



2<sup>nd</sup> Quarter 2009



## 2009 SECOND QUARTER RESULTS

### CORPORATE HIGHLIGHTS

<i>(In thousands, except per share data, unaudited)</i>	Three months ended		Six months ended	
	June 30, 2009	June 30, 2008	June 30, 2009	June 30, 2008
Revenue	\$ 4,551	\$ 2,538	\$ 9,000	\$ 7,845
Margin	295	(178)	1,670	992
Margin %	6.5%	(7.0%)	18.6%	12.6%
EBITDA (Note 1)	(619)	(1,596)	(839)	(2,029)
Earnings (loss) before income taxes	(1,388)	(2,377)	(2,455)	(3,598)
Net earnings (loss)	(1,388)	(2,377)	(2,455)	(3,598)
Earnings (loss) per share – basic	(0.11)	(0.20)	(0.20)	(0.30)
Earnings (loss) per share – diluted	(0.11)	(0.20)	(0.20)	(0.30)

Note 1: Earnings Before Income Taxes, Depreciation and Amortization (“**EBITDA**”) is a non-GAAP measure calculated by adding back to income from continuing operations, the sum of interest (income)/expense, taxes and depreciation/amortization of property, plant and equipment. EBITDA does not have a standardized meaning prescribed by GAAP and is not necessarily comparable to similar measures prescribed by other companies. EBITDA is used by many analysts in the oil and gas industry as one of several important analytical tools. The following is the calculation of EBITDA for the periods presented above.

### EBITDA

<i>(In thousands, except per share data, unaudited)</i>	Three months ended		Six months ended	
	June 30, 2009	June 30, 2008	June 30, 2009	June 30, 2008
Net earnings (loss)	\$ (1,388)	\$ (2,377)	\$ (2,555)	\$ (3,458)
Add (deduct):				
Income taxes	-	-	-	-
Interest expense – net	189	176	441	360
Amortization	580	605	1,175	1,209
EBITDA	(619)	(1,596)	(839)	(2,029)

**MANAGEMENT DISCUSSION AND ANALYSIS OF OPERATING RESULTS AND FINANCIAL CONDITION OF GARNEAU INC.**

*The following discussion Management Discussion and Analysis (“MD&A”) is management’s assessment of Garneau Inc.’s (“Garneau” or the “Company” or the “Corporation”) financial condition and operating results for the period ending June 30, 2009 and should be read in conjunction with the Company’s unaudited financial statements and related notes for the period ending June 30, 2009 in addition to the Company’s audited financial statements and related notes, MD&A for the year ended December 31, 2008. Additional information on Garneau Inc. is available through the System for Electronic Document Analysis and Retrieval (“SEDAR”) at [www.sedar.com](http://www.sedar.com) and includes the Corporation’s Annual Information Form and other required securities filings.*

*This MD&A contains certain "forward looking statements". These statements relate to future events or future performance and reflect management of the Company's expectations and belief regarding Garneau's growth, results of operations, performance, business prospects, opportunities or industry performance and trends. These forward looking statements reflect management of the Company's current internal projections, expectations or beliefs and are based on information currently available to us. In some cases, forward looking statements can be identified by words such as "may", "will", "should", "believe", "expect", "plan", "anticipate", "could", "plan", "estimate", "project", "predict", "potential", "continue" or the negative of these words or other comparable terminology. A number of factors could cause actual events or results to differ materially from the results discussed in the forward looking statements. In evaluating these statements, readers should specifically consider various factors, including, but not limited to, the risks and uncertainties discussed under "Risk Factors" and elsewhere in this MD&A. Actual results may differ materially from any forward looking statement. Although management of the Company believes that the forward looking statements contained in this MD&A are based upon reasonable assumptions, investors cannot be assured that actual results will be consistent with these forward looking statements. These forward looking statements are made as of the date of this MD&A, and management of the Company does not assume any obligation to update or revise them to reflect new events or circumstances, except as required pursuant to applicable securities laws.*

*In particular, this document contains forward looking statements pertaining to the Company's future growth; compliance with financial covenants; status of credit facilities; changes in accounting policies; results of operations, performance and business prospects and opportunities.*

*Actual results could differ materially from those anticipated in these forward looking statements as a result of, among other things, competition for capital and skilled personnel; general economic conditions in Canada and the United States; the Company's ability to raise capital and short term and long term financing; incorrect assessments of the value of acquisitions; fluctuations in the market for oil and gas and related products and services; liabilities and risks, including environmental liabilities and risks; fluctuations in foreign exchange or interest rates and stock market volatility; political and economic conditions; failure of counter-parties to perform on contracts; regional competition; demand for the Company's services; the Company's ability to attract and retain customers and employees; amounts retained by the Company for capital expenditures; uncertainties in weather and temperature affecting the duration of the service periods and the activities that can be completed; fixed costs in relation to variable revenue streams; and any or all of the factors discussed under "Business Risks".*

