# FORACO INTERNATIONAL S.A.

## MANAGEMENT'S DISCUSSION & ANALYSIS

## Three-month period ended March 31, 2012

# FORACO INTERNATIONAL S.A.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

The following Management's Discussion and Analysis ("MD&A") relates the results of operations, liquidity and capital resources of Foraco International S.A. ("Foraco" or the "Company"). This report has been prepared by Management and should be read in conjunction with the Company's quarterly unaudited consolidated interim financial statements for the three-month period ended March 31, 2012, including the notes thereto. These quarterly unaudited interim financial statements were prepared in accordance with International Financial Reporting Standards ("IFRS"). Following the decision taken by the Accounting Standards Board, IFRS became the accounting standards for all issuers in Canada on January 1, 2011. The Company adopted IFRS and made an explicit and unreserved statement that its consolidated financial statements comply with IFRS in 2004.

Except as otherwise stated in Note 2 to the unaudited consolidated interim financial statements, these quarterly unaudited consolidated interim financial statements were prepared using accounting policies and methods consistent with those used in the preparation of the Company's audited consolidated financial statements for the year ended December 31, 2011. Except when otherwise stated, all amounts presented in this MD&A are denominated in US Dollars ("US$"). The discussion and analysis within this MD&A are as of May 7, 2012.

### Caution concerning forward-looking statements

This document may contain "forward-looking statements" and "forward-looking information" within the meaning of applicable securities laws. These statements and information include estimates, forecasts, information and statements as to Management's expectations with respect to, among other things, the future financial or operating performance of the Company and capital and operating expenditures. Often, but not always, forward-looking statements and information can be identified by the use of words such as "may", "will", "should", "plans", "expects", "intends", "anticipates", "believes", "budget", and "scheduled" or the negative thereof or variations thereon or similar terminology. Forward-looking statements and information are necessarily based upon a number of estimates and assumptions that, while considered reasonable by management, are inherently subject to significant business, economic and competitive uncertainties and contingencies. Readers are cautioned that any such forward-looking statements and information are not guarantees and there can be no assurance that such statements and information will prove to be accurate and actual results and future events could differ materially from those anticipated in such statements. Important factors that could cause actual results to differ materially from the Company's expectations are disclosed under the heading "Risk Factors" in the Company's Annual Information Form dated March 9, 2012, which is filed with Canadian regulators on SEDAR (www.sedar.com). The Company expressly disclaims any intention or obligation to update or revise any forward-looking statements and information whether as a result of new information, future events or otherwise. All written and oral forward-looking statements and information attributable to Foraco or persons acting on our behalf are expressly qualified in their entirety by the foregoing cautionary statements.

## This MD&A is presented in the following sections:

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## Business Overview

Headquartered in Marseille, France, Foraco is a worldwide drilling service provider currently operating in 18 countries and five continents. On March 31, 2012, the Company had 2,989 employees and operated 194 drill rigs worldwide, providing a diverse range of drilling services to its customer base. The Company has developed and acquired significant expertise in destructive and non-destructive drilling, as well as proprietary drill rig design capabilities. These capabilities allow Foraco to tailor solutions to meet the specific conditions and drilling requirements of certain customers, such as mining companies, governmental organizations and international development funds. Through its global operations the Company services a range of industries focusing on mining and water.

Foraco specializes in drilling in harsh environments and isolated locations including arctic, desert and mountainous regions, generally under conditions where operations are challenged by logistical matters and geographic barriers. The Company's engineers and technicians have developed special drilling methods which respond to the requirements of certain areas in which geology prevents the use of standard techniques and equipment. The Company has specialized equipment for, among other uses, helicopter-based drilling campaigns, combination rigs able to perform multi-drilling technique contracts, desert-suited rigs and large diameter core sampling systems.

## Interim Consolidated Financial Highlights

*Financial highlights*

| | Q1 2012 | Q1 2011 |
|---|---|---|
| **Revenue** | **88,163** | **65,333** |
| **Gross profit (1)** | **20,383** | **14,521** |
| *As a percentage of sales* | *23.1%* | *22.2%* |
| **EBITDA** | **21,337** | **15,456** |
| *As a percentage of sales* | *24.2%* | *23.7%* |
| **Operating profit** | **12,842** | **8,605** |
| *As a percentage of sales* | *14.6%* | *13.2%* |
| **Profit for the period** | **9,102** | **5,944** |
| **EPS (in US cents)** | | |
| Basic | 11.97 | 7.75 |
| Diluted | 11.83 | 7.65 |

**(1) includes amortization and depreciation expenses related to operations**

In the first half of 2010, the Company completed two significant acquisitions, a company in Chile providing services to major and junior mining companies in South America, and a company in Russia operating in far-east Russia and eastern Siberia. Q1 2011 and Q1 2012 are therefore reported under the same perimeter and are comparable.

