

High Arctic Energy Services Inc.

(formerly High Arctic Energy Services Trust)

Consolidated Balance Sheets

As at September 30, 2007 and December 31, 2006

(\$ Million Unaudited)

| | September 30, 2007 \$ | December 31, 2006 \$ |
|---|-----------------------------|----------------------------|
| Assets | | |
| Current assets | | |
| Cash and cash equivalents | 4.0 | 3.1 |
| Accounts receivable (note 10) | 28.6 | 38.4 |
| Work-in-progress (note 2) | 1.4 | - |
| Deferred financing costs (note 2) | 0.6 | - |
| Inventory | 1.6 | 2.3 |
| Prepaid expenses | 1.6 | 0.8 |
| Assets held for sale (note 5) | 9.1 | - |
| | <hr/> | <hr/> |
| | 46.9 | 44.6 |
| Investment (note 3) | - | 3.0 |
| Property and equipment (note 4) | 171.9 | 123.9 |
| Rigs and equipment under construction (note 5) | 8.6 | 61.9 |
| Due from Transeuro Energy Corp. (note 10) | 17.8 | - |
| Future taxes (note 13) | 7.9 | - |
| | <hr/> | <hr/> |
| | 253.1 | 233.4 |
| Liabilities | | |
| Current liabilities | | |
| Accounts payable and accrued liabilities | 22.9 | 35.1 |
| Income taxes payable | 1.6 | - |
| Prepaid mobilization revenue (note 2) | 3.3 | - |
| Current portion of credit facility (note 6) | 51.2 | 10.9 |
| Distributions payable | - | 3.3 |
| Due to related parties (note 9) | 4.2 | 0.4 |
| | <hr/> | <hr/> |
| | 83.2 | 49.7 |
| Credit Facility (note 6) | 71.6 | 107.7 |
| | <hr/> | <hr/> |
| | 154.8 | 157.4 |
| Shareholders' equity | | |
| Share capital (note 7) | 126.4 | 89.2 |
| Contributed surplus (note 8) | 1.5 | 0.7 |
| Warrants (note 7) | 0.8 | - |
| Retained earnings (deficit) | (30.4) | (13.9) |
| | <hr/> | <hr/> |
| | 98.3 | 76.0 |
| | <hr/> | <hr/> |
| | 253.1 | 233.4 |
| Basis of presentation (note 1) | | |
| Commitments and contingencies (note 10) | | |

See accompanying notes

Approved on behalf of the Corporation by:

(signed) "Jed Wood" Director

(signed) "Christopher Warren" Director

High Arctic Energy Services Inc.

(formerly High Arctic Energy Services Trust)

Consolidated Statements of Net Earnings (Loss), Comprehensive Income (Loss) and Retained Earnings (Deficit)

(\$ Million except per unit amounts - Unaudited)

| | Three months ended | | Nine months ended | |
|--|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
| | September 30, 2007 \$ | September 30, 2006 \$ | September 30, 2007 \$ | September 30, 2006 \$ |
| Revenue (note 12) | 29.0 | 27.8 | 90.8 | 86.2 |
| Expenses | | | | |
| Oilfield services | 20.5 | 15.1 | 65.6 | 49.1 |
| General and administration | 4.3 | 3.4 | 17.9 | 11.7 |
| Amortization | 6.0 | 2.9 | 16.5 | 11.3 |
| Foreign exchange (gain) loss | 1.1 | (0.2) | 1.8 | (0.6) |
| | 31.9 | 21.2 | 101.8 | 71.5 |
| Operating earnings (loss) | (2.9) | 6.6 | (11.0) | 14.7 |
| Interest (note 5) | 2.3 | 0.5 | 4.7 | 1.1 |
| Gain on sale of property, equipment and investments | - | - | (2.9) | - |
| Impairment on assets held for sale (note 5) | 7.5 | - | 7.5 | - |
| Net earnings (loss) before income taxes | (12.7) | 6.1 | (20.3) | 13.6 |
| Income taxes (recovery) (note 13) | 0.7 | 0.2 | (5.9) | 0.7 |
| Net earnings (loss) and comprehensive income (loss) | (13.4) | 5.9 | (14.4) | 12.9 |
| Retained earnings (Deficit) – beginning of period | (17.0) | (11.5) | (13.9) | (6.0) |
| Distributions as a Trust | - | (6.1) | (2.1) | (18.6) |
| Retained earnings (Deficit)– end of period | (30.4) | (11.7) | (30.4) | (11.7) |
| Earnings (loss) per share - basic and diluted | \$ (0.31) | \$ 0.23 | \$ (0.39) | \$ 0.50 |

Basis of presentation (note 1)

See accompanying notes

High Arctic Energy Services Inc.

(formerly High Arctic Energy Services Trust)

Consolidated Statements of Cash Flows

(\$ Million - Unaudited)