*The forward-looking statements contained herein are based on certain key expectations and assumptions of the Company concerning ability to continue as a going concern, financial performance, business prospects, strategies, conditions in general economic and financial markets, regulatory developments, competition, exchange rates, applicable royalty rates, tax laws, the sufficiency of budgeted capital expenditures in carrying out planned activities, the availability and cost of labour and services and the ability to obtain financing on acceptable terms, which are subject to change based on commodity prices, market conditions and potential timing delays. Although management considers these assumptions to be reasonable based on information currently available to it, they may prove to be incorrect.*

**Management has included the above summary of assumptions and risks related to forward-looking information provided in this MD&A in order to provide shareholders with a more complete perspective on the Company's future operations and such information may not be appropriate for other purposes.**

## **FINANCIAL**

### **Second Quarter 2009 vs Second Quarter 2008**

Second quarter revenue for the three month period ended June 30, 2009, totaled \$4.6 million which was a \$2.0 million increase from the \$2.5 million recorded for the comparative quarter ended June 30, 2008. The increased revenue is a direct result of fabrication completing a coating plant project and the associated recognition of the deferred revenue recorded at December 31, 2008.

Consolidated margin for the second quarter ended June 30, 2009, totaled \$0.3 million, which is \$0.5 million higher than the \$(0.2) million loss recorded for the comparative period. The margin increase is directly attributed to decreased operating costs through staff reduction and increased cost management measures.

Second quarter net loss for the three month period ended June 30, 2009, totaled \$(1.4) million which was a \$1.0 million decrease in net loss from the \$(2.4) million recorded for the comparative quarter ended June 30, 2008. This is due to aggressive cost cutting measures instituted which include staff reductions and strong purchasing and cost management controls.

No comprehensive income or loss and no opening or closing balances for accumulated comprehensive income or loss is recorded for the quarter ended June 30, 2009.

### **Pipeline**

Pipeline revenues for the quarter ended June 30, 2009, totaled \$0.9 million, a decrease of \$0.9 million from \$1.8 million recorded in the second quarter ended June 30, 2008. The decrease is due to customer apprehension surrounding our current financial situation.

Pipeline gross margins for the quarter ended June 30, 2009, increased \$0.2 million from \$(0.2) million to a break even point for the comparative period ended June 30, 2008. The break even margin is due to decreased revenues from fixed and indirect costs.

Due to the decrease in pipeline revenue, the net losses for the pipeline division rose to \$(1.5) million for the quarter ended June 30, 2009, a decrease of \$(0.5) million from the \$(2.0) million net losses reflected in the comparative period ended June 30, 2008.

***Fabrication***

Fabrication revenues for the quarter ended June 30, 2009, totaled \$3.6 million, an increase of \$2.9 million from \$0.7 million recorded in the second quarter ended June 30, 2008. The increase is due to recognition of the deferred revenue recorded at December 31, 2008.

Fabrication margin of \$0.3 million for the quarter ended June 30, 2009, was an increase of \$0.2 million from the \$0.1 million recorded for the period ended June 30, 2008.

Fabrication net income before tax for the quarter ended June 30, 2009, was an increase of \$0.5 million as compared to the \$(0.4) million of net losses for the comparative period.

***Corporate and Interest***

The Corporation's selling, general and administrative expenses totaled \$0.8 million for the quarter ended June 30, 2009, which is a decrease of \$0.7 million from the \$1.5 million from the expenses recorded at June 30, 2008. This is due to Corporation's reduction in staff and strong cost control.

Amortization expense for the quarter ended June 30, 2009 totaled \$0.6 million, which equals the amortization expense recorded for the three month period ended June 30, 2008.

There was \$33 thousand in other expenses for the quarter ended June 30, 2009, a decrease of \$27 thousand from \$60 thousand of other income for the comparative quarter ended June 30, 2008.

Interest costs on the operating loan and the loan payable of \$0.2 million for the three month period ended June 30, 2009 which equates to the \$0.2 million recorded for the period ended June 30, 2008.

***Second Quarter 2009 vs First Quarter 2009***

Second quarter revenue for the three month period ended June 30, 2009, totaled \$4.5 million which was a \$0.1 million increase from the \$4.4 million recorded for the first quarter ended March 31, 2009.

The consolidated margin for the second quarter ended June 30, 2009 totaled \$0.3 million, which is \$1.1 million less than the \$1.4 million recorded for the quarter ended March 31, 2009. The margin decrease is attributed to the reduced activity at the coating plant and associated fixed costs to maintain the plant.

Second quarter net loss for the three-month period ended June 30, 2009, totaled \$(1.4) million which was a \$0.3 million increase in net loss from the \$(1.1) million recorded for the first quarter ended March 31, 2009. The increase in loss between the periods is due to having to reinstitute fixed costs to operate the coating plant in the third quarter.

***Pipeline***

Pipeline revenues for the quarter ended June 30, 2009, totaled \$0.9 million, a decrease of \$1 million from \$1.9 million recorded in the first quarter ended March 31, 2009. The decrease is a direct result of reduced coating orders due to the uncertainty of our current financial situation.

