares outstanding** | | | | |
| Basic | **14,508,798** | 12,933,058 | n/a | n/a |
| Diluted | **14,508,798** | 12,933,058 | n/a | n/a |

(1) See page 28 for a further explanation of this non-GAAP measure.
(2) Represents earnings before interest, taxes, depreciation and amortization (see page 28 for a further explanation of this non-GAAP measure).

## RESULTS OF OPERATIONS

### Sales

**Sales by segment**

| | For the three months ended June 30 | | Change | |
|---|---|---|---|---|
| | **2009** | 2008 | **$** | **%** |
| Fluids | $ **6,867,958** | $ 10,658,262 | $ (3,790,304) | -35.6% |
| Steel | **3,250,509** | - | 3,250,509 | 100.0% |
| | $ **10,118,467** | $ 10,658,262 | $ (539,795) | -5.1% |

| | For the six months ended June 30 | | Change | |
|---|---|---|---|---|
| | **2009** | 2008 | **$** | **%** |
| Fluids | $ **23,070,710** | $ 32,858,795 | $ (9,788,085) | -29.8% |
| Steel | **17,384,859** | - | 17,384,859 | 100.0% |
| | $ **40,455,569** | $ 32,858,795 | $ 7,596,774 | 23.1% |

*Fluids*

In the second quarter of 2009, industry drilling rig utilization rates averaged 10.7%, representing an 8% decrease from the same period last year when drilling rig activity averaged 18.7%. With the continued decrease in drilling activity in the second quarter, the Company has experienced a decline in the demand for drilling fluids resulting in a 35.6% decrease in revenues in the second quarter of 2009 compared to the same period in 2008. The Alberta and Saskatchewan markets largely contributed to the decrease in revenues as both markets experience considerable slowdown in those regions.

During the second quarter of 2009 the Company has seen a decrease in revenues from the Alberta warehouses of approximately 39.4% while the decline in overall drilling activity for the Alberta market is approximately 42%. Saskatchewan had 623 wells drilled during the six months ended June 30, 2009, which generated $1,224,015 in revenues for the Company from this region, which the Company had $1,956,875 in revenues for the same period in 2008. The drilling programs in Northern British Columbia have seen a decrease in drilling activity of 15% with 374 wells drilled in the region compared to 441 wells drilled during the same period last year. Revenues generated from the non-oilfield division were $410,660 for the six months ended June 30, 2009 compared to $315,772 for the same period in 2008, while sales to United States amounted to $307,936 compared to $785,988 for the same period in 2008.

*Steel Products*

During the three months ended June 30, 2009, the steel products division generated revenues of $3,250,509. During the quarter, the Company had gross sales of $7,541,019, but were offset with $4,290,510 of unforeseen sales cancellations that were out of the Company's normal operations. Unusual late deliveries and postponement of drilling activity due to the economic downturn caused these sales cancellations late in the second quarter, resulting in net sales of $3,250,509 for the second quarter. The steel products division sells primarily to the oil and gas industry and therefore the decrease in drilling activity in Western Canada during the second quarter affected the division's sales as there was less demand for steel products. In addition, many oil and natural gas companies delayed many capital projects which impacted the demand for steel products. The global economic crisis has caused steel prices to become extremely volatile, which has led the Company to reduce selling prices to be competitive based on current market demand for steel products. It is anticipated that steel prices will remain depressed for the short term with a recovery to more reasonable prices late in the year.

Sales in the United States for the three and six months ended June 30, 2009 amounted to $310,323 and $3,795,634, respectively. The Company will continue its growth in the US market as it is significantly larger than the Canadian market and more geographically dispersed, which mitigates some of the seasonality that occurs in the Canadian market. Bri-Chem has three inventory yards in New Orleans, Louisiana, Chicago, Illinois and Houston, Texas to warehouse and distribute tubing, casing and steel products to customers in the US. With the decrease in drilling activity in 2009, the steel products division has began concentrating on developing its customer base to distribute steel products to the construction industry with the opportunity to capitalize on the building infrastructure market.

**Gross margin**

| | For the three months ended June 30 | | Change | |
|---|---|---|---|---|
| | **2009** | 2008 | **$** | **%** |
| Gross margin | **$ 1,869,387** | $ 1,969,054 | $ (99,667) | -5.1% |
| % of sales | **18.5%** | 18.5% | | 0.0% |
| | **For the six months ended June 30** | | **Change** | |
| | **2009** | 2008 | **$** | **%** |
| Gross margin | **$ 6,686,304** | $ 6,306,688 | $ 379,616 | 6.0% |
| % of sales | **16.5%** | 19.2% | | -2.7% |

The gross margin as a percentage of sales for the three months ended June 30, 2009 remained the same as in 2008, while the gross margin as a percentage of sales for the six months ended June 30, 2009 decreased by 2.7%. The decrease in margins during the six months ended June 30, 2009 was due to decreased selling prices on steel as the price of steel commodities decreased significantly over the last six months. The fluids division had many customers requesting less costly alternatives for drilling fluids in an attempt to control their costs, resulting in lower margins on fluid sales. Margins on fluid sales vary based on the seasonality of product mix whereby winter drilling activity requires more technologically advanced fluids which are higher margin products compared to spring and summer months. The steel products division maintained a margin of 16.8% for the six months ended June 30, 2009.

Given the current global economic crisis, and in particular steel commodity prices, we anticipate our gross margin for future quarters to be comparable to the six month gross margin. Steel commodity prices are at depressed amounts and are not expected to recover until the later part of 2009, which will result in the Company lowering prices to stay competitive with the market place. There have been cost reductions of certain drilling fluid products which the Company continued to pass through to customers. With the Company's excess fluid inventory, margins will be similar to the six month gross margin as there is a timing difference between the selling price reduction and the cost reduction from vendors. As inventory is reduced to more reasonable levels, gross margins will stabilize in the later part of 2009. We are unable to predict the value of the Canadian dollar in relation to foreign currencies in the future; therefore, we are uncertain as to the potential impact on the Company's gross margin in relation to foreign purchases of product.