*Acquisitions of businesses*

On April 20, 2012, the Company completed the acquisition of a 51% shareholding in WFS Sondagem S.A. ("Servitec"), a Brazilian drilling service provider, for an amount of US$ 44.4 million through a combination of US$ 20.1 million cash and 4,816,509 Foraco shares at US$ 5.05 representing US$ 24.3 million. As part of this agreement, the Company has an option to acquire, and the current shareholders of Servitec have an option to sell, the remaining 49% after three years. The corresponding purchase consideration will depend upon a formula based on the average 2012, 2013 and 2014 EBITDA of Servitec and on the net cash as at December 31, 2014. The maximum amount payable for this tranche is capped at US$ 75 million.

This acquisition did not impact Q1 2012 results except for transaction costs incurred during the period as disclosed hereafter.

First Quarter ended March 31, 2012 – Q1 2012

*Increased Revenue*

- Q1 2012 revenue amounted to US$88.2 million compared to US$ 65.3 million in Q1 2011, an increase of 35% or US$ 22.8 million in organic growth.

*Increased Profitability*

- Q1 2012 gross profit including depreciation within cost of sales increased to US$ 20.4 million (23.1% of revenue) compared to US$14.5 million (22.2% of revenue) in Q1 2011, an increase of 40% or US$ 5.9 million.

- Q1 2012 EBITDA amounted to US$ 21.3 million (24.2% of revenue) compared to US$ 15.5 million in Q1 2011 (23.7% of revenue).

- Q1 2012 net profit after tax amounted to US$ 9.1 million (10.3% of revenue), an increase of 53% or US$ 3.2 million compared to Q1 2011 which amounted to US$5.9 million (9.1% of revenue).

- Q1 2012 earnings per share amounted to 11.97 US cents (basic) and 11.83 US cents (diluted), compared to 7.75 US cents (basic) and 7.65 US cents (diluted) in Q1 2011.

## Results of Operations

***Comparison of the three-month periods ended March 31, 2012 and March 31, 2011***

*Revenue*

The following table provides a breakdown of the Company's revenue for Q1 2012 and Q1 2011 by reporting segment and geographic region:

| (In thousands of US$) *(unaudited)* | Q1 2012 | % change | Q1 2011 |
|---|---|---|---|
| **Revenue** | | | |
| *Reporting segment* | | | |
| Mining | 83,028 | 39% | 59,745 |
| Water | 5,135 | -8% | 5,588 |
| ***Total revenue*** | ***88,163*** | ***35%*** | ***65,333*** |
| *Geographic region* | | | |
| South America | 37,297 | 45% | 25,715 |
| Africa | 23,444 | 38% | 16,935 |
| North America | 16,449 | 13% | 14,623 |
| Asia Pacific | 9,080 | 49% | 6,111 |
| Europe | 1,891 | -3% | 1,950 |
| ***Total revenue*** | ***88,163*** | ***35%*** | ***65,333*** |

Q1 2012 revenue amounted to US$ 88.2 million, an increase of 35% or US$ 22.8 million compared to Q1 2011.

The Mining segment, up US$ 23.2 million, is driven by the contribution of all geographic areas benefiting from a strong worldwide demand. In Europe (Russia), the variation is not significant as the activity only resumed in March after the winter break.

The Water segment slightly decreased to US$ 5.1 million in Q1 2012 compared to US$ 5.6 million in Q1 2011. Activities in this segment are principally carried out in Africa. Offsetting the decline in traditional water drilling services has been the significant growth in mining related water. Water for mining now represents 73% of this segment compared to 7% for the same period a year ago.

Revenue in South America amounted to US$ 37.3 million in Q1 2012 (US$ 25.7 million in Q1 2011) an increase of 45%. This was mainly generated by new long-term contracts with major companies in Chile linked to continued strong demand.