Pipeline gross margins broke even for the quarter ended June 30, 2009 is an increase of \$0.4 million from \$(0.4) million loss for the three months period ended March 31, 2009 as a result of the reduction in fixed and indirect costs of sales through staff reductions.

The decrease in pipeline revenue and gross margin increased the net losses for the pipeline division to \$(1.5) million for the quarter ended June 30, 2009, equaled the \$(1.5) million net losses reflected in the period ended March 31, 2009.

***Fabrication***

Fabrication revenues for the quarter ended June 30, 2009 totaled \$3.6 million, an increase of \$1.1 million from \$2.5 million recorded in the first quarter ended March 31, 2009. The increased revenue is a direct result of fabrication completing a coating plant project and the associated recognition of the deferred revenue recorded at December 31, 2008.

Fabrication margin of \$0.3 million for the quarter ended June 30, 2009 was a decrease of \$0.7 million from the \$1 million recorded for the period ended March 31, 2009. The deferred revenue and work in progress were both recognized on the coating plant.

Net income before tax for the fabrication division for the quarter ended June 30, 2009 totaled \$0.1 million was an increase of \$0.5 million as compared to the \$(0.4) million of net losses for the comparative period.

***Corporate and Interest***

The Corporation's selling, general and administrative expenses totaled \$0.8 million for the quarter ended June 30, 2009, which is a decrease of \$0.7 million from the \$1.5 million from the expenses recorded at March 31, 2009. This is due to Corporation's reduction in staff and strong cost control.

Amortization expense for the quarter ended June 30, 2009 totaled \$0.6 million, which equals the amortization expense recorded for the three month period ended March 31, 2009.

There was \$33 thousand in other income for the quarter ended June 30, 2009, a decrease of \$6 thousand from \$39 thousand of other income for the first quarter ended March 31, 2009.

Interest costs on the operating loan and the loan payable of \$0.2 million for the three month period ended June 30, 2009 which equates to the \$0.2 million recorded for the period ended March 31, 2009.

***First six months of 2009 vs First six months of 2008***

The revenue for the six month period ended June 30, 2009, totaled \$9.0 million which was a \$1.2 million increase from the \$7.8 million recorded for the comparative quarter ended June 30, 2008. The increased revenue is a direct result of fabrication completing a coating plant project and the associated recognition of the deferred revenue recorded at December 31, 2008.

Margin for the six months ended June 30, 2009 totaled \$1.7 million, which is \$0.7 million higher than the \$1 million recorded for the comparative period. The margin increase is directly attributed to decreased indirect and fixed operating costs.

The net loss for the six month period ended June 30, 2009, totaled \$(2.5) million which was a \$1.1 million decrease in net loss from the \$(3.6) million recorded for the comparative period ended June 30, 2008.

***Pipeline***

Pipeline revenues for the six months ended June 30, 2009, totaled \$2.9 million, a decrease of \$2.6 million from \$5.5 million recorded in the second quarter ended June 30, 2008. The decrease is a direct result of reduced coating orders due to the uncertainty of our current financial situation.

Pipeline gross margins were \$0.4 million for the six months ended June 30, 2009 a decrease of \$0.2 million from \$0.6 million for the comparative period ended June 30, 2008.

The decrease in pipeline revenue and gross margin increased the net losses for the pipeline division to \$(3.2) million for the six months ended June 30, 2009, an increased loss of \$(0.2) million from the \$(3.0) million net losses reflected in the comparative period ended June 30, 2008.

***Fabrication***

Fabrication revenues for the six months ended June 30, 2009 totaled \$6.2 million, an increase of \$3.8 million from \$2.3 million recorded in the six months ended June 30, 2008. The increased revenue is a direct result of fabrication completing a coating plant project and the associated recognition of the deferred revenue recorded at December 31, 2008. There is also an increase from completing a contract with a new fabrication customer.

Fabrication margin of \$1.3 million for the six months ended June 30, 2009 was an increase \$0.9 million from the \$0.4 million recorded for the period ended June 30, 2008.

Net income before tax for the fabrication division for the six months ended June 30, 2009 totaled \$0.7 million as compared to the \$(0.6) million of net losses for the comparative period.

***Corporate and Interest***

The Corporation's selling, general and administrative expenses totaled \$2.4 million for the six months ended June 30, 2009, which is a decrease of \$0.5 million from the \$2.9 million from the expenses recorded at June 30, 2008.

Amortization expense for the six months ended June 30, 2009 totaled \$1.2 million, which is equal to amortization expense recorded for the six month period ended June 30, 2008.

There was \$33 thousand in other income for the six months ended June 30, 2009, a decrease of \$57 thousand from \$90 thousand of other income for the comparative period ended June 30, 2008.

Interest costs on the operating loan and the loan payable of \$0.4 million for the six month period ended June 30, 2009 which is an increase to the \$81 thousand recorded for the period ended June 30, 2008.

