



DESTINY RESOURCE SERVICES CORP.

Management Discussion and Analysis

For the Year Ended December 31, 2003

2003 ANNUAL REPORT
FOR THE YEAR-ENDED DECEMBER 31, 2003

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion and analysis of financial results for the years ended December 31, 2003 and 2002 should be read in conjunction with the Company's consolidated financial statements and related notes contained in this Annual Report. Certain statements included in this discussion constitute forward-looking statements that involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements of the Company, or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such factors include general economic and business conditions, which among other things, affect demand for the Company's services; industry capacity; the ability of the Company to implement its business strategy; and changes in, or the failure to comply with government regulations, especially health, safety and environmental laws, regulations and guidelines.

OVERVIEW

With the Company burdened by high debt levels and with the \$10.0 million 8% subordinated debenture maturing on July 2, 2004 Destiny determined it was in the best interest of shareholders for the Company to reduce debt through the use of proceeds from the sale of non-core businesses and to restructure the remaining debt.

During the year ended December 31, 2003 the Company initiated a number of major transactions to achieve this debt reduction objective. These transactions, which saw the Company dispose of two of its three business segments, pay down debt and restructure its remaining debt have significantly altered the composition of the Company as outlined below.

A) BUSINESS DISPOSITIONS

Surface Preparation

Battle River Oilfield construction

- Sold the assets and the business in two stages
- Sold the premises and the business in November 2003
- Sold heavy equipment in February

Post-Drilling Construction

McConnell Welding & Construction
 Big Foot Metal Systems
 Team Pipeline

- Sold the assets and the business in October 2003
- Sold the assets and the business in September 2003
- Shutdown the business and sold the assets at auction in December 2003

B) CORE BUSINESSES RETAINED

Seismic Front-End Services

Destiny Resources
 Double R Drilling
 Wolf Survey & Mapping

C) SELECT FINANCIAL INFORMATION OF MAJOR TRANSACTIONS

<i>(all amounts in \$millions)</i>	Proceeds on Sale	Gain (loss) on Sale	Term Loan Proceeds	Long-term Debt Repaid	Debenture repayment	2003 Revenue (to date of disposition)	2002 Revenue
Business Dispositions							
Battle River Oilfield Construction	\$4.4	\$0.5		\$0.6 ⁽¹⁾	\$3.0 ⁽¹⁾	\$11.6	\$13.3
McConnell Welding & Construction	\$2.0	\$(0.2)		\$0.2		\$8.3	\$9.8
Big Foot Metal Systems	\$0.4	\$0.0		\$0.0		\$1.0	\$1.7
Team Pipeline	\$1.3	\$0.3		\$0.5		\$5.0	\$2.4
New Financing							
Term loan ⁽¹⁾			\$3.55	\$0.3	\$2.0		
	\$8.1	\$0.6	\$3.55	\$1.5	\$5.0	\$25.9	\$27.2

⁽¹⁾ Please note that these transactions occurred subsequent to December 31, 2003

The effects of these transactions are as follows:

- The Company's continuing operations will consist of one business segment, being Seismic Front-End Services, which is comprised of seismic survey and mapping, seismic line clearing and shot-hole drilling.
- For financial statement reporting, the results of operations and the financial position of Battle River Oilfield Construction, McConnell Welding and Construction, Big Foot Metal Systems and Team Pipeline have been presented in the 2003 consolidated financial statements as discontinued operations.
- The Company has reported an overall gain on the dispositions of \$0.6 million
- Total gross proceeds of the sales are approximately \$8.1 million. The proceeds have been utilized as follows:
 - \$1.5 million has been applied to the reduction of long-term debt
 - \$5.0 million has been applied against the 8% subordinated debentures. This reduction in amount outstanding on the debentures provided the opportunity for the Company to negotiate an extension on the maturity date of the debentures from July 2004 to July 2008.
 - the balance, after deducting costs and other adjustments, will be used for capital expenditures and to supplement working capital.
- On a combined basis the businesses that have been sold or are in the process of being sold had revenue 9 to the dates of disposition) for the year ended December 31, 2003 of \$25.9 million (2002 - \$27.2 million) or 48% (2002 – 54%) of the Company's total revenue.