In Africa, the Q1 2012 revenue increased by 38% or US$ 6.5 million compared to Q1 2011. This is mainly due to the expansion of mining operations in West Africa.

Revenue in North America increased by 13%, from US$ 14.6 million in Q1 2011 to US$ 16.4 million in Q1 2012. This increase is realized through long term contracts with major companies.

In Asia-Pacific, Q1 2012 revenue amounted to US$ 9.1 million, an increase of 49% or US$ 3.0 million compared to Q1 2011. In Australia, 2 new Reverse Circulation rigs started operating in Q3 2011 and 2 additional rigs are expected in Q2 2012 to meet the increase demand from major companies.

Revenue in Europe was stable at US$ 1.9 million as the seasonal activity in Russia resumed in March.

*Gross Profit*

The following table provides a breakdown of the Company's gross profit by reporting segment for Q1 2012 and Q1 2011:

| (In thousands of US$) *(unaudited)* | Q1 2012 | % change | Q1 2011 |
|---|---|---|---|
| **Gross profit** | | | |
| *Reporting segment* | | | |
| Mining | 18,808 | *44%* | 13,035 |
| Water | 1,575 | 6% | 1,486 |
| ***Total gross profit*** | ***20,383*** | ***40%*** | ***14,521*** |

Overall, Q1 2012 gross profit amounted to US$ 20.4 million (or 23% of revenue), an increase of US$ 5.9 million or 40% compared to Q1 2011 (US$ 14.5 million or 22% of revenue).

The mining segment gross profit as a percentage of revenue improved to 23% in Q1 2012 from 22% in Q1 2011, and the water segment gross profit margins increased to 31% in Q1 2012 from 27% in Q1 2011.

Focus on risk management when entering new contracts, optimization of production equipment through long-term contracts, and proper execution of contracts are key contributors to margin growth.

*Selling, General and Administrative Expenses*

The following table provides an analysis of the selling, general and administrative expenses (SG&A), which represent the vast majority of operating expenses other than cost of sales, for Q1 2012 and Q1 2011:

| (In thousands of US$) *(unaudited)* | Q1 2012 | % change | Q1 2011 |
|---|---|---|---|
| Selling, general and administrative expenses | 7,541 | 27% | 5,916 |
| *As a percentage of revenue* | *8.6%* | | *9.1%* |

During the quarter, SG&A expenses were impacted by transaction costs related to the acquisition of Servitec amounting to US$ 0.3 million and costs associated with the reinforcement of the corporate structure. SG&A decreased to 8.6% of revenue in Q1 2012 as compared to 9.1% in Q1 2011, as a result of the growth strategy implemented by the Company.

*Operating Profit*

The following table provides a breakdown of the Company's operating profit for Q1 2012 and Q1 2011 by reporting segment:

| (In thousands of US$) *(unaudited)* | Q1 2012 | % change | Q1 2011 |
|---|---|---|---|
| **Operating profit** | | | |
| *Reporting segment* | | | |
| Mining | 11,710 | *54%* | 7,625 |
| Water | 1,132 | *16%* | 980 |
| ***Total operating profit*** | ***12,842*** | ***49%*** | ***8,605*** |

Operating profit increased to US$ 12.8 million (or 14.6% of revenue) in Q1 2012 compared to US$ 8.6 million (or 13.2% of revenue) in Q1 2011. This increase of US$ 4.2 million is primarily due to the growth in revenue, the increasing level of gross margin and the reduction of SG&A as a percentage of revenue.

*Finance Costs*

Net financial expenses amounted to US$ 0.6 million in Q1 2012, compared to US$ 0.6 million for the corresponding 2011 period.

*Income Tax*

In the first quarter of 2012, the effective corporate income tax rate was estimated at 26%, compared to 25% in the same period last year. The income tax expense is recognized based on Management's best estimate of the average annual income tax rate expected for the full financial year on a tax jurisdiction by tax jurisdiction basis.

**Seasonality**

The continuing geographical expansion of the Company progressively reduces its overall exposure to seasonality and its influence on business activity. In West Africa, most of the Company's operations are suspended between July and October due to the rainy season. In Canada, seasonal slow periods occur during the winter freeze and spring thaw or break-up periods. Depending on the latitude, this can occur anytime from October until late December (freezing) and from mid-April through to mid-June (break-up). Operations at mine sites continue throughout the year. Russia is also affected by the winter period during which operations are suspended. In Asia Pacific and in South America, where the Company operates exclusively in the Mining segment, a seasonal slowdown in activity occurs around year-end and in August when the winter season peaks.