**CASH FLOW**

Cash used in operations in the second quarter of 2009 totaled \$(0.9) million compared to \$(1.8) million in the second quarter of 2008 and \$(0.6) million in the first quarter of 2009 with the changes reflecting the changes in income as well as the changes in net working capital. Accounts receivable totaled \$1.8 million at June 30, 2009, a decrease of \$0.5 million from the \$2.3 million recorded at December 31, 2008, resulting from collection of receivables during the quarter. Unbilled revenue totaled \$0.2 million at June 30, 2009, a decrease of \$0.1 million over the \$0.3 million recorded at December 31, 2008 and pertains to a decrease in work in progress on fabrication projects at June 30, 2009.

Cash provided from investing activities totaled \$146 thousand for the six months ended June 30, 2009 and is attributable to the sale of a small section of land to make way for a highway expansion which is a \$1.34 million dollar increase compared to the \$(1.2) million cash used to purchase assets for the six months ended June 30, 2008.

Cash used in financing activities for the three months ended June 30, 2009 totaled \$32 thousand which is a \$1.2 million decrease from the cash provided from financing for the three months ended June 30, 2009. The cash provided from financing for the six months ended June 30, 2009 is \$574 thousand, a decrease of \$888 thousand in cash provided from financing for the six months ended June 30, 2008. This decrease in financing is due to continued increased cost management.

**REELPIPE**

Garneau Inc. has continued suspension of any additional spending on the development of its composite pipe product, Reelpipe® until we complete our strategic alternatives analysis. Garneau Inc. has not capitalized any amounts related to the development of Reelpipe® during the period ended June 30, 2009.

***Research and Development***

All research and development costs are related to maintaining the intellectual and contractual rights associated with Reelpipe®. We expended \$65 thousand in the six months ended June 30, 2009, a \$40 thousand dollar increase from the \$25 thousand for the period ended March 31, 2009.

**CAPITAL EXPENDITURES**

Garneau Inc. has suspended any capital expenditures that are not required repairs or maintenance.

**BASIS OF PRESENTATION – GOING CONCERN**

These consolidated financial statements have been prepared on a going concern basis in accordance with Canadian GAAP. The going concern basis of presentation assumes that the Corporation will continue in operation for the foreseeable future and be able to realize its assets and discharge its liabilities and commitments in the normal course of business.

There is significant doubt about the appropriateness of the use of the “going concern” assumption.

The Corporation:

- experienced a loss of \$2,455 for the six months ended June 30, 2009 (June 30, 2008: a loss of \$3,598);
- has an accumulated deficit of \$14,627 (December 31, 2008: an accumulated deficit of \$12,173);
- had negative cash flows from operations before adjusting for changes in working capital of \$600 for the six months ended June 30, 2009 (June 30, 2008: negative cash flows of \$2,080);
- has a working capital deficiency as at June 30, 2009 of \$11,798 (December 31, 2008: a deficiency of \$10,658); and
- has received notice from its primary lender demanding repayment of all amounts owing to it.

The Corporation is in breach of its debt service and working capital covenants under its loan agreement (including certain capital leases); the breaches have not been waived by the Corporation's primary lender. Based on the Corporation's current projections, the Corporation believes it is unlikely that it will be in compliance with the existing loan agreement financial covenants during fiscal 2009.

The Corporation's primary lender demanded repayment of all amounts owing to it be paid no later than August 31, 2009, and stated that it will exercise such rights as it considers necessary to collect all amounts owing. The Corporation is in receipt of the statutory Notice of Intention to Enforce Security from the lender pursuant to section 244 of the Bankruptcy and Insolvency Act (Canada) and the ten day notice period required pursuant thereto has expired. The Corporation has waived its right to any other notice or demand from the lender.

The Corporation is assessing its business strategy. Alternatives being evaluated include, but are not limited to:

- attempting to secure financing from existing and alternate sources;
- attempting to obtain additional working capital from investors or from the partial sale of its business or the sale of certain assets, including potential sale-lease back arrangements;
- reorganizing the Corporation to allow its shares to be vended to a purchaser;
- identifying opportunities to generate sustainable profits in the foreseeable future from operations; and
- voluntarily filing an application with the Court of Queens Bench of Alberta (the "**Court**") for creditor protection under the Companies' Creditors Arrangement Act.

The Corporation has engaged an agent to solicit interest from parties in participating in certain of these strategic alternatives. Management is of the opinion that viable strategic alternatives exist to enable the Corporation to continue as a going concern. No agreements with lenders, investors or other counterparties have been reached and there can be no assurance that any such agreements will be reached. In addition, pursuance of any such strategic alternative could be subject to the approval of the Corporation's primary lender. There can be no assurance that any such plan would be confirmed or approved by the Corporation's primary lender, or that any such plan could be implemented successfully. Furthermore, there can be no assurance that future operations will generate sustainable profits.

The ability of the Corporation to continue as a going concern and to realize the carrying value of its assets and discharge its liabilities when due is dependent upon the successful completion of the actions taken or planned by Management, some of which are described above, which Management believes can mitigate the adverse conditions and events which raise significant doubt about the validity of the "going concern" assumption used in preparing these financial statements. There is no certainty that these and other strategies, including but not limited to

strategies that are contingent upon actions of third parties as well as improved market acceptance and revenues for the Corporation's products and services, will be sufficient to permit the Corporation to continue as a going concern.

