

# High Arctic Energy Services Inc.

## Management Discussion and Analysis

### Three months ended March 31, 2011

The following is Management's Discussion and Analysis ("MD&A") of the financial condition and results of operations of High Arctic Energy Services Inc. (the "Corporation", "High Arctic" or "HAES") for the three months ended March 31, 2011 as compared to the same period in 2010. It also contains information on the Corporation's future outlook based upon currently available information. This MD&A should be read in conjunction with the unaudited interim consolidated financial statements and accompanying notes for the three months ended March 31, 2011 (the "Interim Financial Statements") and the audited financial statements for the year ended December 31, 2010 and annual MD&A of the audited financial statements. Readers should also read the "*Forward-Looking Statements*" contained at the end of this document.

The Interim Financial Statements and the MD&A are reported in Canadian dollars unless otherwise stated. The Interim Financial Statements of the Corporation have been prepared in accordance with IAS 34 Interim Financial Reporting and IFRS 1 *First Time Adoption of International Financial Reporting Standards* as issued by the International Accounting Standards Board ("IASB"). The Interim Financial Statements do not include all the information and disclosures required in the consolidated annual financial statements, and therefore this MD&A should be read in conjunction with the Corporation's consolidated annual financial statements as at December 31, 2010.

The MD&A is dated June 1, 2011.

## Corporate Profile

High Arctic Energy Services Inc. is incorporated under the laws of Alberta, Canada. High Arctic is a publicly traded company and listed on the Toronto Stock Exchange under the symbol "HWO". The head office of the Corporation is located at 8112 Edgar Industrial Drive, Red Deer, Alberta, Canada, T4P 3R2. High Arctic's principal focus is to provide contract drilling and work over services and other oilfield services to the oil and gas industry in Canada and Papua New Guinea.

The Canadian operation is focused on the provision of snubbing services and the supply of nitrogen to a large number of oil and natural gas exploration and production companies operating in Western Canada. The Corporation fleet of equipment in Canada at March 31, 2011 included 21 snubbing units, 10 nitrogen pumpers, 5 nitrogen transports and 3 rack and pinion underbalanced workover units. High Arctic is active in Papua New Guinea where it provides contract drilling and workover services.

## Outstanding Share Data

The Corporation's authorized share capital consists of an unlimited number of common shares and an unlimited number of preferred shares.

As at March 31, 2011 there were 251,918,722 issued and outstanding common shares. That number includes 36,500,000 shares issued under the Share Incentive Plan (*see Note 12 of the Interim Financial Statements*) some of which may be cancelled under certain circumstances related to a three year vesting period requirement. A total of 25,191,872 stock options (being 10% of all outstanding shares) are available for grant under the Stock Option Plan. As at March 31, 2011, a total of 5,546,500 stock options were outstanding (*see Note 13 of the Interim Financial Statements*) and expire at various dates up to 2016, at exercise prices ranging from \$0.13 to \$12.61 per share.

The Corporation's common shares trade on the Toronto Stock Exchange under the symbol HWO. The closing price of the shares on June 1, 2011 was \$0.35 per share. Based upon 252,183,147 issued common shares on that date, the Corporation has an approximate market capitalization of \$88.3 million.

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**Industry Indicators and Market Trends**

The following table provides quarterly information for the last eight quarters to assist with the understanding of the oilfield services industry and the effect that commodity prices have on industry activity levels. In addition, the Corporation's international financial results are impacted by fluctuations in the U.S. dollar to Canadian dollar exchange rate.

	2011	2010				2009		
Average for the period	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2
<b>Oil and natural gas prices</b>								
West Texas Intermediate (US \$ /bbl)	\$93.98	\$85.03	\$76.17	\$77.89	\$78.63	\$76.07	\$68.20	\$56.88
AECO (C\$ /Mcf)	\$3.77	\$3.58	\$3.72	\$3.86	\$5.36	\$4.28	\$3.02	\$3.66
<b>Other industry indicators</b>								
Well completions in Western Canada <sup>(1)</sup>	4,276	5,352	2,767	2,323	3,133	1,746	1,667	1,504
Gas well drilling in Western Canada <sup>(1)</sup>	1,660	2,132	1,124	1,122	1,490	578	661	894
Active drilling rigs in Western Canada <sup>(1)</sup>	534	399	323	154	431	273	176	92
Average drilling rig utilization rates <sup>(1)</sup>	68%	50%	41%	19%	54%	32%	21%	11%
US/Canadian dollar exchange rate	1.015	0.987	0.962	0.973	0.961	0.946	0.910	0.858