RESULTS OF OPERATIONS

The following analysis compares financial results for the years ended December 31, 2003 and 2002. Please note that the analysis pertains to the Company's continuing operations of Seismic Front-End Services. Excluded from the analysis are businesses that have been classified in the consolidated financial statements as discontinued operations. The businesses that have been excluded are:

Surface Preparation

- Battle River Oilfield construction

Post-Drilling Construction

- McConnell Welding & Construction
- Big Foot Metal Systems
- Team Pipeline

Please also note that the sections on working capital, long-term debt, and debentures provide analysis based on the audited consolidated balance sheets shown on page 16 of this annual report, and provide further analysis based on the unaudited pro forma balance sheets and accompanying notes presented on pages 12 & 13 of this annual report, that give effect to certain early 2004 transactions that complete the Company's reorganization.

REVENUE

Revenue for 2003 was \$28.1 million, a \$5.0 million or 22% increase from the \$23.1 million recorded in 2002. This increase in revenue is attributable to a slight increase in overall industry activity and more significantly to successful marketing efforts that have resulted in an increase in market share in the Company's survey & mapping and seismic drilling divisions. This increase is offset somewhat by a decline in activity in the line clearing division resulting from much of the available work being located in northeastern British Columbia where our clients often support work being contracted to First Nations companies

GROSS MARGIN

Gross margin totaled \$3.3 million, a \$1.9 million or 136% increase from the \$1.4 million recorded in 2002. As a percentage of revenue, gross margin increased from 6.0% in 2002 to 12% for 2003. This overall increase in gross margin is attributed primarily to the following factors:

- The Company altering its cost structure so that a greater portion of direct expenses are variable as opposed to fixed which results in a reduction in overall costs.
- Improved field efficiency in the Company's survey & mapping division as profit performance is starting to catch up to the tremendous revenue growth that this division has achieved over the past two years.
- The Company's seismic drilling division had the benefit of operating for a full year with lower operations level overhead that resulted from initiatives undertaken by new management in the later part of 2002 and into 2003.

Partially offsetting the positive factors detailed above is a decrease in the gross margin of the Company's line clearing division. This decrease in gross margin is due to higher competitive factors, including much of the line clearing work being performed in northeastern British Columbia where our clients often support work being contracted to First Nations companies

During 2002 the following specific factors contributed to reduced gross margins :

- High ramp up costs and difficult drilling conditions on three shot-hole drilling programs in Alberta and the Arctic resulted in lower than normal field margins.
- Adapting to a significant new client's field methodology in Wolf Survey & Mapping's business resulted in lower than normal field margins on one significant project.

GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses , which represent primarily the costs associated with the corporate head office, totaled \$1.1 million in each of 2003 and 2002. The \$1.1 million is net of general and administrative costs directly attributable to discontinued operations. The Company expects that general and administrative expense will be approximately \$1.0 million for fiscal 2004

AMORTIZATION AND WRITE-DOWN OF CAPITAL ASSETS AND GOODWILL

Amortization and write-down of capital assets and goodwill totaled \$1.3 million in 2003 versus \$9.1 million in 2002. \$6.9 million of the total \$7.8 million decrease is due to the Company recording in 2002 a \$3.9 million write-down of goodwill and a \$3.0 million write-down of capital assets taken to provide carrying values that are in line with the future benefits to be provided by these assets. The remaining \$0.9 million decrease is due to \$1.0 million lower amortization of capital assets as a result of lower carrying values arising from the 2002 write-down, offset by a \$0.1 million write-down taken in 2003 after establishing the market value of the Company's vacant Fairview premises that is currently for sale.

LOSS ON DISPOSAL OF CAPITAL ASSETS

During 2003 the Company reported an overall gain of \$0.1 million on the disposal of capital assets compared to reporting a loss of \$0.2 million during 2002. These amounts represent the result of normal course disposition of capital assets.