| | Three months ended | | Nine months ended | |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 30, 2007 | September 30, 2006 | September 30, 2007 | September 30, 2006 |
| | \$ | \$ | \$ | \$ |
| Cash provided by (used in): | | | | |
| Operating activities | | | | |
| Net earnings (loss) and comprehensive income (loss) | (13.4) | 5.9 | (14.4) | 12.9 |
| Add non-cash items: | | | | |
| Amortization | 6.0 | 2.9 | 16.5 | 11.3 |
| Share-based compensation | 0.1 | 0.2 | 0.8 | 0.3 |
| Future taxes (recovery) | (0.9) | - | (7.9) | - |
| Gain on sale of property and equipment and investments | - | - | (2.9) | - |
| Impairment on assets held for sale | 7.5 | - | 7.5 | - |
| | (0.7) | 9.0 | (0.4) | 24.5 |
| Change in non-cash working capital balances | (21.4) | (6.6) | (23.4) | 0.3 |
| | (22.1) | 2.4 | (23.8) | 24.8 |
| Investing activities | | | | |
| Property and equipment and rigs and equipment under construction | (8.4) | (40.0) | (30.3) | (86.9) |
| Property and equipment held for sale | 9.1 | - | 9.1 | - |
| Proceeds on sale of property and equipment and investments | 1.1 | - | 8.4 | - |
| Change in non-cash working capital balances | 5.1 | 0.3 | (3.1) | 1.1 |
| | 6.9 | (39.7) | (15.9) | (85.8) |
| Financing activities | | | | |
| Advances from (to) related parties | 1.5 | 1.3 | 3.8 | 1.3 |
| Change in current portion of credit facility | 28.0 | (39.1) | 40.3 | (3.2) |
| Change in long-term portion of credit facility | (14.4) | 80.3 | (36.1) | 80.3 |
| Issuance of shares, net of costs | - | 0.9 | 38.0 | 0.9 |
| Distributions as a Trust | - | (6.1) | (2.1) | (18.6) |
| Change in non-cash working capital balances | - | 0.1 | (3.3) | 0.2 |
| | 15.1 | 37.4 | 40.6 | 60.9 |
| Net increase (decrease) in cash and cash equivalents | (0.1) | 0.1 | 0.9 | (0.1) |
| Cash and cash equivalents – beginning of period | 4.1 | 1.0 | 3.1 | 1.2 |
| Cash and cash equivalents – end of period | 4.0 | 1.1 | 4.0 | 1.1 |
| Supplemental information | | | | |
| Cash paid for: | | | | |
| Interest | 2.5 | 1.4 | 6.4 | 2.5 |
| Income taxes | - | 0.2 | 0.3 | 0.7 |

Basis of presentation (note 1)

See accompanying notes

High Arctic Energy Services Inc.

(formerly High Arctic Energy Services Trust)

Notes to Consolidated Financial Statements

September 30, 2007

(tabular amounts in millions of dollars, except per unit amounts - Unaudited)

1 Basis of presentation

High Arctic Energy Services Inc. (the "Corporation") is incorporated under the laws of Alberta, Canada and commenced operations on June 29, 2007 as a consequence of reorganization through a Plan of Arrangement approved by the security holders of the High Arctic Energy Services Trust (the "Trust"). The reorganization resulted in the Corporation acquiring the business of the Trust through the exchange of each outstanding Trust Unit or Exchangeable Share of the Trust on a one-for-one basis, after accounting for the conversion factor applicable to certain Exchangeable Shares, for common shares of the Corporation (see note 7). For accounting purposes, the Corporation is considered a continuation of the Trust.

The Corporation's principal focus is to engage in the global oilfield services business by providing specialized drilling and production services, equipment, design and development and technical support and training to the Canadian and international oil and gas industry. The Corporation's Canadian operations are considered to have some seasonality with peak levels in the first and fourth quarters.

These unaudited consolidated interim financial statements are stated in Canadian dollars and have been prepared by management in accordance with Canadian Generally Accepted Accounting Principles ("GAAP") on a going concern basis. They follow the same accounting policies as the audited consolidated financial statements of the Trust for the year ended December 31, 2006, except as discussed below, and should be read in conjunction with these statements. The consolidated earnings and cash flows for the periods prior to June 29, 2007 are those of the Trust. The going concern basis presumes the realization of assets and discharge of liabilities in the normal course of business for the foreseeable future. The Corporation's ability to continue as a going concern is dependent upon achieving profitable operations and upon obtaining additional financing. The Corporation has obtained waivers from its banking covenants (see notes 6 and 10) as a result of not generating sufficient cash flows from operations. While the Corporation is focusing its best efforts on these matters (see note 15), the outcome cannot be predicted at this time. There is therefore a risk regarding the Corporation's ability to continue as a going concern. These financial statements do not include any adjustments to the amounts and classification of assets and liabilities that might be necessary should the Corporation be unable to continue in business and therefore be unable to realize its assets and discharge its liabilities in the normal course of business. Such adjustments could be material.

2 Accounting policies

The Corporation follows a policy of deferring start-up costs for new contracts as work-in-progress and amortizing these costs upon commencement of contract revenues. These costs are amortized over the lesser of the number of contract months or one year. Costs incurred to negotiate new or modify existing debt prior to its issuance are deferred and amortized over the term of the related debt provided the receipt of funding is probable. After the facility is operative such costs are deducted from the related debt and amortized using the effective interest rate method. Lastly, the Corporation defers prepaid mobilization revenues and recognizes them at the time the related services are performed.

On January 1, 2007, the Trust adopted the new CICA Handbook sections 3855 – Financial Instruments – Recognition and Measurement, 1530 – Comprehensive Income, and 3865 – Hedges. The financial instruments standard establishes the recognition and measurement criteria of financial assets, financial liabilities and derivatives. All financial instruments are required to be measured at fair value on initial recognition of the instrument, except for certain related party transactions. Measurement in subsequent periods depends on whether the financial instrument has been classified as held-for-trading, available-for-sale, held-to-maturity, loans and receivables, or other financial liabilities as defined by the standard.

Financial assets and financial liabilities held-for-trading are measured at fair value with changes in those fair values recognized in net earnings. Financial assets available-for-sale are measured at fair value, with changes in those fair values recognized in other comprehensive income. Financial assets held-to-maturity, loans and receivables and other financial liabilities are measured at amortized cost using the effective interest method of amortization. The methods used by the Corporation in determining the fair value of financial instruments are unchanged as a result of implementing the new standard. The financial instrument guidelines require that costs related to obtaining debt financing be expensed as incurred or deducted from the related debt and accreted over the term of the debt as interest expense using the effective interest rate method. The corporation has elected to deduct these expenses from the related debt to be incurred.

