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FISCAL 2010 | First Quarter Management Discussion and Analysis

December 31, 2009



Commercial Solutions Inc.
Fiscal 2010 First Quarter Management Discussion and Analysis

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This discussion and analysis of the financial results of Commercial Solutions Inc. (“Commercial” or the “Company”) is as of February 12, 2010 and should be read in conjunction with the interim consolidated financial statements and accompanying notes. The financial data presented herein has been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”) and in Canadian dollars. Additional information relating to the Company, including the Annual Information Form can be found at the System for Electronic Document Analysis and Retrieval (“SEDAR”) web site at www.sedar.com.

RESULTS OF OPERATIONS

For the three months ended December 31st	2009	2008	% Change
Revenue	\$ 21,251,236	\$ 35,788,582	-40.6%
Gross margin (\$)	5,875,121	9,958,821	-41.0%
Gross margin (%)	27.6%	27.8%	-
Operating expenses	a 6,246,766	9,053,527	-31.0%
(Loss) earnings before interest, tax, depreciation and amortization expenses (“EBITDA”)	(371,645)	905,294	-141.1%
Interest expense and refinancing costs	342,512	287,855	19.0%
Depreciation and amortization	524,107	561,703	-6.7%
(Loss) earnings before tax	(1,238,264)	55,736	-2321.7%
Income tax (recovery) expense	(394,388)	17,752	-2321.7%
NET (LOSS) EARNINGS AND COMPREHENSIVE (LOSS) INCOME	\$ (843,876)	\$ 37,984	-2321.7%
(Loss) earnings per share			
Basic	\$ (0.04)	\$ 0.00	
Diluted	\$ (0.04)	\$ 0.00	

a See page 8 for a further explanation of these non-GAAP measures.

Revenue

First quarter revenue is lower in comparison to the same period in the prior year primarily due to the lower natural gas drilling activity in Western Canada. Although there was a steep decline in the oil and gas prices in the first quarter of the last fiscal year, rigs were slow to come off the market and the brunt of the drilling and exploration capital cuts were felt during the remaining quarters of fiscal 2009. The reduction in the drilling activity subsequent to the first quarter of fiscal 2009 significantly impacted the Company’s revenues. The diversity in Commercial’s revenue base generally lessens the impact of the seasonal activity in the energy sector; however, due to the general economic downturn, the activity in the remaining primary markets continues to be weak. However, there is an improvement from the last few quarters and revenue in the current period has increased by 5.0% in comparison to the last quarter in fiscal 2009.

Earnings before Interest, Tax, Depreciation and Amortization (“EBITDA”)

EBITDA in the current period was lower than the same period in the prior year primarily due to lower revenues partially offset by lower operating expenses. Decrease in operating expenses of 31.0% from the prior year is the result of the significant cost cutting measures taken by management throughout fiscal 2009. The Company continues to review its operating expenses to minimize operating losses and to return the Company to a profitable position. As a result, further employee reductions were implemented in the current period. Related severance costs were accrued in the current period.

Gross margins were consistent with the prior year. The margins in the current period continue to reflect pricing pressures with competitors but the reduction is partially offset by sales of higher margin offshore products.

Negative EBITDA has improved over the last two quarters with EBITDA loss in the current quarter being 63.8% less than the last quarter of fiscal 2009 and 75.3% less than the third quarter of fiscal 2009. This is the result of slightly improved revenues and significantly lower operating expenses.

Major components of the EBITDA variance from the same period in the prior year are as follows:

Q1 2009 EBITDA	\$	905,294
Lower gross profit as a result of lower sales		(4,083,700)
Lower operating costs		2,871,806
Higher restructuring costs		(65,045)
Q1 2010 EBITDA	\$	(371,645)

Interest Expense

Interest expense includes interest on bank indebtedness, long-term debt and notes payable, as well as amortization of transaction costs on long-term debt. Interest expense is higher in the current period primarily due to increased interest expense on the mezzanine loan and its related amortized transaction costs. This is offset by lower interest expense on the bank indebtedness, as the outstanding balance decreased by 35.0% in the current period. The significant decrease in bank indebtedness is due to the reduction in working capital investment and operating costs.

Income Taxes

The effective income tax rate for the current period is 31.85%, which is consistent with the prior year.

Net Loss

Commercial experienced a net loss in the current period in comparison to net earnings in the same period in the prior year. This is due to lower EBITDA and higher interest expense offset by lower income tax expense.