These financial statements do not reflect adjustments that would be necessary if the "going concern" assumption were not appropriate, including if the Corporation was to dispose, whether voluntarily or involuntarily, of a significant portion of or all of its assets used in operations. The potential range of outcomes that may or may not be achieved materially affect the degree of uncertainty associated with the measurement of many amounts in these consolidated financial statements. If the "going concern" basis was not appropriate for these financial statements, then adjustments would be necessary to the carrying value of assets and liabilities, the reported revenues and expenses, and the balance sheet classifications used and those adjustments could be material. Furthermore, the audited financial statements do not purport to reflect or to provide for the consequences of any creditor protection proceedings, wind-up of the Corporation, or the results if the Corporation's primary lender makes an application to the Court to place the Corporation into bankruptcy. In particular, these consolidated financial statements do not purport to show: (a) as to assets, the realizable value on a liquidation basis or their availability to satisfy liabilities; (b) as to pre-bankruptcy application liabilities, if such application or similar action were to occur, the amounts that may be allowed for claims or contingencies, or the status and priority thereof; (c) as to shareholder accounts, the effect of any changes that may be made in the Corporation's capitalization; or (d) as to operations, the effect of any changes that may be made in the Corporation's business.

## **DEMAND DEBT FACILITY**

The Corporation's primary lender demanded repayment of all amounts owing to it be paid no later than August 31, 2009 and stated that it will exercise such rights as it considers necessary to collect all amounts owing. The Corporation is in receipt of the statutory Notice of Intention to Enforce Security from the lender pursuant to section 244 of the Bankruptcy and Insolvency Act (Canada) and the ten day notice period required pursuant thereto has expired. The Corporation has waived its right to any other notice or demand from the lender.

On June 27, 2007, the Corporation entered into a new credit facility with its existing lender. Under this facility the Corporation is required to meet certain financial debt covenants with respect to debt to tangible net worth, the ratio of current assets to current liabilities, and debt service coverage.

The maximum amount available under the demand revolving operating loan at June 30, 2009 was \$5,000 (December 31, 2008 - \$6,250) subject to a borrowing based formula on the level of eligible accounts receivable and inventories. Canadian dollar advances under the operating loan bear interest at the lender's prime rate plus 3.5% (December 31, 2008 - 1.5%). US dollar advances under the operating loan bear interest at the lenders US Dollar prime rate plus 3.5% (December 31, 2008 - 1.5%). On July 29, 2008, the Corporation's lender eliminated the option to pay LIBOR plus 1.975% on US Dollar advances. At June 30, 2009 and 2008, no funds were advanced under the US dollar arrangement. Letters of guarantee and credit for performance and bid guarantees when issued, reduce the amount available for borrowing under the facility.

Under the demand debt facility, the Corporation also had available at June 30, 2009:

- A demand revolving evergreen loan available to a maximum of \$1,224 (December 31, 2008 - \$2,300) to finance the cost of capital upgrades, limited to the lesser of the total cost of upgrades and the maximum available limit, bearing interest at the lender's prime rate plus 4.0% (December 31, 2008 - 2.0%).

**MANAGEMENT DISCUSSION AND ANALYSIS**

For the three months ended June 30, 2009 and 2008

*(Amounts in thousands of Canadian dollars, except per share amounts or unless otherwise specified)*

- A demand bank loan available to a maximum of \$5,621 (June 30, 2008 – \$6,500) repayable in monthly installments of principal and interest based upon an amortization period of 20 years, bearing interest at the lender's prime rate plus 3.5% (December 31, 2008 – 0.875%).
- A finance lease facility available to a maximum of \$63 (December 31, 2008 – \$200), bearing interest at the lender's prime rate plus 0.875% (Note 6).
- The letter of guarantee under the Import Facility is no longer available.

The demand loan amounts outstanding at June 30, 2009 and December 31, 2008 are as follows:

	2009	2008
Demand revolving evergreen bank loan, payable in monthly principal installments of \$52. Interest is charged at the rate of bank prime plus 4.0%.	\$ 1,224	\$ 1,621
Demand non-revolving bank loan, payable in monthly principal installments of \$55. Interest is charged at the rate of bank prime plus 3.5%.	5,621	5,980
	<b>\$ 6,845</b>	<b>\$ 7,601</b>

As collateral for the demand debt facility, the Corporation has provided a general security agreement creating a first priority charge over all assets, a floating charge over all present and after acquired real property, and assignment of all insurance.

As at June 30, 2009 the Corporation was not in compliance with its debt service ratio or its working capital coverage ratio covenants under its demand debt facility, which have not been waived by the Corporation's lender. Based on the Corporation's current projections, the Corporation believes it is unlikely that it will be in compliance with the existing loan agreement financial covenants during 2009. The debt service covenant under its loan agreement (including certain capital leases) is determined quarterly based on the trailing four quarters of net earnings (loss) plus depreciation plus interest expense ending on each determination date. The working capital coverage ratio under its loan agreement is determined quarterly and is based on the total current assets divided by the total current liabilities.