The Corporation has no financial instruments or activities that give rise to other comprehensive income. The Corporation's cash and cash equivalents are designated as held-for-trading and are measured at carrying value, which approximates fair values due to the short-term nature of these instruments. Accounts receivable are designated as loans and receivables and are measured at cost, which approximates fair value due to the short-term nature of these items. Accounts payable and accrued liabilities, distribution payable, due to related parties and credit facility are designated as other liabilities having a similar short-term nature and are measured at cost.

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3 Investment

| | September 30, 2007 | December 31, 2006 |
|----------------------|-----------------------|----------------------|
| | \$ | \$ |
| Investment – at cost | - | 3.0 |

In October 2005, the Trust exercised its option to acquire 10 per cent of the outstanding shares of Sense EDM AS (“Sense/EDM”) for total cash consideration of 16.5 Kroner, or approximately \$3.0 million Canadian. On April 3, 2007, the Trust sold its investment in Sense/EDM for proceeds of 26.5 million Norwegian Kroner or approximately \$5.0 million. The proceeds of the sale were forwarded to Sense/EDM by the purchaser and applied against amounts asserted by Sense/EDM to be owed to them by the Trust, pending resolution of a dispute (see note 10).

4 Property and equipment

| | September 30, 2007 | | |
|---|--------------------|-----------------------------|-------|
| | Cost | Accumulated amortization | Net |
| | \$ | \$ | \$ |
| Automotive | 1.3 | 0.7 | 0.6 |
| Computer hardware | 0.7 | 0.3 | 0.4 |
| Computer software | 0.7 | 0.4 | 0.3 |
| Equipment – field | 35.7 | 10.7 | 25.0 |
| Equipment – drilling rigs | 64.3 | 5.3 | 59.0 |
| Equipment – hydraulic workover rigs | 61.4 | 13.4 | 48.0 |
| Equipment – snubbing, air drilling and nitrogen | 58.4 | 23.1 | 35.3 |
| Equipment – office | 0.7 | 0.2 | 0.5 |
| Leasehold improvements | 4.0 | 1.2 | 2.8 |
| | 227.2 | 55.3 | 171.9 |
| | December 31, 2006 | | |
| | Cost | Accumulated amortization | Net |
| | \$ | \$ | \$ |
| Automotive | 0.7 | 0.6 | 0.1 |
| Computer hardware | 0.7 | 0.2 | 0.5 |
| Computer software | 0.4 | 0.3 | 0.1 |
| Equipment – field | 29.6 | 7.0 | 22.6 |
| Equipment – drilling rigs | 16.2 | 0.6 | 15.6 |
| Equipment – hydraulic workover rigs | 60.7 | 11.5 | 49.2 |
| Equipment – snubbing, air drilling and nitrogen | 52.1 | 19.4 | 32.7 |
| Equipment – office | 0.5 | 0.1 | 0.4 |
| Leasehold improvements | 3.2 | 0.5 | 2.7 |
| | 164.1 | 40.2 | 123.9 |

High Arctic Energy Services Inc.

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Notes to Consolidated Financial Statements

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(tabular amounts in millions of dollars, except per unit amounts - Unaudited)

5 Rigs and equipment under construction

| | 9 Months Ended September 30, 2007 \$ | Year ended December 31, 2006 \$ |
|--|--|--|
| Equipment – hydraulic workover and drilling rigs | | |
| Opening balance | 23.9 | 16.5 |
| Construction costs and capitalized interest added in the period | 7.2 | 44.0 |
| Units completed and transferred to property and equipment | (22.3) | (36.6) |
| Units completed and transferred to assets held for sale, net of impairment | (8.0) | - |
| | 0.8 | 23.9 |
| Equipment – snubbing, air drilling and nitrogen | | |
| Opening balance | 38.0 | 10.6 |
| Construction costs and capitalized interest added in the period | 12.3 | 40.0 |
| Units completed and transferred to property and equipment | (42.5) | (12.6) |
| | 7.8 | 38.0 |
| | 8.6 | 61.9 |

The Corporation capitalizes interest on the equipment loan relating to rigs and equipment under construction. During the three and nine months ended September 30, 2007 a total of \$0.2 million and \$1.7 million was capitalized to rigs and equipment under construction respectively (2006 - \$0.9 million and \$1.4 million respectively).

The Corporation has completed construction of a heliportable rig and related support equipment. Construction of this rig had been undertaken to support an anticipated contract with Transeuro Energy Corp. ("Transeuro") that will now not occur (see also note 10). The Corporation has undertaken steps to sell the rig and has included its estimated net realizable value of \$8.0 million in assets held for sale, resulting in impairment on assets held for sale of \$7.5 million.

6 Credit facility

The Corporation has a revolving credit facility with a syndicate of commercial lenders that was amended subsequent to the quarter ended September 30, 2007 (see Note 15). The facility is composed of a \$20-million operating line and a \$100-million equipment based revolving loan. Until October 22, 2007, amounts drawn bear interest at prime plus 0.5% to prime plus 1% depending on the level to which the facility is drawn. At September 30, 2007 the rate in effect was prime plus 1%. The operating line ("Facility A") may be drawn to a maximum of the lesser of \$20 million and 75% of Canadian accounts receivable aged less than 90 days (the "Facility A Borrowing Base"). The equipment loan ("Facility B") may be drawn to a maximum of the lesser of \$100 million and 75% of the appraised orderly liquidation value of eligible equipment (the "Facility B Borrowing Base"). In addition, the Corporation entered into a bridge facility credit agreement dated July 12, 2007 for a \$20 million multi-draw bridge loan facility (the "Bridge Loan") that bears interest at prime plus 6.25%, which Bridge Loan was subsequently drawn down in full by the Corporation. The obligations under the revolving credit facility and the Bridge Loan are secured by, among other things, the pledge of accounts receivable and the eligible equipment pursuant to debentures under which the Corporation and certain subsidiaries grant security over all of their respective assets.