**Operating expenses**

**Salaries and employee benefits**

| | For the three months ended June 30 | | Change | |
|---|---|---|---|---|
| | **2009** | 2008 | **$** | **%** |
| Salaries and benefits | **$ 1,440,863** | $ 821,868 | $ 618,995 | 75.3% |
| % of sales | **14.2%** | 7.7% | | 6.5% |

| | For the six months ended June 30 | | Change | |
|---|---|---|---|---|
| | **2009** | 2008 | **$** | **%** |
| Salaries and benefits | **$ 3,129,545** | $ 1,762,082 | $ 1,367,463 | 77.6% |
| % of sales | **7.7%** | 5.4% | | 2.3% |

The dollar increase in salary and employee benefits for the three and six months ended June 30, 2009 relates to twenty additional staff brought in from the Bri-Chem Steel acquisition in August 2008. Bri-Chem Steel had salaries and benefits of $627,954 and $1,322,477 during the three and six months ended June 30, 2009. The reduced sales caused an increase in expenses as a percentage of sales.

**Selling, general and administration**

| | For the three months ended June 30 2009 | 2008 | Change $ | % |
|---|---|---|---|---|
| Selling | $ **139,480** | $ 114,964 | $ 24,516 | 21.3% |
| Professional and consulting | **169,031** | 90,217 | 78,814 | 87.4% |
| General and administration | **281,544** | 107,979 | 173,565 | 160.7% |
| Rent, utilities and occupancy costs | **435,997** | 167,144 | 268,853 | 160.9% |
| Foreign exchange (gain)/loss | **(301,145)** | (35,580) | (265,565) | 746.4% |
| | $ **724,907** | $ 444,724 | $ 280,183 | 63.0% |
| **Selling, general and administrative expenses (as a % of sales)** | | | | |
| Selling | **1.4%** | 1.1% | | |
| Professional and consulting | **1.7%** | 0.8% | | |
| General and administration | **2.8%** | 1.0% | | |
| Rent, utilities and occupancy costs | **4.3%** | 1.6% | | |
| Foreign exchange (gain)/loss | **-3.0%** | -0.3% | | |
| | **7.2%** | 4.2% | | |

| | For the six months ended June 30 2009 | 2008 | Change $ | % |
|---|---|---|---|---|
| Selling | $ **268,149** | $ 271,033 | $ (2,884) | -1.1% |
| Professional and consulting | **342,462** | 221,910 | 120,552 | 54.3% |
| General and administration | **619,248** | 241,983 | 377,265 | 155.9% |
| Rent, utilities and occupancy costs | **813,646** | 305,850 | 507,796 | 166.0% |
| Foreign exchange (gain)/loss | **(596,902)** | 225,253 | (822,155) | -365.0% |
| | $ **1,446,603** | $ 1,266,029 | $ 180,574 | 14.3% |
| **Selling, general and administrative expenses (as a % of sales)** | | | | |
| Selling | **0.7%** | 0.8% | | |
| Professional and consulting | **0.8%** | 0.7% | | |
| General and administration | **1.5%** | 0.7% | | |
| Rent, utilities and occupancy costs | **2.0%** | 0.9% | | |
| Foreign exchange (gain)/loss | **-1.5%** | 0.7% | | |
| | **3.6%** | 3.9% | | |

The following is an analysis of the selling, general and administrative categories:

Selling expenses decreased for the three months ended June 30, 2009 due to the acquisition of Bri-Chem Steel in Q3 of 2008. Bri-Chem Steel incurred $37,254 of selling costs during the three months ended June 30, 2009 and $78,401 of selling costs for the six months ended June 30, 2009. The Company has taken steps to control costs during the current global economic crisis. Sales personnel in Bri-Chem Steel were provided automobiles for travel which totaled $35,494, to meet customers and acquire new business. Late in Q2, the Company provided steel sales personnel a vehicle allowance, which is now included as part of the employees overall compensation. Selling costs relate to customer relation costs, promotion and travel costs.

Professional and consulting expenses increased due to increased consulting fees relating to the Company's International Financial Reporting Standards conversion implementation along with increased audit fees due to the acquisition of Bri-Chem Steel. Costs in this category are comprised of audit, legal, advisory and consulting fees.

General and administration expenses decreased significantly over the same prior period due mostly to foreign exchange. With the global economic recession, the US dollar has weakened in relation to other currencies. The decrease in the US dollar resulted in a foreign exchange gain during the six months ended June 30, 2009 causing the Company to have a favourable position in purchases in foreign currencies. The Company reported a foreign exchange gain of $596,902 for the six months ended June 30, 2009 compared to a $225,253 loss for the same comparative period in 2008. These foreign exchange gains arose on the translation of the foreign denominated assets and liabilities held by the Company. General and administration expenses were $619,248 excluding the foreign currency translation effects for the six months ended June 30, 2009, compared to $241,637 for the same comparative period in 2008. General and administration expenses relating to Bri-Chem Steel were $295,616 for the six months ended June 30, 2009. In addition the Company had an increase of $168,593 in insurance costs due to insuring more inventories and the increased coverage required as a result of the Bri-Chem Steel acquisition. Given the current global economic conditions, the Company recorded $50,606 in bad debts for the six months ended June 30, 2009 compared to a recovery of bad debts of $21,400 for the same period in 2008. General and administration costs consist of licenses, office and computer expenses, insurance and general bank charges.

Warehouse rent, utilities and occupancy cost expenses increased for the three and six months ended June 30, 2009 due to $489,186 of costs of operating the steel distribution warehouse. During the second quarter the steel division commenced its move into a new 36,000 square foot facility in Leduc, Alberta and the relocation costs have been recorded as occupancy costs during the quarter. Liquid storage tank rentals increased as the Company has expanded its storage capacity for liquid invert to include Edson, Estevan and Grande Prairie and Fort St. John. Costs in this category are comprised mainly of rent, utilities, warehouse expense for the Leduc, Camrose, Acheson and Estevan locations as well as liquid storage tank rentals.