Provided the lender does not exercise its rights under the demand feature of the demand debt facility, the contractual repayments of principal, classified as a current liability, are as follows:

<b>2009</b>	\$ 604
<b>2010</b>	1,149
<b>2011</b>	920
<b>2012</b>	820
<b>2013</b>	700
And subsequent years	2,651
Total scheduled repayments	<b>\$ 6,845</b>

On May 29, 2009, the Corporation entered into a Fourth Credit Extension Agreement effective May 29, 2009. Under the amended terms of the agreement, the Operating Line is not to exceed \$5.0 million, and the remaining facilities are not to exceed the outstanding principal amounts as at May 29, 2009, as follows: the line on the Evergreen Loan – \$1.242 million; the Demand Loan – \$5.676 million; and the Lease Line – \$73 thousand. The agreement also included an extension of the agreement to August 31, 2009 effective May 29, 2009.

**SELECTED QUARTERLY INFORMATION:**

(In thousands, except per share data)

Three Months Ended (unaudited)								
	Jun. 30/09	Mar. 31/09	Dec. 31/08	Sept. 30/08	Jun.30/08	Mar. 31/08	Dec. 31/07	Sept. 30/07
Total Revenues	4,551	4,448	2,698	6,744	2,538	5,307	4,351	3,793
Net Earnings (loss)	(1,388)	(1,067)	(2,482)	(581)	(2,337)	(1,221)	(1,708)	(1,034)
Basic Earnings (loss) per Share	(0.11)	(0.09)	(0.20)	(0.05)	(0.20)	(0.10)	(0.14)	(0.09)
Diluted Earnings (loss) per Share	(0.11)	(0.09)	(0.20)	(0.05)	(0.20)	(0.10)	(0.14)	(0.09)
Total Assets	22,120	25,367	26,558	27,084	27,995	28,950	29,885	29,202
Long Term Capital Lease Obligations	-	-	-	-	63	91	118	-

The seasonality of the pipe coating business and project nature of international contracts results in wide quarterly fluctuations in revenue generated by the Corporation and net earnings (loss) there from.

**OUTSTANDING SHARES DATA:**

At June 30, 2009, the Corporation had 12,116,402 outstanding common shares and 620,800 outstanding options to acquire common shares, of which 340,785 of these options were vested and exercisable. During the quarter ended June 30, 2009, no options were exercised.

**RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS:**

**CAPITAL DISCLOSURES:**

Effective January 1, 2008, the Corporation prospectively adopted the Canadian Institute of Chartered Accountants (“CICA”) Handbook Section 1535, *Capital Disclosures* (“CICA 1535”). CICA 1535 requires disclosure of an entity’s objectives, policies and processes for managing capital, quantitative data about the entity in regards to capital and whether the entity has complied with any capital requirements and if it has not complied, the consequences of such non-compliance. The Corporation has provided the required disclosures in Note 11 to its consolidated financial statements for the year ended December 31, 2008.

**FINANCIAL INSTRUMENTS – DISCLOSURE AND PRESENTATION:**

Effective January 1, 2008, the Corporation adopted CICA Handbook Sections 3862, *Financial Instruments – Disclosures* (“CICA 3862”) and Handbook Section 3863, *Financial Instruments – Presentation* (“CICA 3863”), which replaced Section 3861, *Financial Instruments – Disclosure and Presentation*.

CICA 3862 requires entities to provide disclosures in their financial statements that enable users to evaluate the significance of financial instruments on the entity’s financial position and its performance and the nature and extent of risks from financial instruments to which the entity is exposed during the period and at the balance sheet date, and how the entity manages those risks.

The Corporation has provided the required disclosures in Note 12 to its consolidated financial statements for the year ended December 31, 2008.

CICA 3863 establishes standards for presentation of financial instruments and non-financial derivatives. It deals with the classification of financial instruments, from the perspective of the issuer, between liabilities and equity, the classification of related interest, dividends, gains and losses, and the circumstances in which financial assets and financial liabilities are offset. The adoption of this standard did not have a material impact on the presentation of financial instruments in the Corporation's financial statements.

#### INVENTORIES:

Effective January 1, 2008, the Corporation adopted CICA Handbook Section 3031, *Inventories* ("CICA 3031"), which provides new guidance on the recognition, measurement and disclosure of inventories. The recognition and measurement changes include the elimination of the last-in first-out method, the requirement to measure inventories at the lower of cost and net realizable value, the allocation of overhead based on normal capacity, the use of the specific cost method for inventories that are not ordinarily interchangeable or goods and services produced for specific purposes, the requirement for an entity to use a consistent cost formula for inventory of a similar nature and use, and the reversal of previous write-downs to net realizable value when there is a subsequent increase in a value of inventories.

The Corporation retrospectively adopted the CICA 3031 requirements without restatement. The adoption of CICA 3031 did not have a material effect on the opening deficit or net loss for the year ended December 31, 2008.