(1) Source: Canadian Association of Oilwell Drilling Contractors (CAODC)

Increases or decreases in the price of oil and natural gas can materially impact spending on drilling and well completion activities. High Arctic's business activity depends on the overall drilling and well completion activity in the industry and therefore on the level of spending by oil and gas companies. The Canadian oilfield services sector is cyclical and is significantly affected by the activity levels of exploration and production companies.

Oil prices increased in the first quarter of 2011 by 10% (\$8.95 US per barrel) to an average price of \$93.98 US per barrel as compared to the average price at the end of the fourth quarter of 2010 of \$85.03 US per barrel. Natural gas prices have continued to remain relatively weak. The AECO reference natural gas price averaged \$3.77 CAD per Mcf in the first quarter of 2011, up 5% (\$0.19 CAD per Mcf) as compared to the average price in the fourth quarter of 2010, but that is down almost 30% from the first quarter of 2010. Natural gas prices continue to remain a concern to the industry and should continue to have a negative impact on natural gas drilling activity in Western Canada.

The Canadian oilfield services sector is subject to seasonality with peak levels in the first and fourth quarters. The CAODC reported 4,276 wells were completed in Canada during the first quarter of 2011; an increase of 36% (1,143 wells) from the 3,133 wells completed in the same period in 2010.

High Arctic's Canadian business is primarily dependent on natural gas well drilling and completions. Gas well completions in the first quarter of 2011 totalled 1,660, which was an increase of 170 (11%) gas wells as compared to the same period in 2010 when 1,490 natural gas wells were completed. The Corporation experienced improved equipment utilization rates in the first quarter of 2011 partially due to the first call status with two major customers in Canada and through increased industry activity levels. The result was that High Arctic's Canadian revenue improved in the first quarter of 2011.

The Corporation has significant international operations in Papua New Guinea where it provides contract drilling services and workover services. The Corporation's international activity is based on longer term contracts and thus less affected in the short term by the volatility of oil and gas prices. These contracts are denominated in U.S. dollars. The continued strength of the Canadian dollar as compared to the U.S. dollar had a negative impact on the financial results in the first quarter of 2011.

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The Canadian dollar value rose approximately 3% during the first quarter of 2011 as compared to the U.S. dollar. A full 3% nominal change in the value of the Canadian dollar relative to the U.S. dollar would have resulted in approximately a \$0.3 million change in earnings.

## Selected Comparative Financial Information

The following is a summary of selected financial information of the Corporation. All figures are presented in accordance with the International Financial Reporting Standards ("IFRS"):

\$ millions (except per share amounts)	Three Months Ended March 31			Year ended December 31
	2011	2010	Change	2010
<b>Revenue</b>	35.9	34.6	1.3	119.3
<b>Net earnings for the period</b>	7.3	4.5	2.8	14.5
per share (basic)	\$0.03	\$0.10	(\$0.07)	\$0.09
per share (diluted)	\$0.03	\$0.08	(\$0.05)	\$0.09
<b>Cash flow provided by operating activities<sup>(1)</sup></b>	10.4	6.4	4.0	22.6
<b>Operating earnings from continuing operations</b>	9.2	8.1	1.1	24.6
<b>EBITDA<sup>(2)</sup></b>	10.5	10.0	0.5	33.3

(1) Cash flow provided by operating activities is defined as cash provided by continuing operating activities before the net change in non-cash operating assets and liabilities.

(2) EBITDA is a non-GAAP measure (see *Net Earnings to EBITDA*).