Trailing Twelve Months and Seasonal Nature of Business

The following table provides an opportunity for insight into the trailing twelve months results. The Company has experienced a decline in sales over the last twelve months primarily due to the decline in the oil and gas sector. Approximately 50.0% of the Company’s sales are related to the energy industry. Typically, the oil and gas industry slows down in April and May due to spring thaw, therefore, the Company incurs a seasonal decline in its third quarter.

Summary of Quarterly Data

	FISCAL 2009			FISCAL 2010	TOTAL
	Q2	Q3	Q4	Q1	
Revenue	\$ 29,333,030	\$ 20,749,108	\$ 20,152,690	\$ 21,251,236	\$ 91,486,064
Gross margin \$	7,693,549	5,715,399	6,289,072	5,875,121	25,573,141
Gross margin %	26.2%	27.5%	31.2%	27.6%	28.0%
Operating expenses	a 8,421,711	7,218,392	7,316,712	6,246,766	29,203,581
EBITDA	a (728,162)	(1,502,993)	(1,027,640)	(371,645)	(3,630,440)
NET LOSS	\$ (20,659,429)	\$ (1,619,260)	\$ (1,641,443)	\$ (843,876)	\$ (24,764,008)
Basic loss per share	\$ b (1.03)	\$ (0.08)	\$ (0.08)	\$ (0.04)	\$ c (1.23)
Diluted loss per share	\$ b (1.03)	\$ (0.08)	\$ (0.08)	\$ (0.04)	\$ c (1.23)

- a See page 8 for a further explanation of this non-GAAP measure.
- b If the \$19,548,494 impairment of goodwill were excluded from the fiscal 2009 Q2 results, the basic and diluted loss per share would have been (\$0.06).
- c If the Q2 2009 \$19,548,494 impairment of goodwill were excluded from the above results, the trailing twelve month basic and diluted loss per share would have been (\$0.26).

	FISCAL 2008			FISCAL 2009	TOTAL
	Q2	Q3	Q4	Q1	
Revenue	\$ 37,477,869	\$ 33,921,608	\$ 38,314,864	\$ 35,788,582	\$ 145,502,923
Gross margin \$	10,826,122	9,689,904	11,326,194	9,958,821	41,801,041
Gross margin %	28.9%	28.6%	29.6%	27.8%	28.7%
Operating Expenses	a 9,013,668	9,069,986	9,202,325	9,053,527	36,339,506
EBITDA	a 1,812,454	619,918	2,123,869	905,294	5,461,535
NET EARNINGS (LOSS)	\$ 611,497	\$ (15,071,350)	\$ 819,096	\$ 37,984	\$ (13,602,773)
Basic earnings (loss) per share	\$ 0.03	\$ b (0.75)	\$ 0.04	\$ 0.00	\$ c (0.68)
Diluted earnings (loss) per share	\$ 0.03	\$ b (0.75)	\$ 0.04	\$ 0.00	\$ c (0.68)

- a See page 8 for a further explanation of this non-GAAP measure.
- b If the \$15,000,000 impairment of goodwill were excluded from the fiscal 2008 Q3 results, the basic and diluted earnings per share would have been \$0.00.
- c If the \$15,000,000 impairment of goodwill were excluded from the fiscal 2008 Q3 results, the trailing twelve months basic and diluted earnings per share would have been \$0.07.

FINANCIAL POSITION, LIQUIDITY AND CAPITAL RESOURCES

Commercial continues to maintain its strong balance sheet by focusing on effectively managing its working capital and overall debt. The following table summarizes key consolidated financial position data:

	As at December 31st	2009	2008
Total current assets		\$ 37,861,011	\$ 52,037,521
Total current liabilities		21,658,136	36,624,065
NET INVESTMENT IN WORKING CAPITAL		\$ 16,202,875	\$ 15,413,456
TOTAL TANGIBLE ASSETS		\$ 43,100,319	\$ 58,941,034
Current bank indebtedness		10,423,512	18,738,057
Current portion long-term debt		76,304	1,950,894
Long-term debt		2,827,397	237,369
Notes payable		1,195,039	598,495
TOTAL DEBT		\$ 14,522,252	\$ 21,524,815
Working capital ratio		1.75	1.42
Days sales in receivables		54.9	55.0
Inventory turns		2.5	3.5
Days purchases in payables		53.5	50.9

The Company's primary capital needs are for the purchase of inventory, and the funding of accounts receivable, debt service payments and capital expenditures. As working capital levels may vary primarily due to seasonal fluctuations and timing of payments and receipts, the Company utilizes its operating credit facility which assists with the timing of cash flows as required.

On December 9, 2009, the Company secured a Restated Credit Facility with the Canadian Imperial Bank of Commerce (the "Lender") which provides \$15,000,000 operating line of credit for monthly renewal up to October 31, 2010. The new facility rolled in the previous operating line of credit of \$12,457,348 and the acquisition line of \$770,002 for a total of \$13,227,350 on closing date.