#### GOODWILL AND INTANGIBLE ASSETS:

In 2008, the CICA issued Handbook Section 3064, *Goodwill and Intangible Assets* ("CICA 3064"). CICA 3064, which replaces Section 3062, *Goodwill and Other Intangible Assets*, and Section 3450, *Research and Development Costs*, establishes standards for the recognition, measurement and disclosure of goodwill and intangible assets. This new standard is effective for the Corporation's interim and annual consolidated financial statements commencing January 1, 2009. There is no material impact on the financial statements.

### **FUTURE CANADIAN ACCOUNTING PRONOUNCEMENTS**

#### BUSINESS COMBINATIONS:

In October of 2008, the CICA issued Handbook Section 1582, *Business Combinations* ("CICA 1582"), concurrently with Handbook Sections 1601, *Consolidated Financial Statements* ("CICA 1601"), and 1602, *Non-controlling Interests* ("CICA 1602"). CICA 1582, which replaces Handbook Section 1581, *Business Combinations*, establishes standards for the measurement of a business combination and the recognition and measurement of assets acquired and liabilities assumed. CICA 1601, which replaces Handbook Section 1600, carries forward the existing Canadian guidance on aspects of the preparation of consolidated financial statements subsequent to acquisition, other than non-controlling interests. CICA 1602 establishes guidance for the treatment of non-controlling interests subsequent to acquisition through a business combination. These new standards are effective for the Corporation's interim and annual consolidated financial statements commencing on January 1, 2011 with earlier adoption

permitted as of the beginning of a fiscal year. The Corporation is assessing the impact of the new standards on its consolidated financial statements.

### **INTERNAL CONTROLS OVER FINANCIAL REPORTING (“ICFR”)**

The Corporation has historically operated with an implemented system of internal controls over financial reporting that it believes adequately protects the assets of the Corporation and is appropriate for the nature of its business and the size of its operations. These internal controls include disclosure controls and procedures designed to ensure that information required to be disclosed by the Corporation is accumulated and communicated to our management as appropriate to allow timely decisions regarding required disclosure.

It should be noted that while the Corporation’s Chief Executive Officer and Interim Chief Financial Officer believe that the Corporation’s disclosure controls and procedures historically in place, provide a reasonable level of assurance that the system of internal controls are sufficient, subject to the comments below, they do not guarantee that the disclosure controls and procedures, will prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

The Chief Executive Officer and Interim Chief Financial Officer of the Corporation are responsible for designing internal controls over financial reporting or causing them to be designed under their supervision in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian Generally Accepted Accounting Principles (“**GAAP**”).

The Corporation’s Chief Executive Officer and Interim Chief Financial Officer have concluded based on their evaluation that, partially due to the limited number of staff and resources at Garneau, inherent weaknesses in areas of internal controls over financial reporting are present, including segregation of duties, lack of financial expertise at certain levels in the finance functions with respect to complex and non-routine accounting transactions, documented review of financial reporting entries and reconciliations, controlled use of spreadsheets, information technology safeguards, risk assessment processes, physical controls, documentation controls and controls at the entity level. In addition, the Corporation has not effectively implemented a process and sufficient monitoring controls with respect to the application of revenue recognition standards on certain contracts. As a result of these weaknesses there is no guarantee that a material misstatement would not be prevented or detected. Implementation of strengthened financial reporting controls will occur during 2009, where required.

Management of the Corporation completed an evaluation of these existing internal controls over financial reporting.

As at December 31, 2008 we assessed the effectiveness of the Corporation’s Internal Control over Financial Reporting (“**ICFR**”). In making this assessment we used the criteria set forth in the Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (“**COSO**”). During this process we identified material weaknesses in internal controls over financial reporting as described below.

We did not maintain effective processes in controls related to the following:

- Specific to complex and non routine transactions and revenue recognition and period end controls: There was a lack of sufficient accounting and finance personnel with and

appropriate level of technical accounting knowledge and training commensurate with the complexity of the Corporation's financial accounting and reporting requirements.

- Segregation of duties and complete formalized policy and document review: Specifically certain duties with the accounting and human resources department were not properly segregated and policies and review procedures were not completely formalized due to a smaller number of staff and staff turnover.
- IT user access controls: specifically due to the limitation in resources, system users are not properly restricted from access to the system.

In response to the material weaknesses identified above, the Corporation has undertaken the following actions:

- We have taken steps to rectify the complex and non-routine transactions and period end control weaknesses by reorganizing the corporate accounting group and recruiting new staff with the appropriate levels of experience and technical skills to prevent a reoccurrence of these issues.
- Increased segregation of duties and enhanced documentation and review of our IT process will occur during the first two quarters of 2009.