INTEREST EXPENSE

Total interest expense was \$2.4 million, an increase of \$0.2 million compared to the 2002 total of \$2.2 million. The largest component of interest expense, being interest on the Company's 8% debenture, remained unchanged at \$0.8 million per year as the balance outstanding was reduced only minimally by \$0.1 million late in 2003. The \$0.2 million increase in interest expense is due to:

- \$0.1 million in cross border nonrefundable withholding taxes being assessed on debenture interest and being reported as interest expense.
- operating loan interest expense being \$0.1 million higher in 2003 as result of the increase in business volume and as a result of the Company losing approximately \$1.0 million of working capital as the result of one large bad debt during 2003.
- the amortization of deferred charges being \$0.2 million higher in 2003 primarily as the result of the Company writing-off as part of the reorganization the deferred charges related to past financings.

Offsetting these decreases is a 2003 \$0.2 million decrease interest on long-term debt as a result of both regularly scheduled repayments and repayments arising on the sale of assets.

GAIN ON DISPOSAL OF SUBSIDIARY COMPANY

In 2002 a gain of \$0.6 million (reflecting net liabilities disposed) was recognized on the disposition of the Company's International subsidiaries.

INCOME TAXES

The Company was not in a taxable position for the year ended December 31, 2003 with minor "capital" taxes being the only tax expense provided for. The total net income tax provision for 2002 reflects a decrease in future tax liabilities of \$1.4 million due to the operating loss incurred, net of minor current "capital" tax expense. The Company has approximately \$11.1 million of unutilized Canadian non-capital tax loss carry forwards available, the benefit of which has not been fully recognized in the financial statements.

During the year ended December 31, 2003 the Company, by virtue of the acquisition of 56% of the common shares of the Company and the 8% subordinated debentures, had previously reported non-capital tax losses carried forward reduced by \$4.9 million due to the application of certain provisions of the Income Tax Act pertaining to debt forgiveness.

LIQUIDITY AND CAPITAL RESOURCES

Destiny's capital requirements consist primarily of working capital necessary to fund operations, capital expenditures related to the purchase and manufacture of operating equipment and capital to finance strategic acquisitions. Sources of funds to satisfy these capital requirements include cash flow from operations, external lines of credit, equipment financing, term loans and equity markets.

The Company believes that it has the capital resources and availability to meet both its working capital and maintenance capital expenditure requirements for 2004 and beyond.

WORKING CAPITAL

At December 31, 2003 the Company has a working capital surplus of \$1.0 million compared to a working capital deficiency of \$0.8 million as at December 31, 2002. This \$1.8 million increase is a result of positive cash flow from operations and to the net proceeds, after debt repayments, on the sale of the discontinued operations being applied to working capital.

After giving pro forma effect to certain reorganization transactions that occurred subsequent to year end (please see the pro forma balance sheet and accompanying notes presented on pages 12 & 13 of this annual report, the Company has a working capital surplus of \$1.5 million as at December 31, 2003. This \$0.5 million increase over the \$1.0 million working capital surplus as at December 31, 2003 described above is due to the term loan financing. Of the gross proceeds of \$3.6 million, \$2.3 was applied to debt repayments with the balance of \$1.3 million being used to supplement working capital. The \$1.3 million in working capital was partially offset by a \$0.8 million increase in the current portion of long-term debt which leaves the Company with a net \$0.5 million increase in working capital arising from the pro forma transactions.

CAPITAL ASSETS

Capital assets have increased by \$0.1 million from \$5.1 million as at December 31, 2002 to \$5.2 million as at December 31, 2003. The net increase is a result of capital expenditures of \$1.4 million being offset by amortization expense for the year of \$1.3 million.

LONG-TERM DEBT

The Company had three objectives in restructuring its long-term debt. First, to pay down as much long-term debt as possible through proceeds realized on the sale of non-core assets and businesses, second, to refinance \$2.0 million of the debentures with long-term debt, and third, to consolidate its remaining long-term debt under one loan. The Company achieved all three objectives.