**Amortization**

| | For the three months ended June 30 | | Change | |
|---|---|---|---|---|
| | **2009** | 2008 | **$** | **%** |
| Property and equipment | **$ 145,812** | $ 74,227 | $ 71,585 | 96.4% |
| Intangibles | **256,566** | 116,219 | 140,347 | 120.8% |
| Total | **$ 402,378** | $ 190,446 | $ 211,932 | 111.3% |

| | For the six months ended June 30 2009 | 2008 | Change $ | % |
|---|---|---|---|---|
| Property and equipment | **$ 271,449** | $ 171,853 | $ 99,596 | 58.0% |
| Intangibles | **649,798** | 233,610 | 416,188 | 178.2% |
| Total | **$ 921,247** | $ 405,463 | $ 515,784 | 127.2% |

Amortization expense increased during the three and six months ended June 30, 2009 when compared to the same period last year. The increase relates to $1,001,697 of capital additions over the past year, including $738,248 of fixed assets from the acquisition of Bri-Chem Steel in August 2008. In addition, amortization of intangibles increased related to the customer relationships, tradename, sales backlog and non-compete agreements due to the acquisition of Bri-Chem Steel in 2008.

**Interest**

| | For the three months ended June 30 2009 | 2008 | Change $ | % |
|---|---|---|---|---|
| Interest on long-term debt | **$ 165,776** | $ 174,441 | $ (8,665) | -5.0% |
| Interest on short-term operating debt | **323,015** | 200,672 | 122,343 | 61.0% |
| Interest on obligations under capital lease | **959** | - | 959 | |
| Total | **$ 489,750** | $ 375,113 | $ 114,637 | 30.6% |

| | For the six months ended June 30 2009 | 2008 | Change $ | % |
|---|---|---|---|---|
| Interest on long-term debt | **$ 343,221** | $ 298,547 | $ 44,674 | 15.0% |
| Interest on short-term operating debt | **823,756** | 552,462 | 271,294 | 49.1% |
| Interest on obligations under capital lease | **4,674** | - | 4,674 | |
| Total | **$ 1,171,651** | $ 851,009 | $ 320,642 | 37.7% |

Interest on long-term debt decreased during the three month period ended June 30, 2009 when compared to the same period last year due to the decrease in the prime interest rate and the commencement of the repayment of the sub-debt. Interest on short-term operating debt has increased for the three month period ended June 30, 2009 when compared to the same period last year as the Company had a higher revolving line of credit balance due to increased activity levels, carrying more inventories as a result of the downturn in economy.

As at June 30, 2009, long-term debt consisted of a $2,200,000, 6% note payable plus accrued interest issued to shareholders of the Company as a result of the January 2007 reverse takeover of Gwelan Supply Ltd., promissory notes payable of $3,000,000 plus accrued interest to the former owners of Bri-Chem Steel, a $1,563,071 prime plus 0.85% demand loan outstanding with a Canadian chartered bank, and a $2,760,000 subordinated loan bearing interest at prime plus 7% with a financial institution.

**Income taxes**

The provision for income taxes in the second quarter of 2009 is a recovery of $340,868 compared to current tax expense of $33,197 in the same period last year. The decrease in current taxes for the three months ended June 30, 2009 resulted from decreased earnings and a reduction in the Company's effective tax rate for 2009. The Company's current income tax effective rate is 28.7% for the three months ended June 30, 2009.

**Net (loss) earnings and earnings per share**

| | For the three months ended June 30 | | Change | |
|---|---|---|---|---|
| | **2009** | 2008 | **$** | **%** |
| Net (loss) earnings | **$ (847,643)** | $ 103,706 | $ (951,349) | -917.4% |
| % of revenue | **-8.4%** | 1.0% | | |
| EBITDA (1) | **$ (296,383)** | $ 702,462 | $ (998,845) | -142.2% |
| % of revenue | **-2.9%** | 6.6% | | |

| | For the six months ended June 30 | | Change | |
|---|---|---|---|---|
| | **2009** | 2008 | **$** | **%** |
| Net earnings | **$ 12,340** | $ 1,368,480 | $ (1,356,140) | -99.1% |
| % of revenue | **0.0%** | 4.2% | | |
| EBITDA (1) | **$ 2,110,156** | $ 3,278,576 | $ (1,168,420) | -35.6% |
| % of revenue | **5.2%** | 10.0% | | |

(1) Represents earnings before interest, taxes, depreciation and amortization (see page 28 for a further explanation of this non-GAAP measure).

Net earnings from operations for the three months ended June 30, 2009 decreased by $951,349 to ($847,643) from $103,706 for the same period last year. Net earnings, as a percentage of revenues, for the first quarter of 2009 was (8.4%) compared to 1.0% for the three months ended June 30, 2009. EBITDA from operations decreased by 142.2% in the second quarter of 2009 when compared to the same quarter last year. The decrease in net earnings and EBITDA is due to the decrease in fluid sales as the result of lower drilling activity and decreased gross margin as the result lower selling prices on steel and fluid products in order to remain competitive in the marketplace.

Earnings per share for the three and six months ended June 30, 2009 were based on the weighted average number of shares outstanding during the period. The basic and diluted weighted average number of shares outstanding for the three months ended June 30, 2009 was 14,504,183. During the first half of the year, the Company purchased 10,000 common shares under the Normal Course Issuer Bid.

## SUMMARY OF QUARTERLY DATA

| (in thousands of Cdn $) | | 2009 Q2 | | 2009 Q1 | | 2008 Q4 | | 2008 Q3 | | Total TTM |
|---|---|---|---|---|---|---|---|---|---|---|
| Sales | $ | 10,118 | $ | 30,337 | $ | 46,240 | $ | 32,184 | $ | 118,879 |
| Gross margin ($) | | 1,869 | | 4,817 | | 6,639 | | 5,493 | | 18,818 |
| Gross margin (%) | | 18.5% | | 15.9% | | 14.4% | | 17.1% | | 15.8% |
| EBITDA [(1)] | | (296) | | 2,407 | | 2,954 | | 3,521 | | 8,586 |
| **Net (loss) earnings** | $ | (848) | $ | 860 | $ | 1,235 | $ | 1,883 | $ | 3,130 |
| Basic earnings per share | $ | (0.06) | $ | 0.06 | $ | 0.09 | $ | 0.14 | $ | 0.23 |
| Diluted earnings per share | $ | (0.06) | $ | 0.06 | $ | 0.09 | $ | 0.14 | $ | 0.23 |