The Company also closed on a two-year term mezzanine debt agreement for \$3,000,000 during the current period, on October 8, 2009. This loan injection was a condition precedent to the Restated Credit Facility agreement. Proceeds from the mezzanine loan were used to partially pay down the previous operating line with the Lender and supplement working capital requirements.

Both working capital ratio and working capital investment have improved primarily due to the addition of long-term mezzanine debt as detailed above. Normalized for this change, working capital ratio is 1.54 and net working capital investment is \$13,202,875. Although working capital ratio increased, the net investment in working capital has decreased compared to the same period in the prior year due to the less than proportionate decrease in bank indebtedness in comparison to decreases in accounts receivable and inventory.

Management continues to monitor and implement strict controls over the Company's investment in working capital. The Company is committed to aggressive ongoing inventory management efforts that work towards the goal of minimizing inventory balances while still meeting the customer's needs. This includes centralized inventory purchasing, opportunity-based distribution to branches and an asset recovery program where inventory with lower than average turnover is put through a different marketing plan to increase success of sale. Management monitors credit risk on accounts receivable by operating under a sound credit-granting process and maintaining appropriate credit administration, measurement and monitoring process.

As at December 31, 2009, the Company was operating within its bank covenants with the Lender. These covenants are monitored and reported on a monthly basis. Covenants include: (i) margin requirements between loans and certain receivables and inventory balances, (ii) minimum working capital ratio of 1.35, and (iii) minimum trailing twelve month adjusted negative EBITDA as follows: a) at closing date, \$4,000,000; b) at March 31, 2010, \$2,000,000; c) at June 30, 2010, \$1,000,000; and, d) at September 30, 2010 and thereafter, \$NIL. The Company continues to work towards complying with these covenants over the term of the agreement. However, as a result of uncertain and weak economic conditions, the Company cannot be certain of achieving the covenants.

The Company continues periodic discussions regarding an asset based loan (“ABL”) as it believes that ABL’s are well suited for the Company’s financing needs and allows the Company to take advantage of its strong balance sheet. Management intends to complete the assessment and switch to an ABL facility before the end of the current fiscal year. With the current secured position with the Lender and the possibility of changing to an ABL loan, management believes that the Company has sufficient capital resources to meet its growth and operating requirements in the short term.

Summary of Cash Flows

The following table highlights the Company’s cash flows during the period:

	For the three months ended December 31st	
	2009	2008
Total cash from operations	\$ 3,704,383	\$ 339,576
Total cash from financing	\$ (3,626,391)	\$ 43,225
Total cash from investing	\$ (77,992)	\$ (382,801)
Free cash flow *	\$ 3,626,391	\$ (43,225)

* Free cash flow is a non-GAAP measure and is defined as cash provided by (used in) operating activities less net capital expenditures.

The Company generated \$3,704,383 cash flow from operating activities in the current period partially due to its continued effort in the reduction of inventory in the current year. Timing of accounts payable offset by accounts receivable further contributed to cash inflows in the current period.

Management anticipates generating positive free cash flows from operations over the current fiscal year from disciplined working capital management and reduced capital expenditures. The free cash flow is expected to be used to continue reducing bank indebtedness over the current year.

The Company utilized \$3,626,391 in financing activities in the current period. Positive cash flows from operating activities was used to reduce the operating line of credit.

Cash flow used for investment activity was at \$77,992 in the current period as investment in property and equipment primarily centered on improvements in the management information systems. Capital expenditures are expected to continue at low levels in comparison to prior years with the objective of maximizing free cash flow.

Share Capital

Commercial has authorized an unlimited number of common shares and an unlimited number of preferred shares with no par value. As at December 31, 2009 the Company had 20,100,806 common shares outstanding. The Board of Directors may grant options to purchase up to 1,608,064 common shares. As at December 31, 2009, options to purchase 1,001,000 common shares were outstanding at an average exercise price of \$1.58 per common share. Subsequent to December 31, 2009, a total of 529,000 options were issued to key employees of the Company.

During the current period, the Company issued warrants as part of the agreement on the mezzanine loan. As at December 31, 2009, number of warrants outstanding was 1,200,000. Each whole warrant entitles the holder to purchase one Common Share of the Company at a price of \$0.31 per share for a period of three years. The warrants were treated as transaction costs of the debt and were recorded as part of contributed surplus. The fair value of the warrants are calculated as \$197,375 at inception using the Black Sholes pricing model.