**Effect of Exchange Rates**

The Company mitigates its exposure to foreign currency fluctuations by balancing its costs, revenues and financing in local currencies, resulting in a natural hedge.

The exchange rates for the periods under review are as follows against the US$:

| | Closing Q1 2012 | Average Q1 2012 | Closing Q1 2011 | Average Q1 2011 |
|---|---|---|---|---|
| € | 0.75 | 0.76 | 0.71 | 0.73 |
| CAD$ | 1.00 | 1.00 | 0.97 | 0.99 |
| AUD$ | 0.97 | 0.95 | 0.97 | 0.99 |
| CLP | 487 | 479 | 479 | 487 |

## Liquidity and Capital Resources

The following table provides a summary of the Company's cash flows for Q1 2012 and Q1 2011:

| (In thousands of US$) | Q1 2012 | Q1 2011 |
|---|---|---|
| Cash generated from operations before working capital requirements | 21,315 | 15,651 |
| Working capital requirements, interest and tax | (23,433) | (12,178) |
| **Net cash flow from (used in) operating activities** | **(2,118)** | **3,473** |
| Purchase of equipment in cash | (8,629) | (6,411) |
| Consideration payable related to acquisitions | - | (3,800) |
| **Net cash used in investing activities** | **(8,629)** | **(10,211)** |
| Proceeds from short term credit facilities, net | 10,119 | 5,179 |
| Acquisition of treasury shares | (1,917) | (484) |
| Dividends paid | (2,125) | - |
| **Net cash from financing activities** | **6,077** | **4,695** |
| Exchange differences | 1,175 | 396 |
| **Variation in cash and cash equivalents** | **(3,495)** | **(1,647)** |

Working capital requirements are high in the first quarter as they are affected by the seasonality in South America, North America and Russia. In each case, activity picks up during the quarter, generating significant sales and therefore increasing working capital requirements.

For the first quarter, cash generated from operations before changes in operating assets and liabilities increased to US$ 21.3 million in Q1 2012 compared to US$ 15.7 million in Q1 2011.

During the quarter, the working capital requirements after interests and tax paid amounted to US$ 23.4 million compared to US$ 12.2 million for the same period last year as a result of the increased activity in Q1 2012 compared to the same quarter last year.

During the quarter, the Company acquired operating equipment through US$ 8.6 million in cash purchases. This compares to a total of US$ 6.4 million in cash purchases and US$ 4.8 million in finance leases during the same period in 2011. During Q1 2012, two new rigs and ancillary equipment were delivered with an additional 2 rigs delivered in April.

During the same period, the Company paid dividends to its minority shareholders in Russia amounting to US$ 2.1 million.

As of March 31, 2012, cash and cash equivalents totaled US$ 20.8 million compared to US$ 24.3 million as at December 31, 2011. Cash and cash equivalents are held at or invested within top tier financial institutions.

On March 31, 2012, financial debts and equivalents amounted to US$ 62.3 million (US$ 49.2 million as at December 31, 2011).

As at March 31, 2012, the maturity of the financial debt (borrowing and other financial debts) can be analyzed as follows (in thousands of US$):

| Maturity | Less than one year | Between one and five years | More than five years | Total |
|---|---|---|---|---|
| Bank overdraft | 19,350 | — | — | **19,350** |
| Assignment of trade receivables with recourse | 13,321 | — | — | **13,321** |
| Bank financing | 3,771 | 5,905 | — | **9,676** |
| Capital lease obligations | 9,673 | 10,247 | — | **19,920** |
| **Total financial debt** | **46,115** | **16,152** | | **62,267** |

Assignment of trade receivables with recourse, which is presented in the table above as "less than one year", is backed by trade receivables and can be renewed as necessary. The Company has used and unused short-term credit facilities of US$ 106.9 million available as at March 31, 2012 (US$ 82.6 million as at December 31, 2011), corresponding to bank overdrafts and assignment of trade receivables. US$ 32.7 million has been drawn down as at March 31, 2012.

As at March 31, 2012, the net debt amounted to US$ 41.4 million. The ratio of debt (net of cash) to shareholders' equity increased to 0.24 from 0.15 as at December 31, 2011 (0.24 as at March 31, 2011) as a result of the seasonal variation of working capital requirements.