| (in thousands of Cdn $) | | 2008 Q2 | | 2008 Q1 | | 2007 Q4 | | 2007 Q3 | | Total TTM |
|---|---|---|---|---|---|---|---|---|---|---|
| Sales | $ | 10,658 | $ | 22,201 | $ | 21,358 | $ | 18,889 | $ | 73,106 |
| Gross margin ($) | | 1,969 | | 4,338 | | 3,915 | | 3,281 | | 13,503 |
| Gross margin (%) | | 18.5% | | 19.5% | | 18.3% | | 17.4% | | 18.5% |
| EBITDA [(1)] | | 702 | | 2,576 | | 2,180 | | 1,838 | | 7,296 |
| **Net earnings (loss)** | $ | 104 | $ | 1,265 | $ | 427 | $ | 1,175 | $ | 2,971 |
| Basic earnings (loss) per share | $ | 0.01 | $ | 0.10 | $ | 0.03 | $ | 0.09 | $ | 0.23 |
| Diluted earnings (loss) per share | $ | 0.01 | $ | 0.10 | $ | 0.03 | $ | 0.09 | $ | 0.23 |

(1) EBITDA is a non-GAAP measure which the Company defines as earnings before interest, taxes, depreciation, amortization (See page 28 for a further explanation of this non-GAAP measure).

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 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.

## FINANCIAL CONDITION & LIQUIDITY

| **Balance Sheet**<br>**As at** | | **June 30**<br>**2009** | | December 31<br>2008 |
|---|---|---|---|---|
| Current assets | **$** | **66,126,098** | $ | 88,089,363 |
| Property and equipment | | **4,050,015** | | 3,797,515 |
| Other assets | | **8,425,022** | | 9,074,821 |
| **TOTAL ASSETS** | **$** | **78,601,135** | $ | 100,961,699 |
| Current liabilities | **$** | **44,962,664** | $ | 66,756,163 |
| Long-term liabilities | | **7,756,250** | | 8,401,179 |
| **TOTAL LIABILITIES** | | **52,718,914** | | 75,157,342 |
| Share capital | | **15,284,774** | | 15,295,274 |
| Retained earnings and contributed surplus | | **10,597,447** | | 10,509,083 |
| **TOTAL SHAREHOLDERS' EQUITY** | | **25,882,221** | | 25,804,357 |
| **TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY** | **$** | **78,601,135** | $ | 100,961,699 |

| **Financial Ratios** | **June 30**<br>**2009** | December 31<br>2008 |
|---|---|---|
| Working capital ratio | **1.47** | 1.32 |
| Days sales in receivables | **54.4** | 99.8 |
| Inventory turns | **2.3** | 2.7 |
| Days purchases in payables | **42.7** | 58.2 |

As at June 30, 2009, the Company had positive working capital of $21,163,434 compared to $21,333,200 at December 31, 2008. The Company's current ratio (defined as current assets divided by current liabilities) was 1.47 to 1 for the six months ended June 30, 2009 compared to 1.32 to 1 at December 31, 2008. The increase in the working capital ratio is the net result of increased inventory levels (due to the dramatic slowdown in the resource industry) and collection of receivables and prepaids whose cash inflow reduced trade payables and the bank operating line. As at June 30, 2009, the Company had $27,480,631 outstanding under its available credit facilities of $35,000,000, with a Canadian chartered bank, as compared to $37,666,571 at December 31, 2008. Subsequent to the second quarter end, the Company renewed and amended its credit facility, which resulted in an increase to the line of credit to $40,000,000 with an additional $5,000,000 from December 1, 2009 to April 30, 2010. The Company's total debt to tangible net worth covenant was adjusted to 2.75 to 1 on December 31, 2009 and 2.50 to 1 by June 30, 2010. The Company does not anticipate any breach of this amended covenant.

The decrease in days sales in receivables from December 2008 is due to collections of winter drilling sales and the Company factoring approximately $4.6 million of receivables to meet payment requirements for steel products. Due to the seasonal nature of the oil and gas industry in Western Canada, the Company collects many of its receivables during the spring and summer months and has significant receivable balances in the fall and winter when the drilling programs typically are at their busiest. This results in a significant timing difference in the calculation of the days sales in receivables. The decrease in days purchases in payables is due to fewer purchases during the spring as the result of higher inventory levels.

Accounts receivable decreased by $28,437,283 (65.9%) from fiscal 2009 Q1's balance of $43,175,808 to $14,738,525. The Company has receivables of $6,363,232 related to the steel products division. The Company collected many accounts from the winter drilling programs in the first quarter of 2009 while experiencing decreased sales in the second quarter of 2009 due to decreased drilling activity.

Inventory increased by $10,154,832 (25.4%) creating inventory turnover of 2.3 for the six months ended June 30, 2009 compared to 2.7 turns at the Company's year end. The increased inventory is due to two main reasons:

- The continued slowdown in oil and gas activity in the first quarter of 2009. The Company had made commitments to inventory for the fluids division on projected drilling activity levels, however drilling activity slowed down in fiscal 2009 Q1 much earlier than anticipated.
- The current economic climate caused the steel division to experience an unusual level of cancelled steel orders, for which inventory could not be returned to vendors. The cancelled orders resulted in additional inventory of approximately $4,000,000.

The Company's prepaid expenses and deposits have decreased by $3,680,814 as much of the steel products that required prepayment in the fourth quarter of 2008 was received as inventory during the first quarter and there have been minimal purchases during the second quarter. Due to the sharp decline in market demand for steel products and given current inventory levels, the Company is working with vendors to sell the excess inventory at competitive prices and is managing inventory cautiously until current levels are brought down to an amount that will service current market demands.

Payables and accruals were $13,500,307 compared to $24,653,886 at December 31, 2008, a decrease of $11,153,579 or 45.2%, which was a result of the Company using its collection of receivables to pay vendors for products purchased. In addition, the excess inventory has reduced vendor purchases.

The Company's liquidity will depend upon operating cash flows, existing working capital, the unused credit facility and the ability to access debt and equity markets. The Company currently has sufficient liquidity and capital resources to meet the long-term payment obligations of its outstanding loans. The Company continues to assess its requirements for capital on an on-going basis. Due to the financial market turmoil negatively impacting both credit and equity markets, the Company cannot ensure if additional working capital and growth capital will be readily available.