Measures Not In Accordance With Generally Accepted Accounting Principles (“GAAP”)

The following measures included in this report do not have a standardized meaning under Canadian GAAP and, therefore, are unlikely to be comparable to similar measures presented by other companies. There have been no changes in the composition of these non-GAAP financial measures when compared to previously disclosed measures. EBITDA is not a concept recognized by Canadian GAAP, however is recognized in industry as an indirect measure for operating cash flow, a significant indicator of the success of any business. The following is a reconciliation of EBITDA to net earnings for the periods presented in this MD&A:

For the three months ended December 31st	2009	2008
Net (loss) earnings and comprehensive (loss) income	\$ (843,876)	\$ 37,984
Add:		
Income tax (recovery) expense	(394,388)	17,752
Depreciation and amortization	524,107	561,703
Interest expense and refinancing costs	342,512	287,855
EBITDA	\$ (371,645)	\$ 905,294

Operating expenses as presented on page 3 is not a concept recognized by GAAP as it does not include amortization expense and similar type expenses related to operations. The following is a reconciliation of operating expenses as presented in this MD&A to total expenses as presented in the December 31, 2009 consolidated financial statements:

For the three months ended December 31st	2009	2008
Operating expenses	\$ 6,246,766	\$ 9,053,527
Add:		
Depreciation and amortization	524,107	561,703
Interest expense and refinancing costs	342,512	287,855
TOTAL EXPENSES	\$ 7,113,385	\$ 9,903,085

Outlook

The Company continues to be cautious in the near to medium term as there continues to be uncertainty on the impact of the global financial crisis. Recent rig activity in western Canada continues to remain down 30% compared to last year, and per the Canadian Association of Oilwell Drilling Contractors, outlook for the remaining quarters in the year is for activity to remain below typical levels for this time of the year. The Company has difficulty anticipating future revenues in its remaining sectors as market weakness is expected to continue for several more quarters.

Fiscal 2009 was a year where the Company focused on restructuring operations to adjust the Company's cost structure. The benefits of aggressive cost-cutting measures taken will continue to be realized over the current fiscal year. Management continues to monitor and control operating costs in the current year.

Fiscal 2010 is a year where management is focused on increasing top-line results. The Company recently implemented industry leading, innovative sales and marketing programs to improve revenue. The programs target increased communication with its customers, focusing on the Company's ability to provide a "one-stop-shop" benefit to customers through its unparalleled breadth of product offerings. Additionally, the Company is emphasizing its expertise on material management which will allow customers to rely on Commercial to manage their inventory while they focus on their core competencies.

The Company's primary objectives with the above initiatives are the protection and improvement of the Company's EBITDA and cash position. While continually monitoring revenue expectations along with tighter cost controls in place, and a continued strong balance sheet, management expects that Commercial's EBITDA and cash position will continue to improve in fiscal 2010.

Commercial's mission and growth strategy is to build sustaining value for its shareholders through the disciplined management of its operations and a commitment to growing its business in a capital efficient manner. Over the years, Commercial has grown successfully into one of the largest industrial and oilfield parts distributors in Western Canada. Commercial intends to continue with the growth model through organic growth and selective acquisitions as well as work on its program of diversifying its customer base with key industry sectors.

Risk Factors

In the normal course of business, the Company's operations continue to be influenced by a number of internal and external factors, and the Company is exposed to risks and uncertainties that can affect its business, financial condition and operating results. All businesses are subject to risks and the Board and management of the Company take prudent measures to mitigate any risks by which the Company may be affected.

There have been no significant changes to existing risk factors or new key risks identified from the key risks disclosed in the Company's Annual Information Form and Management Discussion and Analysis for the year ended September 30, 2009.

Debt repayment schedule has been updated from September 30, 2009 to include mezzanine loan as follows:

	2010	2011	2012
Bank indebtedness	\$ 10,423,512	\$ -	\$ -
Accounts payable	11,138,320	-	-
Long-term debt (net of transaction costs)	76,304	69,030	2,758,367
Notes payable (estimated timing of payments)	-	1,195,039	-
TOTAL	\$ 21,638,136	\$ 1,264,069	\$ 2,758,367

Critical Accounting Estimates

In preparing the Company's consolidated financial statements in conformity with Canadian GAAP, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the period. The most significant estimates included in these financial statements are the valuations of accounts receivable, the valuation of inventory, the recognition of the appropriate amount of future tax assets, the assumptions included in the calculation to determine the carrying value of goodwill, the inputs into the Black - Scholes option pricing model for stock-based compensation and fair value of warrants, the valuation of intangibles and the carrying value of accrued liabilities. Actual results could differ from these estimates.