At September 30, 2007, in addition to the \$20.0 million drawn on the Bridge Loan, a total of \$102.8 million of the revolving credit facility had been drawn (December 31, 2006 - \$118.6 million).

As a result of amendments to the revolving credit facility dated October 22, 2007, the revolving period of the credit facility has been extended to June 30, 2008 following which the outstanding principal will become repayable in 36 equal monthly payments as follows: to September 30, 2008 - \$8.6 million; to September 30, 2009 - \$34.3 million; to September 30, 2010 - \$34.2 million and to June 30, 2011 - \$25.7 million. The Bridge Loan matures on June 30, 2008.

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As at September 30, 2007, the Facility A Borrowing Base was \$5.8 million and the amount owed by the Corporation was approximately \$2.8 million, providing the Corporation with an excess of \$3.0 million. As at September 30, 2007, the Facility B Borrowing Base was \$92.0 million and the amount owed was \$100 million, resulting in a shortfall of approximately \$8.0 million caused by the transfer of equipment from Canada to the international operations. The Lenders have provided a waiver for the overdrawn amounts until October 31, 2007.

At September 30, 2007, the Corporation had a consolidated leverage ratio or "CLR" (generally defined in its credit facility agreement as consolidated total debt divided by the 12-month trailing adjusted consolidated earnings before interest, depreciation, amortization and taxes) of approximately 6.01 to 1.0. On March 9, 2007 the Trust and its lenders executed an amendment agreement effective December 31, 2006, that amended the maximum permitted CLR at December 31, 2006 and March 31, 2007 to 3.6 to 1.0 and for each quarter ended thereafter to 2.75 to 1.00. On April 30, 2007, the Trust executed with its lenders an agreement to waive the requirement that the proceeds of sale of the Sense/EDM shares be applied to amounts owing under its credit facility. This agreement also eliminated the requirement that amounts received from the issuance of equity and applied to reduce amounts owing under the credit facility would permanently reduce the amounts available to be drawn under the credit facility by an equivalent amount. In conjunction with their consent to the Plan of Arrangement, on June 28, 2007 the lenders agreed to waive compliance with financial covenants of the credit facility for the fiscal quarter ending June 30, 2007. The latest amendments (see note 15) to the credit facilities provide that the CLR test will now be applied monthly, instead of quarterly, and the maximum CLR will be 6.65 to 1.0 for the months ended September 30, 2007 to December 31, 2007 and 4.80 to 1.0 thereafter.

7 Share capital

Authorized

An unlimited number of common shares and an unlimited number of preferred shares may be issued.

Issued

| | September 30, 2007 | | December 31, 2006 | |
|--|-----------------------|--------------|----------------------|--------------|
| | Shares | Amount \$ | Shares | Amount \$ |
| Trust Units Converted to Common Shares | | | | |
| Opening balance | 9,936,405 | 36.8 | 9,769,706 | 35.2 |
| Issuance on private placement | 5,225,442 | 13.6 | - | - |
| Value attributed to warrants on private placement | - | (0.8) | - | - |
| Issuance on prospectus offering | 10,921,746 | 28.4 | - | - |
| Issued on exchange of Series A Exchangeable Shares | 3,500,000 | - | - | - |
| Units issued for DRIP plan and options | - | - | 164,699 | 1.6 |
| Unit issuance costs | - | (4.0) | - | - |
| Options exercised | - | - | 2,000 | - |
| Common Shares (2006 - Trust Units) Issued | 29,583,593 | 74.0 | 9,936,405 | 36.8 |
| Exchangeable Shares Converted to Common Shares | | | | |
| Opening balance | 16,190,808 | 52.4 | 15,745,453 | 52.4 |
| Exchanged – Series A Exchangeable Shares | (3,500,000) | - | - | - |
| Change in conversion ratio - Series B Exchangeable Shares | 167,924 | - | 445,355 | - |
| Common Shares (2006 - Exchangeable Shares) Issued | 12,858,732 | 52.4 | 16,190,808 | 52.4 |
| Common shares outstanding after Plan of Arrangement | 42,442,325 | 126.4 | 26,127,213 | 89.2 |

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Issuance of Trust Units

On March 28, 2007 the Trust issued 5,225,442 Trust Units and 1,306,361 Trust Unit purchase warrants (expiring September 2008) for aggregate consideration of \$13.6 million. On that date, the Trust also issued 2,500,000 Trust Units in exchange for 2,500,000 Exchangeable Shares. The Trust valued the warrants using the following assumptions in the Black-Scholes model: average risk-free interest rate of 4.2%; average expected life of 1.5 years; expected volatility of 40% and a weighted average estimate of distribution yield of nil.

On April 13, 2007 the Trust completed a prospectus offering of 10,921,746 Trust Units for aggregate consideration of \$28.4 million. Concurrent with the transaction the Trust issued 1,000,000 Trust Units in exchange for 1,000,000 Exchangeable Shares.