**Cash flow (used for) from operating activities**

Cash from operating activities increased by $346,879 to $6,050,520 for the three months ended June 30, 2009 compared to the same period in 2008 and increased by $8,587,916 to $11,075,044 for the six months ended June 30, 2009 compared to the six months ended June 30, 2008. The Company's increase in cash from operating activities relates to less cash paid for inventory as the Company had excess inventory levels due to the economic downturn. In addition that Company collected cash from accounts outstanding from the first quarter accounts receivable. With the forecasted decrease in drilling activity, we expect to reduce our inventory levels to more reasonable levels, however due to the lower sales in the second quarter we will experience reduced collection of receivables, thus our short term cash from operations may decrease. Certain products in inventory will be required to be replaced as they are products commonly sold, resulting in an outflow of cash. The Company intends to closely manage its inventory levels and spending in order to conserve its balance sheet strength and minimize any increase in debt levels.

**Cash flow from financing activities**

For the three months ended June 30, 2009, cash used in financing activities was $5,975,909 compared to $5,579,490 for the same period in 2008, while cash used in financing activities increased by $8,346,777 to $10,546,518 for the six months ended June 30, 2009 compared to 2008. The cash used in financing activities was mainly due to repayments on the operating line of credit from the collection of receivables. Due to the seasonal nature of the WCSB, the Company collected a significant portion of its receivables during the second quarter, which it used to repay the operating line. With the downturn in drilling activity in 2009, the Company will not require as much inventory, therefore decreasing the amount of cash required to pay vendors. A sudden increase in the market demand for fluid and steel products can have an adverse effect on the Company's bank indebtedness as additional cash will be required to pay for product. In addition, the Company commenced repayment of the $3,000,000 subordinated debt facility in February 2009. The repayments have been funded through the collection of receivables and the current operating credit facility. The Company also paid interest on one of the promissory notes. The $1,000,000 promissory note due in May 2009 has been postponed until the market returns to more favorable conditions. In addition, $1,000,000 plus interest is due in October 2009 on promissory notes as part of the acquisitions made by the Company. These payments will be funded through the operating credit facility provided funds are available, otherwise they will be postponed until such time the Company has the available funds to pay the amounts due.

**Cash flow used for investing activities**

Cash used in investing activities amounted to $74,611 for the second quarter in 2009 compared to $124,151 for the same period last year and cash used in investing activities amounted to $528,526 an increase of $241,139 or 84% for the six months ended June 30, 2009 compared to 2008. Cash used during the first half of the year related to the purchase of a blender, a liquid invert mixer, a loader for steel products and numerous computer equipment and furniture and fixtures. The Company is not expecting any major capital expenditures for the remainder of the year.

**Commitments**

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

| | |
|---|---|
| 2010 | $ 1,257,140 |
| 2011 | 1,054,002 |
| 2012 | 974,261 |
| 2013 | 927,023 |
| 2014 | 926,880 |
| | $ 5,139,306 |

## Goodwill

Goodwill represents the excess of the purchase price of an acquisition over the estimated 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. The Company believes that goodwill is not impaired at the end of quarter.

## Intangibles

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. Intangible assets with indefinite useful lives are reviewed for impairment annually. The Company has no intangible assets with indefinite 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 technology, technological expertise and proprietary blends | 3 years straight-line |
| Tradename | 5 years straight-line |
| Non-competition agreements | 3 to 5 years straight-line |

## Property and equipment

The Company's investment in property and equipment for the quarter was costs to complete the new fluids blender in Acheson as well as new computers and furniture. The capital expenditures were funded from the line of credit. Capital expenditures typically are comprised of betterments and upgrades to existing assets. The Company ensures equipment is efficient and profitable or the equipment is replaced when the cost of maintenance and operating the equipment is not feasible. Future capital expenditures of approximately $100,000 are being proposed to make improvements on the yard and warehouse in Estevan. The Company plans to fund these capital expenditures from the credit line available.

**Off-balance sheet arrangements**

The Company did not enter into any off-balance sheet arrangements during the current or comparable reporting period.

**Transactions with related parties**

During the three and six months ended June 30, 2009, the Company incurred selling, general and administration expenses in the normal course of operations with Western America Capital Group, an affiliated company which a certain director controls, as follows:

a) Management advisory services of $30,000 and $60,000, respectively (June 30, 2008 – $30,000 and $60,000).

b) Accounting, administrative and corporate expenses of $11,645 and $20,795, respectively (June 30, 2008 – $16,052 and $31,052).

c) The Company paid total director fees of $4,500 (June 30, 2008 - $4,000) to Eric Sauze and Albert Sharp. Subsequent to the second quarter end, the Company paid director fees of $27,750 to the above named directors, as well as Don Caron (also a director).

The Company expensed interest of $33,000 and $66,000, respectively (June 30, 2008 - $45,774 and $93,774) on promissory notes payable issued in 2006 which are held by two of the Company's directors and significant shareholders. In addition, the Company expensed $44,877 and $89,261, respectively (June 30, 2008 – nil) 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.

## OUTLOOK

Although many capital projects have been delayed or cancelled as a result of the global economic downturn, which in turn has impacted the demand for fluid and steel products, Bri-Chem remains focused on maintaining strong customer relationships, managing inventory levels and controlling costs. Over the medium to longer term, the Company is confident that given its solid customer relationships and diverse geographic product offering, it will see future growth in revenue and profitability when the economy returns to more normal activity levels.

Bri-Chem continued to have increased sales growth for the six months ended June 30, 2009 of 23.1%, despite operating cautiously due to the current economic instability that exists. With volatile commodity prices and the weakened demand for products, the Company has put significant emphasis on controlling costs through this decline. This volatility combined with the continued uncertainty and reduced access to the debt and equity markets, increases the importance of maintaining strong financial flexibility.

Oil and gas well completions and rig utilizations have continued to decline since 2008 and although we are anticipating drilling activity to increase in second half of 2009, we foresee fluid sales for the remainder of the year being lower than the same period in 2008. The Petroleum Services Association of Canada (PSAC) has forecasted a total of 9,500 wells to be drilled in Canada for 2009, a decrease of 41%

over the prior year. With the Company's strategically located warehouses and strong competitive position, we are optimistic that the demand for our drilling fluids will decline less than the overall decrease in industry activity.