Future Accounting Pronouncements

In February 2008, the Accounting Standards Board of Canada (AcSB) confirmed that the use of International Financial Reporting Standards (IFRS) will be required for publicly accountable enterprises for fiscal years beginning on or after January 1, 2011. The Company anticipates implementation of this standard in its first quarter of the fiscal year 2012 and is currently evaluating the impact of their adoption on its consolidated financial statements.

The Company has completed an initial review of IFRS and has made a preliminary classification of the IFRS into those that could have a significant, moderate or no impact on the Company's financial reporting. The Company is currently developing its IFRS conversion plan which will include a deeper analysis of the IFRS standards, with priority being placed on those that have been identified as possibly having a significant impact. The analysis of each IFRS standard will include identifying the differences between IFRS and the Company's accounting policies, assessing the impact of the difference, and where necessary, analyzing the various policies that the Company could elect to adopt.

The Company has established a timeline in which certain milestones of the process in the adoption of IFRS are to be accomplished. The Company is closely monitoring regulatory developments made by the Canadian Securities Administrator that may affect the timing or nature of disclosure of its adoption of IFRS. The Company is also monitoring developments in accounting made by the AcSB and the International Accounting Standards Board (IASB) to ensure that on adoption of IFRS, the Company is fully compliant with IFRS as issued by the IASB.

Related Party Transactions

During the current period, the Company entered into the following related party transactions:

- a) Legal fees of \$68,733 (2008 - \$89,233) were paid to a law firm for corporate matters of which a director, Mr. William Rosser, is a partner. Of this amount, \$15,609 (2008 - \$66,129) is included in accounts payable.
- b) Management consulting fees of \$37,563 (2008 - \$43,750) were paid to a company, 371070 Alberta Ltd., over which an officer and director, Mr. Jim Barker, has significant influence.
- c) Management consulting fees of \$Nil (2008 - \$15,000) were paid to a company, Western America Venture Management Inc., over which a former director, Mr. Don Caron, had significant influence.
- d) The Company paid directors' fees and expenses of \$25,213 (2008 - \$15,040) to its four (2008 - four) independent directors, namely: Dr. Ken Harrison, Mr. Daryl Kruper, Mr. Alan Martin, and Mr. Richard Smith.

In management's opinion, these transactions are all in the normal course of operations and are recorded at the exchange value, which was the amount of consideration established and agreed to by the related parties.

Disclosure Controls and Procedures, and Internal Control Over Financial Reporting

The Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") are responsible for designing disclosure controls and procedures to ensure that material information is being made known to the appropriate individuals. In addition, the CEO and CFO are responsible to design internal controls over financial reporting or cause 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 GAAP.

Disclosure Controls and Procedures ("DC&P")

An evaluation of the effectiveness of the Company's DC&P was conducted as of December 31, 2009, by and under the supervision of the Company's management, including the CEO and CFO. Based on this evaluation, the CEO and CFO have concluded that the DC&P were effective as at December 31, 2009.

Internal Controls over Financial Reporting ("ICFR")

The Company's management, including the CEO and the CFO, has evaluated the design of the Company's ICFR using the framework and criteria established in the Internal Control – Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management has concluded that the Company's ICFR as of December 31, 2009 were effective.

Management has concluded that the consolidated financial statements fairly represent the Company's consolidated financial position and consolidated results of operations as of and for the three ended December 31, 2009.

Forward Looking Statement

This Management Discussion and Analysis contains forward looking statements relating to such matters as expected financial performance, business prospects, and development activities and like matters. These statements involve risks and uncertainties, including but not limited to, the risk factors described elsewhere. Actual results could differ materially from those projected as a result of these risks and should not be relied upon as a prediction of future events. Commercial undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events, with an exception of securities laws requirements.



Corporate Information

Officers and Directors

Jim Barker
President, Chairman and Director
Edmonton, Alberta

Dr. Ken Harrison
Director
Edmonton, Alberta

Rozina Kassam, CA
Chief Financial Officer
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Daryl Kruper
Director
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Alan Martin, CA CBV
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Bill Rosser
Corporate Secretary and Director
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Shares Listed

Toronto Stock Exchange
Trading Symbol – “CSA”

Transfer Agent

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Share Capital

Issued: 20,100,806 common shares

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BEARINGS & P.T.



SAFETY



FIREFIGHTING



FIELD



INDUSTRIAL



ENERGY SERVICES

ISO 9001:2008 Registered Organization

Commercial Solutions Inc. is a fully integrated supplier of Maintenance, Repair and Operation products and expert solutions to Canadian industry. For full details about our operating divisions and areas of expertise, please visit our website.