Bank guarantees as at March 31, 2012, totaled US$ 14.9 million compared to US$ 19.2 million as at December 31, 2011.

*Cash Transfer Restrictions*

Foraco operates in a number of different countries where cash transfer restrictions may exist. The Company organizes its business so as to ensure that the majority of the payments are collected in countries where there are no such restrictions. No excess cash is held in countries where cash transfer restrictions exist.

**Related-Party Transactions**

For details on related-party transactions, please refer to Note 14 of the unaudited consolidated interim financial statements.

## Capital Stock

As at March 31, 2012, the capital stock of the Company amounted to US$ 1,468 thousand, divided into 74,678,750 common shares. Warrants issued as part the acquisition of Adviser are expected to be converted for no consideration into 4,756,539 common shares in May 2012. The total common shares and warrants of the Company are distributed as follows:

| | Number of shares | Warrants | Total | % |
|---|---|---|---|---|
| Common shares held directly or indirectly by principal shareholders | 37,596,497 | - | 37,596,497 | 47.33% |
| Common shares held directly or indirectly by individuals in their capacity as members of the Board of Directors * | 1,754,251 | 500,071 | 2,254,322 | 2.84% |
| Common shares held by the Company** | 1,719,498 | - | 1,719,498 | 2.16% |
| Common shares held by the public | 33,608,504 | 4,256,468 | 37,864,972 | 47.67% |
| **Total common shares and warrants issued and outstanding** | **74,678,750** | **4,756,539** | **79,435,289** | |
| Common shares held by the Company | (1,719,498) | - | (1,719,498) | |
| **Total common shares and warrants issued and outstanding excluding shares held by the Company** | **72,959,252** | **4,756,539** | **77,715,791** | |

**In the table above, the shares owned indirectly are presented for an amount corresponding to the pro rata of the ownership interest*

***1,719,498 common shares are held by the Company to meet the Company's obligations under the employee free share plan and for the purposes of potential acquisitions.*

## Critical Accounting Estimates

The unaudited consolidated interim financial statements have been prepared in accordance with IFRS. The Company's significant accounting policies are described in Note 2 to the annual and unaudited consolidated interim financial statements. As required by IAS 1, the depreciation of property, plant and equipment related to operations is included within cost of sales.

**Non-IFRS measures**

EBITDA represents Net income before interest expense, income taxes, depreciation, amortization and non-cash share based compensation expenses. EBITDA is a non-IFRS quantitative measure used to assist in the assessment of the Company's ability to generate cash from its operations. The Company believes that the presentation of EBITDA is useful to investors because it is frequently used by securities analysts, investors and other interested parties in the evaluation of companies in the drilling industry. EBITDA is not defined in IFRS and should not be considered to be an alternative to Profit for the period or Operating profit or any other financial metric required by such accounting principles.

The reconciliation of the EBITDA with the operating profit is as follows:

| (In thousands of US$) *(unaudited)* | Q1 2012 | Q1 2011 |
|---|---|---|
| Operating profit....................................................... | 12,842 | 8,605 |
| Depreciation expense ............................................. | 8,112 | 6,606 |
| Non-cash employee share-based compensation...... | 383 | 245 |
| ***EBITDA*** ................................................................. | ***21,337*** | ***15,456*** |

**Litigation**

There is no significant pending litigation.

**Subsequent Events**

On April 20, 2012, the Company completed the acquisition of a 51% shareholding in WFS Sondagem S.A. (“Servitec”), a Brazilian drilling service provider. The Company has an option to acquire and the current shareholders of Servitec have an option to sell to the Company the remaining 49% after a period of three years.

On April 16, 2012, at the Company’s Annual General Meeting, the shareholders approved a dividend payment of €0.053 or C$ 0.069 per common share and the issuance of 3,516,509 new shares reserved to the Shareholders of Servitec.

**Outlook**

The Company’s business strategy is to continue to grow through the development and optimization of the services it offers across geographical regions and industry segments, as well as through the expansion of its customer base. Foraco expects to continue to execute its strategy through a combination of organic growth and development and acquisitions of complementary businesses in the drilling services industry.

**Risk Factors**

For a comprehensive discussion of the important factors that could impact the Company’s operating results, please refer to the Company's Annual Information Form dated March 9, 2012, under the heading “Risk Factors”, which has been filed with Canadian regulators on SEDAR (www.sedar.com).