Bri-Chem's industrial fluids division is exploring new geographic opportunities both domestically and abroad that will contribute to the growth in this division. We will continue to concentrate on technologically advanced fluids with the emphasis on infrastructure from government agencies, the industrial fluids markets will benefit from the increased demand for fluids in certain industrial, and construction applications. Sales are expected to increase in the third and fourth quarters of 2009 compared to the first half of the year, but are anticipated to be behind those in 2008.

During the economic crisis, steel commodity prices have become volatile. Lower steel demand has caused excess inventories in the market and continued competitive selling prices, which has led to reduced margins in the short term. With the recent addition of two new stock points in Houston, Texas and Chicago, Illinois, the steel division has increased its presence in the marketplace and has positioned itself to take advantage when market inventories are depleted to more normal levels. In the third quarter of 2009, steel manufactures have commenced increases in steel prices, which should improve gross margins; however the overall demand levels need to increase for revenues and profits to increase for this segment.

Management and the Board are constantly evaluating additional acquisition opportunities and will continue to seek and identify targets that fit the corporate requirements as accretive and geographically favorable.

## RISKS AND UNCERTAINTIES

*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 credit risk and current weak economic conditions have made, and will likely continue to make it difficult to obtain cost effective funding. 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 funding will be available when needed and to the extent required, on acceptable terms. If funding 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.

*Leverage and restrictive covenants*

The Company has credit facilities which contain a number of financial covenants that require the Company to meet certain financial ratios and financial condition tests. Failure to comply with the obligations in the credit facilities could result in a default which, if not cured or waived, would permit acceleration of the relevant indebtedness. The Company was in compliance with all of its bank covenants at June 30, 2009.

*Competition and industry conditions*

There is a strong correlation between drilling activity and demand for the Company's product. Industry demand for the Company's drilling products is further determined by activity levels that are focused on deep well drilling and applications common to the foothills region and northern Alberta and British Columbia, areas known for deeper drilling. Oil and gas activity in these geographic regions is normally strong during winter months or other times when climatic conditions are favorable.

The capital expenditure programs of oil and gas companies largely affect the products provided by the Company. The magnitude of capital expenditures determines the demand for the Company's drilling fluids and steel products to the oil and gas industry. The primary catalysts to high expenditures and activity levels in the energy industry are oil and gas prices which, in turn, are influenced strongly by supply and demand expectations. The ability to forecast the price of crude oil or natural gas is extremely difficult as many global factors affecting commodity prices are beyond the control of the Company.

The Company has product returns and cancellations from time to time based on the demand for fluid and steel products and activity levels. These sales returns could have a material impact on the Company's financial results. The Company does record a provision for sales returns based on historical information and current market conditions.

*Alberta Royalty Framework*

The Government of Alberta receives royalties on production of natural resources from lands in which it owns the mineral rights. On October 25, 2007, the Government of Alberta unveiled a New Royalty Framework ("NRF") that introduced new royalties for conventional oil, natural gas and oil sands that are linked to price and production levels. The NRF was implemented effective January 1, 2009. The NRF established new commodity price and volume sensitive rates for the calculation and collection of royalties. These rates may have an impact on capital expenditures related to drilling exploration. The changes to the royalty regime may affect the exploration for, and the development of, oil and natural gas by entities operating in the Province of Alberta, which effects could negatively impact the business and cash flow of the Company.

*Supply-Side Risks*

The Company distributes industrial products manufactured or supplied by a number of major suppliers. The Company does not have long-term contracts with any of its major suppliers. Although the Company believes that it has access to similar products from competing suppliers, any disruption in the Company's sources of supply, particularly of the most commonly sold items or any material fluctuation in the quality, quantity or cost of such supply, could have a material adverse effect upon the Company's results of operations and financial condition. Also, supply shortages occur at times as a result of unanticipated demand, production difficulties or delivery delays. In such cases, suppliers often allocate products among distributors. Future supply shortages may occur from time to time and may have a short-term material adverse effect on the Company's results of operations and financial condition.

*Oil and Natural Gas Prices*

The revenue, cash flow and earnings of the Company are substantially dependent upon and affected by the level of activity associated with oil and natural gas exploration. Both short-term and long-term trends in oil and natural gas prices affect the level of such activity. Worldwide military, political and economic events, including initiatives by the Organization of Petroleum Exporting Countries, may affect both the demand for and the supply of oil and natural gas. Weather conditions, governmental regulation, levels of consumer demand, the availability of pipeline capacity and other factors beyond the Company's control may also affect the supply of and demand for oil and natural gas leading to future price volatility. The drilling industry is cyclical and the fluctuations in the level of oil and natural gas exploration and development activity have a direct impact on the Company's business. Any significant reduction in industry forecasted levels of drilling activity in the WCSB and the United States may severely reduce activity levels for the Company and the resulting cash flows. Future changes in oil and natural gas prices could result in substantial increases or decreases in total revenues of the Company. Prolonged financial instability could result in oil and natural gas projects being deferred or cancelled thereby limiting new revenue streams to the Company.

*Seasonal Weather*

In Canada, the level of activity in the oil and natural gas industry is influenced by seasonal weather patterns. Spring break-up during the second quarter of each year leaves many secondary roads temporarily incapable of supporting the weight of heavy equipment, which results in severe restrictions in the level of energy services. The timing and duration of spring break-up is dependent on weather patterns and the duration of this period will have an impact on the level of business of the Company.

*Credit Risk*

The Company's revenues are predominantly from products sold to oil and gas fluid engineering companies and steel pipe distributors which may result in significant exposure to one customer or on a combined basis to several individual customers. Concentration of credit risk on the Company's trade accounts receivable exists in the oil and gas industry. The Company's management regularly reviews outstanding accounts receivable and follows up with customers when settlement has not occurred on a timely basis. During times of weak economic conditions, the risk of increased payment delays and failure to pay increases due to a reduction in customer's cash flow. Failure to collect accounts receivable from customers could have a material adverse effect on the Company's business, financial condition, results of operations and cash flows. The Company generally grants unsecured credit to its customers; however, it evaluates all new customers as appropriate and analyzes and reviews the financial health of its current customers on an ongoing basis.