Plan of Arrangement

At the Annual and Special Meeting of Securityholders of the Trust held on June 28, 2007 unitholders, optionholders and holders of Exchangeable Shares approved the conversion of the Trust's business into a corporate structure under a Plan of Arrangement. The Plan of Arrangement was subsequently approved by the Alberta Court of Queen's Bench on June 29, 2007. Under the Plan of Arrangement, each outstanding Trust Unit or Exchangeable Share was exchanged, after accounting for the conversion factor applicable to certain exchangeable Shares, for one common share of the Corporation. Additionally, all outstanding options to acquire Trust Units, whether vested or not, were exchanged for options of the Corporation under substantially the same terms and conditions, including, without limitation, the same "in the money" amount, if any.

Per share amounts

The weighted average number of common shares outstanding for the three and nine months ended September 30, 2007 were 42,442,335 and 36,668,107 basic and fully diluted shares respectively (three and nine months ended September 30, 2006 – 25,791,591 and 25,670,297 basic and fully diluted shares respectively).

8 Share-based compensation plans

The Corporation has a Share Option Plan that provides incentive for directors, management and key employees that provides options to purchase shares. A total of approximately 4,244,233 (being 10% of all outstanding shares) are available for grants under the plan.

At September 30, 2007, a total of 4,142,750 shares are outstanding and expire at various dates up to 2012, at amounts that range from \$1.69 to \$13.87 per share. These options were all issued since July 21, 2005, have a term of 5 years and allow the holder to exercise their options over a three-year vesting period with 40% exercisable on the first anniversary date, 30% on the second anniversary date and 30% on the third anniversary date. The exercisable options have an average remaining contractual life of 4.25 years and 666,350 options may be exercised in 2007.

| | Number of Shares | Average Amount \$/share |
|---|---------------------|-------------------------------|
| Total Outstanding December 31, 2006 | 1,619,000 | 12.62 |
| Granted | 2,993,900 | 2.66 |
| Exercised | - | - |
| Forfeited | (470,150) | 8.44 |
| Total Outstanding September 30, 2007 | 4,142,750 | 4.78 |

The Corporation recognized share-based compensation expense and contributed surplus of \$0.8 million for the nine months ended September 30, 2007 (2006 - \$0.3 million) using the following assumptions in the Black-Scholes model: average risk-free interest rate of 4.2%; average expected life of 5 years; expected volatility of 40% and a weighted average estimate of distribution yield of nil (2006 – 8.65%).

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9 Related party transactions

In the normal course of business, during the three and nine months ended September 30, 2007 the Corporation incurred premises rent of \$0.3 million and \$0.8 million (\$0.3 million and \$0.7 million during the three and nine months ended September 30, 2006) and equipment and vehicle leases payments of \$0.2 million and \$0.7 million (\$0.2 million and \$0.6 million during the three and nine months ended September 30, 2006), to companies controlled by the CEO. Amounts due to or from the related parties on the leases are non-interest bearing, unsecured and repayable on demand.

These transactions are measured at exchange values based on rates charged to arms length customers which, in the opinion of management, approximate fair value.

In May 2007, a company controlled by the CEO advanced \$2.0 million to the Corporation to enable the acquisition of rental equipment that was put into service the following month by the Corporation. The parties have negotiated that the amount bears interest at 12%, is repayable by December 31, 2007 and the only security is the rental equipment.

The total balance owing to companies controlled by the CEO as at September 30, 2007 is \$4.2 million (2006 - \$0.4 million). See also note 15.

10 Commitments and contingencies

Rigs under construction

In July 2005, the Trust entered into a contract with Sense/EDM AS ("Sense/EDM"), a Norwegian rig manufacturer, to purchase sixteen rigs with an option to cancel the order for all but five of the rigs, subject to certain conditions. During 2006, the Trust determined that it only wished to take delivery of and complete ten of the contracted-for rigs for an estimated cost of approximately \$65.0 million, with deliveries forecast to take place in 2006 and 2007. As a result, the Trust cancelled the order for the remaining six rigs.

The Trust took delivery of and completed four rigs in 2006 and two rigs during 2007. In accordance with performance provisions in the contract and in light of the late deliveries and other performance issues of Sense/EDM, the Trust commenced negotiations to suspend the order for the remaining rigs.

On March 6, 2007, Sense/EDM asserted that the Corporation was still required to take delivery of at least five more rigs and that they were owed approximately \$20 million, including interest, for costs pertaining to the acquisition and completion of the first six rigs and for amounts owing for the next four rigs then under construction.

At December 31, 2006, the Trust had recorded net amounts payable to Sense/EDM of approximately \$8.0 million that the Trust believed represented the maximum amount it was exposed for under this contract. During the quarter ended March 31, 2007, the Trust paid \$3.0 million to Sense/EDM and negotiated the sale of its investment in Sense/EDM for a further 26.5 million Norwegian Kroner or approximately \$5.0 million. This sale closed on April 3, 2007 with the proceeds being forwarded to Sense/EDM by the purchaser and applied on account to amounts ultimately determined as being owed, pending resolution of the dispute.

An agreement to settle the dispute was reached in May, 2007, subject to finalization of a new rig purchase agreement the terms of which the parties have been unable to agree upon. It was agreed that the 6 rigs that the Trust had previously taken delivery of have been paid for in full and that the purchase price for the next four rigs would be a fixed price payable based upon construction progress. All other alleged commitments for additional rigs will be terminated in exchange for a cancellation fee on one further rig. Finalization of the settlement on the terms agreed to will result in the future acquisition of four rigs and a future obligation for the Corporation of approximately \$18-20 million. One possible method to settle the dispute, which both parties are pursuing, would be to sell the rigs to another party. The Corporation has not accrued any amount in its accounts for the possible liability.