Long-term debt decreased by \$4.3 million from \$5.1 million as at December 31, 2002 to \$0.8 million as at December 31, 2003. No new long-term debt was issued during the year. The \$4.3 million decrease is due to \$2.0 million of scheduled repayments, \$1.6 million of proceeds from the auction sale of redundant assets being applied against a term loan and to \$0.7 million of proceeds from the sale of McConnell Welding and Construction and the assets of Team Pipeline being applied against specific equipment loans.

After giving pro forma effect to the Battle River transactions and the term loan financing that occurred subsequent to year end (please see the pro forma balance sheet and accompanying notes presented on pages 12 & 13 of this annual report, the Company has long-term debt of \$3.55 million, being the amount of the term loan financing. Proceeds from the Battle River transactions and the term loan financing were used to retire the remaining equipment loans.

DEBENTURES

The financial reorganization of the Company, which was orchestrated throughout 2003, centered on the 8% subordinated debentures owned by the Company's majority shareholder. In September 2003 the debentures together with the 56.2% of the common shares of the Company owned by First Reserve VIII LLP were sold to Destiny Resources Investment Limited Partnership.

In December 2003 the terms of the debenture were amended. The Company and DRILP agreed: (i) to extend the maturity of the debentures to July 2, 2008; (ii) for the Company to pay \$2,000,000 from the proceeds of the new term debt and \$3,000,000 from the proceeds of the sale of the Battle River heavy equipment as retirement of principal on the debentures; and (iii) to replace the formula for interim payments with a requirement for semi-annual payments based on a formula that incorporates cash flow from operations, proceeds of disposition of assets, capital expenditures and term debt principal payments. No provision has been made for any payments that may be made in 2004.

After giving pro forma effect to the repayment of principal, referred to in the preceding paragraph and shown on the pro forma balance sheet and accompanying notes presented on pages 12 & 13 of this annual report, the amount outstanding on the debentures has decreased from \$10.0 million as at December 31, 2002 to \$4.8 million as at December 31, 2003.

SHAREHOLDERS' DEFICIENCY

During 2003 the Company had no share capital activity. Total shareholder's deficiency increased by \$0.1 million, being the net loss for the year.

3,175,000 common share purchase warrants issued in relation to a previously redeemed debenture expired on October 31, 2003 without being exercised.

BUSINESS RISKS

Destiny is subject to the risks and variables inherent in the oilfield services industry. Demand for the Company's products and services depends on the exploration, development and production activities of energy companies. These activities are directly affected by factors such as oil and gas commodity prices, weather, changes in legislation, exchange rates, the general state of domestic and world economies, concerns regarding fuel surpluses or shortages, substitution through imports or alternative energy sources, changes to taxation or regulatory regimes and the broad sweep of international political risks such as war, civil unrest, nationalization and expropriation or confiscation, which are all beyond the control of the Company and cannot be accurately predicted. The oil market is influenced by global supply and demand considerations and by the supply management practices of OPEC. The natural gas market is primarily influenced by North American supply and demand and by the price of competing fuels. The risks associated with external competition are minimized by concentrating Company activities in areas where it has demonstrated technical and operational advantages and by employing highly competent professional staff. Environmental standards and regulations are continually becoming more stringent in this industry and Destiny is committed to maintaining its high standards. Destiny also mitigates business risks by establishing strategic alliances with reputable partners, developing new technologies and methodologies as well as investigating new business opportunities.-

The risks inherent in the oilfield services industry impact the Company's ability to meet its financial covenants on the debentures and the term loan. Accordingly, the Company may be in violation of its covenants, which might result in repayment being demanded.

OUTLOOK

Following its reorganization the Company has adequate working capital and capitalization. The Company has term debt that has repayment provisions that are appropriate and a cost structure that has sufficient variability as to be able to adapt to the volatility of our industry. The Company has experienced management, at all levels of sales, operations and administration who are motivated to achieve success in both the short- and long-term. The Company provides services to the exploration for and production of a commodity, natural gas, that is escalating in value and is plentiful in the areas in which the Company operates.