## CRITICAL ACCOUNTING ESTIMATES

In preparing the interim consolidated financial statements, in conformity with Canadian generally accepted accounting principles, management is required 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. The most significant estimates included in the consolidated financial statements are the valuations of accounts receivable, the sales return provision, inventory obsolescence, future income tax assets, carrying value of goodwill, intangibles, accrued liabilities and future income tax liabilities. Management feels actual results will not be materially different from these estimates.

## CHANGE IN ACCOUNTING POLICY AND NEW ACCOUNTING POLICY

*Goodwill and Intangible Assets*

Effective January 1, 2009, the Company adopted the new handbook Section 3064 – "Goodwill and Intangible Assets" that supersedes Section 3062 – "Goodwill and Other Intangible Assets" and 3450 – "Research and Development Costs". This section provides additional guidance on when expenditures qualify for recognition as intangible assets and requires that costs can be deferred only when relating to an item meeting the definition of an asset. The new accounting standard is effective for interim or annual financial statements relating to fiscal years beginning on or after October 1, 2008. The adoption of this standard did not have a material impact on its consolidated interim financial statements.

*International financial reporting standards*

During 2008, the Canadian Accounting Standards Board (AcSB) confirmed that publicly accountable enterprises will be required to adopt International Financial Reporting Standards (IFRS) in place of Canadian GAAP for interim and annual reporting purposes. The required transition date is for fiscal years beginning on or after January 1, 2011.

We commenced our IFRS conversion project during 2008 and established a formal project governance structure, including an IFRS Steering Committee, to monitor the progress and critical decisions in the transition to IFRS. This committee is comprised of members of finance management and is responsible for final approval of project recommendations and deliverables to the Audit Committee and the Board of Directors.

The project consists of three phases:

- **Preliminary planning and scoping** – This phase includes the establishment of a dedicated team to work on the IFRS transition, the development of a detailed work plan for the implementation and completion of a high level diagnostic. The high level diagnostic involved a review of the major differences between Canadian GAAP and IFRS and prioritized the IFRS requirements based on their financial reporting impact, business impact and complexity.

- **Detailed assessment and design** - This phase focuses on determining the specific impacts to the Company based on the application of IFRS requirements. This includes the design and development of detailed solutions and work plans by each key area to address implementation requirements. In addition, impact analysis will be performed on all areas of the business, including tax and information technology systems. Accounting policies will be finalized, first-time adoption exemptions will be considered, and a detailed implementation plan and timeline will be developed. This phase also includes the development of a training program.

- **Implementation** – This phase includes implementing the required changes necessary for IFRS compliance. The focus of this phase is the finalization of IFRS conversion impacts, approval and implementation of accounting and tax policies, implementation and testing of new processes, systems and controls, execution of customized training programs and preparation of opening IFRS balances.

During the first quarter of 2009, the Company completed the first phase of the IFRS implementation. The Company has developed an IFRS committee consisting of the Chair of the Audit Committee, Chief

Financial Officer and the Corporate Controller. The Company has also started the detailed assessment of key accounting policy differences between Canadian GAAP and IFRS, as well as determining policy choices and elections allowed under IFRS. The significant areas that may impact the Company include impairment of assets, property, plant and equipment, income taxes, contingencies, stock-based compensation, foreign exchange translation and initial first time adoption of IFRS. During the remainder of 2009, the Company expects to finalize accounting policy choices and evaluate information system requirements. At this stage of the project, it is not possible to quantify the financial reporting differences between Canadian GAAP and IFRS.

*Business combinations*

In January 2009, the CICA issued Handbook Section 1582, "Business Combinations" which will replace section 1581 of the same name and will be applicable to the Company beginning on or after January 1, 2011. This section requires assets and liabilities acquired in a business combination, contingent consideration and certain acquired contingencies to be measured at their fair values as of the date of acquisition. In addition, acquisition related and restructuring costs are to be recognized separately from the business combination and included in the statement of earnings. The adoption of this standard will impact the accounting treatment of future business combinations.

*Consolidated financial statements*

In January 2009, the CICA issued Handbook Section 1601, "Consolidated Financial Statements" which will replace section 1600 of the same name and will be applicable to the Company beginning on January 1, 2011. This section establishes the requirements for the preparation of consolidated financial statements, in particular the standard requires uniform accounting policies to be consistent throughout all consolidated entities and the difference between reporting dates of a parent and a subsidiary to be no longer than three months. The Company does not expect an impact on the financial statements as a result of the implementation of this section.

## FINANCIAL INSTRUMENTS AND OTHER INSTRUMENTS

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

The carrying value of the financial instruments of the Company approximates their fair values. The estimated fair value 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 cash and cash equivalents, accounts receivable, and accounts payable and accrued liabilities approximate their fair value because of the near term to maturity of these instruments. The fair value of promissory notes payable approximates the carrying value as the interest rate is similar to current market rate for similar debt, while the fair value of long term debt reflects the incremental cost of borrowing given current market interest rates.

*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 21%, 15% and 9% respectively of revenue for the three month period ended June 30, 2009 (18%, 12% and 6% for the twelve months ended December 31, 2008) and 11%, 15% and 7% respectively (December 31, 2008 – 19%, 9%, 8%) of total accounts receivable.

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. The Company establishes a provision for bad debts based on specific customers' credit risk, historical trends, and other economic information. For the three months ended June 30, 2009, the Company has recorded an allowance for doubtful accounts of $20,000 (December 31, 2008 - $3,435). The allowance is an estimate of the June 30, 2009 trade receivable balances that are considered uncollectible. Changes to the allowance during the three months ended June 30, 2009 consisted of bad debt expense of $20,000 and a recovery of $648.

Concentrations of credit risk on trade accounts receivable are with customers in the oil and gas industry. A significant decline in economic conditions within the industry would increase the risk that customers will experience financial difficulty and be unable to fulfill their obligations. The Company's exposure to credit risk arising from granting sales is limited to the carrying value of accounts receivable. The Company's revenues are normally invoiced with payment terms of 30 days. Despite the established payment terms, customers in the oil and gas industry, typically pay amounts within 105 days of invoice date.