Accounts receivable

On May 7, 2007 High Arctic Energy Services Limited Partnership (a subsidiary of the Corporation) filed a claim against Transeuro for approximately \$14.6 million plus interest and costs. The claim demands payment for services rendered by High Arctic Energy Services Limited Partnership to Transeuro in late 2006 and early 2007 in accordance with the contract entered into by the parties to provide drilling services at the Beaver River, British Columbia location of Transeuro. The claim was brought as Transeuro has refused repeated requests for payment of amounts due to High Arctic Energy Services Limited Partnership.

Subsequent to the filing of its claim, the Corporation received a copy of a claim filed by Transeuro in the Supreme Court of British Columbia against a Dubai subsidiary of the Trust, High Arctic Energy Services LLC ("High Arctic Dubai"), asserting certain entities owned by the Trust are in breach of various obligations. Among other things, the claim asserts that High

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Arctic Dubai has overcharged for the Beaver River services. There are further claims related to actions taken by High Arctic Dubai in Dubai in response to the failure of Transeuro to pay amounts owing for services rendered in Dubai, Armenia, Papua New Guinea and the Ukraine.

Transeuro sought a stay of the Alberta action commenced by High Arctic LP on the basis that the action should be consolidated into the British Columbia action. Transeuro amended its claim on September 17, 2007 to, among other things, add High Arctic LP as a defendant. On October 2, 2007, the stay of the Alberta action was granted. As a result High Arctic LP and High Arctic Dubai will dispute and defend the claim against them and bring a counterclaim as against Transeuro for the \$14.6 million related to the drilling services provided in Canada and for substantial amounts owing (approximately \$15.0 million) for monies advanced, goods delivered and services rendered in Dubai, Armenia, Ukraine and Papua New Guinea. No timetable has been set for the hearing of the claim by High Arctic Energy Services Limited Partnership or the claim by Transeuro.

The Corporation has not agreed to Transeuro's assertions and believes the Corporation's litigation position is strong. The Corporation has demanded payment of approximately \$30 million from Transeuro. Approximately one-half of this amount relates to international contracts and one-half to the Canadian Beaver River contract. The Corporation is pursuing collection of the entire amount owing plus any related costs and damages.

Nevertheless, due to a lack of certainty regarding collectability, risks inherent in the litigation process, fluctuations in foreign currency, and disputes regarding cancellation fees, invoices and contract terms the Corporation has provided for \$11.5 million in relation to the Transeuro amounts. The \$11.5 million consists of \$5.5 million in relation to revenue that is not recognized in these financial statements due to uncertainty of collection and an allowance for bad debt expense of \$6.0 million relating to the uncertainty over collection of the remaining receivable. These financial statements reflect a net receivable of approximately \$17.8 million which is less than the amount that the Corporation's management intends to ultimately collect.

Income taxes

The Corporation has been informed by a customer in Turkmenistan that there is a possible exposure to the Corporation of US \$1.9 million for taxes in that jurisdiction. Management believes that it has calculated and remitted all taxes properly due in Turkmenistan and the asserted tax exposure is without merit. Therefore, no amount has been accrued in these financial statements for this potential exposure.

Other

The Corporation is involved in two legal actions filed by two suppliers of services related to the drilling services provided to Transeuro. The claims total about \$1.7 million and the Corporation has fully accrued for that amount. As a result of recent settlement negotiations, the Corporation expects to settle both claims through an agreed upon payment plan.

A former employee of the Corporation has commenced a wrongful dismissal suit against the Corporation. A formal offer from the plaintiff to settle for \$500,000 was rejected by the Corporation. The Corporation has not made any provision in its financial statements regarding this claim.

The Corporation is involved in a legal action over services rendered to it. The Corporation is disputing the total invoiced amount of about \$170,000 on the basis that the Corporation did not receive the full benefit of the contracted services and the former employee who contracted the services had a conflict of interest. The Corporation believes it has adequately accrued for any amount that may be owed.

The Corporation has posted a performance bond (that has been guaranteed by Export Development Canada or "EDC") of approximately US\$3.5 million in respect of its contract in Kuwait and would be liable to EDC for this amount if EDC was required to honour the bond as a result of a default by the Corporation in the performance of its obligations under the contract.

Lease obligations

The Corporation has entered into long-term premises leases with a related party, described in note 9, that expire in 2009. The leases contain an option to renew for a further five years. Future minimum lease payments as at September 30, 2007 are:

| | |
|-----------------------|-------|
| | \$ |
| To September 30, 2008 | 1.1 |
| To September 30, 2009 | 1.0 |
| To September 30, 2010 | 0.1 |
| | <hr/> |
| | 2.2 |
| | <hr/> |

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11 Credit risk

During the three and nine months ended September 30, 2007, 59 % and 38 % of the Corporation's sales (15 % and 16 % during the three and nine months ended September 30, 2006) were to two customers (excluding Transeuro). At September 30, 2007, 28 % of the Corporation's accounts receivables (2006 – 5 %) were from these customers.