The Company has started 2004 on a strong footing and is encouraged by the indications of demand for the Company's services for the rest of the year, and for the years beyond.

PRO FORMA CONSOLIDATED BALANCE SHEET

As at December 31, 2003

	December 31, 2003 (as reported)	Battle River Sale (note 2)	Term Loan Financing (note 3)	Team Pipeline Working Capital (note 4)	December 31, 2003 Pro forma (unaudited)
	\$	\$	\$	\$	\$
ASSETS					
CURRENT					
					(note 1)
Accounts receivable	5,672,894				5,672,894
Inventory	459,160				459,160
Prepaid expenses	317,084				317,084
Current assets of discontinued operations	5,313,650	(4,108,229)		(1,205,421)	---
	11,762,788	(4,108,229)		(1,205,421)	6,449,138
Capital assets					
	5,147,120				5,147,120
	16,909,908	(4,108,229)		(1,205,421)	11,596,258
LIABILITIES AND SHAREHOLDERS' DEFICIENCY					
CURRENT					
Bank indebtedness	3,077,302	(441,717)	(1,238,146)	(1,205,421)	192,018
Accounts payable and accrued liabilities	3,651,093				3,651,093
Income taxes payable	68,950				68,950
Current portion of long-term debt	783,942	(472,088)	728,146		1,040,000
Current liabilities of discontinued operations	194,424	(194,424)			---
Current portion of debentures	3,000,000	(3,000,000)			---
	10,775,711	(4,108,229)	(510,000)	(1,205,421)	4,952,061
Long-term debt	---		2,510,000		2,510,000
Debentures	6,833,884		(2,000,000)		4,833,884
Shareholders' deficiency					
Share capital	8,370,998				8,370,998
Deficit	(9,070,685)				(9,070,685)
	(699,687)				(699,687)
	16,909,908	(4,108,229)	---	(1,205,421)	11,596,258

See accompanying notes to the pro forma consolidated balance sheets.

NOTES TO PRO FORMA CONSOLIDATED BALANCE SHEET**As at December 31, 2003**

1. BASIS OF PRESENTATION

This pro forma consolidated balance sheet is expressed in Canadian dollars and has been prepared on a pro forma basis as at December 31, 2003 to give effect to certain reorganization transactions that occurred subsequent to December 31, 2003.

2. COMPLETION OF SALE OF BATTLE RIVER OILFIELD CONSTRUCTION

In February 2004, the Company closed the sale of the heavy equipment of Battle River Oilfield Construction for cash proceeds of \$3,972,621. The proceeds, together with refundable prepaid insurance in the amount of \$135,608 are shown as a reduction in current assets of discontinued operations as at December 31, 2003. The proceeds were used to repay equipment purchase contracts which at December 31, 2003 had balances outstanding of \$194,424, to repay a term loan which at December 31, 2003 had a balance outstanding of \$472,088 and to repay \$3,000,000 of the debentures. The balance of the proceeds was used to supplement working capital and has been shown as a reduction of bank indebtedness.

3. TERM LOAN FINANCING

In February 2004, the Company entered into a \$3,550,000 term loan facility, bearing interest at the lender's base rate plus 3.25%, maturing in 2007. The Company has provided a first charge on specific capital assets and a floating charge on all other assets as collateral for this term loan. The loan proceeds of \$3,550,000 were used to repay all remaining equipment purchase contracts which as at December 31, 2003 had balances outstanding of \$311,854 and to repay \$2,000,000 on the debentures. The balance of proceeds of \$1,236,006 was used to supplement working capital and has been shown as a reduction of bank indebtedness.

4. TEAM PIPELINE WORKING CAPITAL

As at December 31, 2003, the Company had \$1,205,421 of outstanding accounts receivable and refundable prepaid insurance related to the discontinued operations of Team Pipeline. The pro forma consolidated balance sheet as at December 31, 2003 reflects the normal course collection of these amounts with the cash proceeds being shown as reduction in bank indebtedness.