## **DISCLOSURE, CONFIDENTIALITY AND TRADING POLICY**

The Corporation has formal disclosure controls and procedures in place which promote an understanding of the legal requirements among the Corporation's directors, officers and employees as it pertains to the timely, factual and accurate communications with the public for Garneau Inc., together with compliance of trading requirements of Corporation securities and confidentiality of non public disclosed information. An evaluation by the President and Chief Executive Officer and Interim Chief Financial Officer concluded that as a result of the material weaknesses in the Corporation's ICFR discussed above, the disclosure controls and procedures were not effective as of the end of December 31, 2008. These disclosure controls and procedures are in the process of being enhanced further in 2009.

## **CRITICAL ACCOUNTING ESTIMATES**

The Corporation recognizes revenues related to equipment fabrication contracts based on the percentage completion of the individual contracts. Revenues from contracts are determined on a percentage completion method, based on the ratio of costs incurred to date over estimated total costs. For some contracts, using the cost-to-cost method in estimating percentage-of-completion may overstate the progress on the project. For instance, in a project where a large amount of permanent materials are purchased, including the costs of these materials in calculating the percentage-to-completion may overstate the actual progress on the project. For projects where the cost-to-cost method does not appropriately reflect the progress on the projects, we use alternative methods for measuring progress on the project and recognize revenue accordingly.

The Corporation provides an estimate for amortization of assets based on the expected useful life of assets with coating and extrusion equipment calculated on a straight-line method.

The Corporation estimates the allowance for doubtful accounts on a customer-by-customer evaluation of collectability at each reporting date taking into consideration the following factors: the length of time the receivable has been outstanding, specific knowledge of each customer's financial condition and historical experience.

Long-lived assets (property, plant and equipment) are assessed for impairment on at least an annual basis. These impairment tests involve the use of both undiscounted net cash flow analyses to assess the recoverability of the carrying value of these assets and an appraisal of the fair value of long-lived assets. These analyses involve estimates of future cash flows, estimated periods of use and applicable discount rates.

The Corporation has also provided estimates pertaining to the valuation of inventory, valuation of future income taxes and other estimates provided in the normal course of business operations. There have been no significant accounting estimate changes in the past two years which would materially affect the financial performance or financial statements. There are currently no known trends, commitments, or events that Garneau believes will materially affect the accounting estimates.

## **RELATED PARTY TRANSACTIONS**

The Corporation entered into certain transactions for contract fabrication design services with a former director of the Corporation. The contract was cancelled during the year ended 2008. For the three months ended June 30, 2009 the consulting fees paid for these services were \$nil (2008: \$48), which are recorded as part of selling, general and administrative expenses in the consolidated statements of operations. The Corporation also entered into certain transactions with the wife of a director of the Corporation related to the rental of a loader. For the six months ended June 30, 2009, the rental fees paid for these services were \$12 (2008: \$24), which are recorded as part of Pipeline operating costs in the consolidated statements of operations.

## **CONTINGENCIES**

During the period ended June 30, 2009, the Corporation remained a named defendant in a lawsuit with claims in the aggregate amount of \$2.0 million. In the opinion of management, this matter is without substantial merit and no provisions have been made for this claim in the accounts.

During the year ended December 31, 2008, one charge under the Alberta Occupational Health and Safety Act was laid against Garneau with respect to a workplace accident that occurred in 2006. Garneau has pled not guilty, but if convicted Garneau could be liable to pay a fine of not more than \$500,000 plus 15.0% of the total fine.

The Corporation has been named a defendant in a lawsuit and has received claims in the aggregate amount of \$180,000. In the opinion of management, this matter is without substantial merit and no provision has been made for the claim in these financial statements.

The Corporation has received statements of claim from three unsecured trade creditors in the total amount of \$473 thousand. The claims have not yet been resolved.

## **BUSINESS RISKS**

At June 30, 2009, there are no significant changes to the business risks outlined in the Management Discussion and Analysis for the year ended December 31, 2008.

## **OUTLOOK**

The Corporation continues to work with a third party to explore strategic alternatives to strengthen the Corporation's balance sheet. The Corporation expects that 2009 revenue will be comparable to 2008. The Corporation's current financial situation continues to create uncertainty among some of its customers who have taken a "wait and see" approach before committing to additional business for 2009. All of the above factors have contributed to the reduced levels of activity for the year to date and subsequently the reduced demand for the Corporation's pipeline segment activities

Garneau has continued to significantly reduce costs in all operating areas, including the continued suspension of any additional spending on the development of its composite pipe product, Reelpipe®.

The pipeline segment revenues are estimated to be approximately 30% lower than 2008. Operators drilled 5,938 new wells in the first 6 months of 2009. The Corporation's outlook for the number of wells to be drilled in western Canada for 2009 is now in the 10,000 range, representing a 41% reduction from the prior year. Until drilling activity levels increase, the Corporation is concentrating on scheduled project work for summer and fall.

Fabrication revenues are estimated to increase substantially over 2008 with the completion of 2 coating plants and numerous other small projects already completed in the first half of 2009. The Corporation is continuing to exploring fabrication projects internationally and also outside of the oil and gas industry to increase growth despite the current uncertainty surrounding the oil and gas industry in North America.

Sincerely,



Glen R. Garneau  
President and Chief Executive Officer  
Garneau Inc.