12 Segmented information

The Corporation operates one business of providing oilfield services to customers. This business has the following geographic characteristics:

| | Three months ended | | Nine months ended | |
|----------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 30, 2007 | September 30, 2006 | September 30, 2007 | September 30, 2006 |
| | \$ | \$ | \$ | \$ |
| Revenue | | | | |
| Canada | 11.8 | 21.4 | 52.1 | 70.7 |
| International | | | | |
| Papua New Guinea | 11.0 | 0.2 | 17.0 | 0.2 |
| United Arab Emirates | 0.7 | 4.4 | 5.2 | 7.7 |
| Saudi Arabia | - | - | 4.5 | 1.0 |
| Thailand | - | - | 3.8 | - |
| Kuwait/Qatar/Oman | 2.4 | - | 3.6 | - |
| India | 2.2 | - | 2.6 | - |
| Mexico | 0.9 | - | 0.9 | - |
| Turkmenistan | - | 1.7 | - | 6.0 |
| Other | - | 0.1 | 1.1 | 0.6 |
| Total International | 17.2 | 6.4 | 38.7 | 15.5 |
| | 29.0 | 27.8 | 90.8 | 86.2 |

| | September 30, 2007 | December 31, 2006 |
|---|-----------------------|----------------------|
| | \$ | \$ |
| Property and equipment and rigs and equipment under construction | | |
| Canada | 112.7 | 153.0 |
| United Arab Emirates | 61.1 | 32.8 |
| Papua New Guinea | 6.7 | - |
| | 180.5 | 185.8 |

13 Income taxes

The Corporation uses the liability method of tax allocation in accounting for income taxes. Under this method, future tax assets and liabilities are determined for the income tax consequences attributable to differences between amounts recorded in the financial statements and their respective tax bases, using substantially enacted tax rates. The effect of any change in income tax rates on future tax assets and liabilities is recognized in earnings in the period that the change occurs. The future tax asset of \$7.9 million pertains to the differences in tax bases for property and equipment and financing costs.

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Income tax (recovery) is comprised of:

| | Three months ended | | Nine months ended | |
|--------------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 30, 2007 | September 30, 2006 | September 30, 2007 | September 30, 2006 |
| | \$ | \$ | \$ | \$ |
| Current taxes (recovery) | 1.6 | 0.2 | 2.0 | 0.7 |
| Future taxes (recovery) | (0.9) | - | (7.9) | - |
| | <u>0.7</u> | <u>0.2</u> | <u>(5.9)</u> | <u>0.7</u> |

14 Supplementary information

The net change in the following non-cash working capital items increases (decreases) cash flows as follows:

| | Three Months Ended | | Nine Months Ended | |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 30, 2007 | September 30, 2006 | September 30, 2007 | September 30, 2006 |
| | \$ | \$ | \$ | \$ |
| Operations | | | | |
| Accounts receivable, work-in-progress and deferred financing costs | 11.0 | (1.6) | 7.8 | 3.7 |
| Inventory and prepaid expenses | 0.9 | - | (0.1) | (1.3) |
| Due from Transeuro Energy Corp. reclassified | (17.8) | - | (17.8) | - |
| Assets held for sale | (9.1) | - | (9.1) | - |
| Accounts payable and accrued liabilities, income taxes payable and prepaid mobilization revenue | (6.4) | (5.0) | (4.2) | (2.1) |
| | <u>(21.4)</u> | <u>(6.6)</u> | <u>(23.4)</u> | <u>0.3</u> |
| Investing | | | | |
| Accounts payable and accrued liabilities | <u>5.1</u> | <u>0.3</u> | <u>(3.1)</u> | <u>1.1</u> |
| Financing | | | | |
| Distributions as a trust | <u>-</u> | <u>0.1</u> | <u>(3.3)</u> | <u>0.2</u> |

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15 Subsequent events

Credit facility

On October 29, 2007 the Corporation announced that it had negotiated certain amendments to its existing credit facilities effective October 22, 2007. The amendments to the credit facilities require the Corporation to complete the subordinated convertible debenture of at least \$20,000,000 (the "Offering") by November 15, 2007, the details of which were disclosed by the Corporation in a separate press release on October 26, 2007 and are discussed below. The amendments also provide the consents required to complete the transactions contemplated to close the joint venture which are also disclosed by the Corporation in a separate press release disseminated on October 29, 2007 and discussed below.

The terms of the revolving credit facility and Bridge Loan are as discussed in note 6 as amended for the following:

- a) 90% of eligible foreign receivables insured by Export Development Canada may now be included in the Facility A borrowing base.
- b) The revolving term period has been extended to June 30, 2008 after which outstanding principal will become repayable over a 36-month period. The maturity date of the Bridge Loan has been extended to June 30, 2008.
- c) As at August 31, 2007, the Facility B Borrowing Base was \$92.0 million and the amount owed was \$100 million, resulting in a shortfall of approximately \$8.0 million caused by the transfer of equipment from Canada to the international operations. Under the amendments, the Lenders will permit a shortfall of up to \$9 million until February 10, 2008.
- d) The amendment of the revolving credit facility will allow the Corporation to draw up to an additional \$8.0 million under Facility A without the Facility A Borrowing Base limitation. The additional \$8.0 million will be available prior to closing the Offering only if certain conditions are satisfied and the availability after the closing of the Offering will be limited to meeting pre-established cash needs of the Corporation as agreed with the lenders.
- e) As part of the terms of the amendments, a corporation controlled by the chief executive officer of the Corporation has loaned the Corporation \$2.0 million at the same interest rate as applies to the increase in the Facility A and secured on a subordinate basis to the revolving credit facility and Bridge Loan.
- f) The amendment modifies the interest rate and certain other terms of the revolving credit facility including the application of the CLR test. The interest rate applicable to all prime loans after October 22, 2007 will be prime plus 2% for all revolving credit facility amounts drawn up to 2.75x consolidated earnings before interest, depreciation, amortization and taxes; prime plus 4% for the excess drawn over the 2.75x test; and prime plus 6.25% on the Bridge Loan. The amendments also provide that by February 10, 2008, the amounts owing on both Facility A and Facility B must be reduced so that the outstanding amounts meet the borrowing base limits of the facilities and the CLR does not exceed 4.8 to 1.0. The corporation anticipates that it will need to repay approximately \$25 million of debt by that date to avoid an event of default under those covenants.
- g) Commencing March 31, 2008, the Corporation must use 100% of free cash flow (which is generally defined as consolidated earnings before interest, depreciation, amortization and taxes less debt service requirements, maintenance capital expenditures and cash income taxes, all as determined by the lenders acting reasonably) to repay Facility A and Facility B amounts until the CLR has been reduced to 2.75 to 1.0 and thereafter to repay the Bridge Loan.
- h) The Corporation will pay an amendment fee of approximately \$1.1 million under the revolving credit facility. In addition, in consideration for amendments to the Bridge Loan, the Corporation has agreed to pay the lender of the Bridge Loan a fee of \$2.7 million payable by June 30, 2008 and to issue to the lender 500,000 warrants to purchase common shares of the Corporation. The exercise price under the warrants will be \$1.60 per common share and can be exercised at any time up to April 29, 2009. The cash fees will generally be payable out of future equity issues (but excluding the Offering) or other mandatory loan reductions, but no later than June 30, 2008 or upon the occurrence of an event of default.