The aging of accounts receivable was as follows:

| June 30, 2009 | Gross accounts receivable | Allowance for doubtful accounts | Net accounts receivable |
|---|---|---|---|
| Current | $ 6,601,342 | $ - | $ 6,601,342 |
| 31 to 60 days | 2,802,471 | - | 2,802,471 |
| 61 to 90 days | 2,004,987 | - | 2,004,987 |
| 91 to 120 days | 1,249,888 | - | 1,249,888 |
| Over 120 days | 2,131,837 | 52,000 | 2,079,837 |
| Total | $ 14,790,525 | $ 52,000 | $ 14,738,525 |

*Interest rate risk*

Demand loans, obligations under capital lease 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.

The effective interest rate on the bank indebtedness balance at June 30, 2009 was Canadian bank prime interest rate plus 100 basis points (3.25%). The long term debt bears interest at bank prime plus a fixed increment. As at June 30, 2009, with 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 $52,265 (June 30, 2008 - $27,072).

*Currency risk*

The Company is subject to foreign currency risk due to its cash, accounts receivable and accounts payable and accrued liabilities denominated in foreign currencies. Therefore, there is 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 continues to expand its steel operations outside Canada, which increases its exposure to foreign currency risk. Accounts receivable in foreign currency was $3,615,024 as at June 30, 2009 (December 31, 2008 - $10,027,922) and accounts payable in foreign currency outstanding as at June 30, 2009 is $7,809,035 (December 31, 2008 - $12,974,583). The Company does not currently use derivative instruments to reduce its foreign currency risk. For the three months ended June 30, 2009, the Company realized a foreign exchange gain of $301,145 (June 30, 2008 gain of $85,361). Based on the monetary assets and liabilities held in the United States ("US") at June 30, 2009, a five percent increase or decrease in exchange rates would impact the Company's net earnings by approximately $166,081 (June 30, 2008 - $12,577).

*Commodity risk*

Commodity risk arises from the effect that fluctuations of future commodity prices of steel and certain chemicals and may have on the fair value or future cash flows of financial assets and liabilities. The Company does not use derivatives to reduce its commodity risk.

## SHARE DATA

As at August 26, 2009, the Company had 14,504,186 common shares issued and outstanding. The board of directors may grant options to purchase up to 1,400,000 common shares. As of June 30, 2009, options to purchase 1,272,000 common shares were outstanding at an average price of $2.00 per common share. Warrants totaling 350,000 with an average exercise price of $2.03 may be exercised into common shares prior to July 17, 2010.

On December 9, 2008, the Corporation obtained approval from the TSX Venture Exchange to purchase up to 815,000 of the Corporation's common shares by way of a normal course issuer bid ("NCIB"). The NCIB commenced on December 10, 2008 and will terminate on December 9, 2009 or earlier if the number of shares sought in the NCIB has been obtained. The Corporation will purchase the shares in accordance with TSX Venture Exchange requirements with the Corporation paying the market price for the common shares at the time of acquisition. All purchased common shares will be cancelled. The Corporation has purchased a total of 10,000 common shares under the NCIB up to August 26, 2009.

## MEASURES NOT IN ACCORDANCE WITH GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

The following measures included in this report do not have a standardized meaning under Canadian generally accepted accounting principles and, therefore, are unlikely to be comparable to similar measures presented by other companies:

EBITDA (Earnings before interest, taxes, depreciation and amortization) is not a concept recognized by generally accepted accounting principles, however is recognized in industry as an indirect measure for operating cash flow, a significant indicator of the success of any business. Management believes that EBITDA is useful measure of earnings, in addition to net earnings as it provides an indication of the financial results and earnings generated by the Company's primary business activities prior to financing, tax considerations and before non-cash amortization expense.  The following is a reconciliation of EBITDA to net earnings for each of the periods presented in this MD&A:

| **EBITDA** | **(Unaudited) For the three months ended June 30 2009** | 2008 |
|---|---|---|
| Net (loss) earnings | **$ (847,643)** | $ 103,706 |
| Add: | | |
| Interest | **489,750** | 375,113 |
| Depreciation and amortization | **402,378** | 190,446 |
| Income taxes | **(340,868)** | 33,197 |
| EBITDA | **$ (296,383)** | $ 702,462 |

| **EBITDA** | **(Unaudited) For the six months ended June 30 2009** | 2008 |
|---|---|---|
| Net earnings | **$ 12,340** | $ 1,368,481 |
| Add: | | |
| Interest | **1,171,651** | 851,009 |
| Depreciation and amortization | **921,247** | 405,463 |
| Income taxes | **4,918** | 653,624 |
| EBITDA | **$ 2,110,156** | $ 3,278,577 |

Operating expenses is not a concept recognized by generally accepted accounting principles as it does not include interest and amortization expense related to operations. The following is a reconciliation of operating expenses as presented in this MD&A to total expenses as presented in the June 30, 2009 consolidated financial statements:

| **Operating expenses** | | **(Unaudited) For the three months ended June 30** | | |
|---|---|---|---|---|
| | | **2009** | | 2008 |
| Operating expenses | **$** | **2,165,770** | $ | 1,266,592 |
| Add: | | | | |
| Interest | | **489,750** | | 375,113 |
| Depreciation and amortization | | **402,378** | | 190,446 |
| Total expenses | **$** | **3,057,898** | $ | 1,832,151 |

| | | **(Unaudited) For the six months ended June 30** | | |
|---|---|---|---|---|
| | | **2009** | | 2008 |
| Operating expenses | **$** | **4,576,148** | $ | 3,028,111 |
| Add: | | | | |
| Interest | | **1,171,651** | | 851,009 |
| Depreciation and amortization | | **921,247** | | 405,463 |
| Total expenses | **$** | **6,669,046** | $ | 4,284,583 |

# Corporate Information

***Officers and Directors***

Don Caron
Chairman, CEO and Director
Edmonton, Alberta

Alan Campbell
Director
Edmonton, Alberta

Brian Campbell
Director
President, Bri-Chem Supply Ltd.
President, Sodium Solutions Inc.
Edmonton, Alberta

Albert Sharp
Director
Spruce Grove, Alberta

Eric Sauze, CA
Director
Edmonton, Alberta

Jason Theiss, CA
CFO
Edmonton, Alberta

Neil Rasmussen
President, Bri-Chem Steel Corporation
Edmonton Alberta

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Trading Symbol – BRY

***Bankers***

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***Transfer Agent***

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