Offering

On October 26, 2007 the Corporation announced that it had an agreement to sell to an investment dealer, on a bought deal, private placement basis, \$20.0 million aggregate principal amount of 12 percent unsecured convertible debentures due December 31, 2012 (the "Debentures") to qualified investors in the United Kingdom, Europe and Canada. On November 13, 2007 the Corporation announced it had closed the previously announced private placement, on a bought-deal basis, for a total of \$23-million total principal amount of 12 percent unsecured convertible debentures due Dec. 31,

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2012. The conversion price of the debentures is equal to \$1.62 per share (being the volume-weighted average trading price of the High Arctic common shares on Oct. 25, 2007), subject to the terms and conditions set out in the certificates representing the debentures. In addition, the corporation has granted the investment dealer an option entitling it to purchase an additional \$10-million of principal amount of the debentures for a period expiring 72 hours following the closing of the placing, as well as a greenshoe representing 15 per cent of the total principal amount of debentures sold, including pursuant to the investment dealer's option. The debentures and the underlying common shares of High Arctic shall be subject to a statutory four-month hold period expiring March 14, 2008.

The proceeds of the Offering will be used to finance a joint venture agreement (see below) and to provide additional working capital for the Corporation.

Joint Venture Agreement

On October 29, 2007 the Corporation announced that it had executed a joint venture agreement (the "Joint Venture") with the Schlumberger group ("Schlumberger") for the purpose of providing underbalanced drilling ("UBD") services and managed pressure drilling ("MPD") services to the worldwide upstream oil and gas industry. Initially, the Joint Venture will focus on providing UBD and MPD services for projects managed by Schlumberger Integrated Project Management ("IPM"). The Joint Venture will be known as Optimal Pressure Drilling Services.

The Joint Venture will be owned 51% by High Arctic and 49% by Schlumberger. As part of the initial formation of the Joint Venture, High Arctic will sell its existing UBD and MPD equipment (the "Equipment") and the technology associated with its existing UBD and MPD businesses, including intellectual property rights, to the Joint Venture for estimated proceeds of \$18.7 million. The Joint Venture start-up and ongoing capital needs will be proportionately funded by High Arctic and Schlumberger.

The JV Agreement also provides that the parties will enter into a put & call agreement that will allow the Corporation to sell its interest to Schlumberger or Schlumberger to purchase the interest of the Corporation based on a certain premium to the fair market value of the JV Entities at the time of exercise, as calculated under the put & call agreement. The put or the call can be exercised by the holder at any time after the first year from the date of closing and during the first year the call can be exercised by Schlumberger in the event of certain distress events or a change in control of the Corporation. The put & call agreement contains rules for determining the fair market value. Following the exercise of the put or the call, the Corporation will be prevented from conducting UBD and MPD activities and competing directly or indirectly with Schlumberger (and the JV Entities) for a period of three (3) years. However, this non-compete provision does not apply to UBD and MPD activities conducted by HAES within Canada, the United States of America, Western Europe and Papua New Guinea.

The closing date for the joint venture is expected to occur on or before November 15, 2007, once the JV entities have been incorporated and certain other requirements have been satisfied. The closing of the JV Agreement and the purchase and sale of the Equipment is subject to a number of customary conditions including mutual board approval, the acceptance of offers of employment by the requisite employees of the Corporation, absence of any material changes and the availability of funding. As part of closing, the Corporation will contribute US\$18.9 million on the closing date and commit to a further US\$14.3 million on February 1, 2008.

Restatement of previously issued financial statements

During the preparation of the consolidated financial statements for the period ended September 30, 2007, management detected errors in the previously issued quarterly financial statements for the first and second quarters of 2007. The company has been improving its internal control procedures regarding cut-off and completeness and the result is the errors noted below.

The restatement adjustments relate to activities in the first quarter of 2007, including the missed accrual of expenses that should have been accrued as liabilities and the overstatement of revenue as a result of the recording a sale of assets as revenue instead of a reduction of property and equipment. These two adjustments decrease previously reported net earnings by \$1.8 million in the first quarter and increase previously reported net earnings for the second quarter by \$1.2 million.

This restatement has affected the reported earnings for the quarters ended March 31, 2007 and June 30, 2007. Restated financial statements have been prepared for both periods. The adjustment to property and equipment relates to a sale of assets that was recorded as revenue and not a reduction of property and equipment. The assets had an original cost and a net book value of \$0.6 million. Proceeds of the sale were \$0.5 million.

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Accrued liabilities and expenses for the first quarter increased by \$1.2 million as a result of an incorrect accrual as at March 31, 2007. The amounts were correctly accrued by June 30, 2007.