## Highlights for First Quarter of 2011

- EBITDA increased by \$0.5 million (5%) to \$10.5 million for the quarter ended March 31, 2011 as compared to EBITDA of \$10.0 million for the quarter ended March 31, 2010.
- Net earnings for the period were \$7.3 million (\$0.03 per share) for the first quarter of 2011, an increase of \$2.8 million over net earnings of \$4.5 million (\$0.10 per share) for the same period of 2010.
- Cash generated by operating activities from continuing operations during the first quarter of 2011 improved by \$4.0 million (62%) to \$10.4 million as compared to \$6.4 million generated in the first quarter of 2010.
- The Corporation's financial position continued to improve in the first quarter of 2011 as debt was reduced by \$12.8 million to \$23.7 million as at March 31, 2011. The positive working capital balances of \$27.4 million exceeded the debt by \$3.7 million as at March 31, 2011. As at December 31, 2011 the Corporation's debt was \$36.5 million and net debt was \$4.6 million. The debt to EBITDA ratio was 0.7 times as at March 31, 2011 compared to 1.1 times as at December 31, 2010.
- The Canadian business continued to show improvement as revenue increased \$2.9 million (23%) to \$15.6 million in the first quarter of 2011 as compare to revenue of \$12.7 million in the first quarter of 2010. Revenue from international operations was \$20.3 million during the quarter ended March 31, 2011, a decrease of \$1.6 million (7%) from the first quarter, 2010 revenue of \$21.9 million.

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**Overview of Results for the Three Months Ended March 31, 2011**

Oil and gas drilling activity in Canada continued to improve during the first quarter of 2011. While much of the increased activity was targeted at oil, there was also an increase of 11% in gas well completions during the first quarter of 2011 as compared to the same period of 2010. As a result of the increased activity, the prices that the Corporation could charge for its services in Canada improved somewhat and the Corporation's overall equipment utilization rates were at a healthy 77%. The Corporation's international activity is primarily in Papua New Guinea where services are provided under longer term contracts and are less affected in the short term by fluctuations of oil and gas prices. The Corporation's revenue decreased marginally in Papua New Guinea.

The Corporation generated \$35.9 million in revenue from continuing operations during the quarter ended March 31, 2011; an increase of \$1.3 million (4%) from revenue of \$34.6 million in the quarter ended March 31, 2010. Revenue from the Canadian operations was \$15.6 million during the first quarter of 2011 which was a \$2.9 million (23%) increase over 2010 first quarter revenue of \$12.7 million. Revenue from international operations decreased by \$1.6 million (7%) to \$20.3 million for the quarter ended March 31, 2011 as compared to revenue of \$21.9 million during the quarter ended March 31, 2010.

The Corporation recorded net earnings of \$7.3 million (\$0.03 per share) in the first quarter of 2011, as compared to net earnings of \$4.5 million (\$0.10 per share, basic) in the same period of 2010.

The cash and cash equivalents balance decreased \$4.9 million to \$19.4 million at March 31, 2011 as compared to \$24.3 million at December 31, 2010. The decrease was due to a \$12.8 million loan repayment. After consideration of working capital adjustments, cash provided by operating activities in the quarter ended March 31, 2011 was \$10.0 million, compared to cash provided by operating activities of \$6.5 million in the quarter ended March 31, 2010 (*see Cash Flow*). Net capital expenditures to acquire rigs, equipment and other operational assets were \$1.7 million for the first quarter of 2011 which included maintenance capital projects in Canada and new revenue generating assets for the Corporation's Papua New Guinea operations. This compares to capital spending of \$1.1 million in the first quarter of 2010 which was primarily for new revenue generating assets for the Papua New Guinea operations.

During the first quarter of 2011 management continued to focus on its core businesses in Canada and Papua New Guinea and also on reducing the Corporation's debt. The credit facility was reduced by \$12.8 million in the first quarter of 2011 to \$23.7 million at March 31, 2011 down from \$36.5 million at December 31, 2010. Management also worked on a new credit facility that was successfully completed after March 31, 2011 and resulted in a new term loan facility for the Corporation (*see Subsequent Events*).

**Net Earnings to EBITDA**

EBITDA is a non-GAAP measure calculated by looking at net earnings before the deduction of interest expense, taxes, share-based compensation, gain on sale of investment and amortization. The following table provides a quantitative reconciliation of net earnings to EBITDA for three months ended March 31, 2011 and 2010 and includes the impact of discontinued operations.

	IFRS	
	Three months ended March 31, 2011	Three months ended March 31, 2010
<b>Net earnings (loss)</b>	<b>7.3</b>	<b>4.5</b>
<b>Add (deduct)</b>		
Interest and financing fees	0.9	2.0
Taxes	1.0	1.5
Amortization	1.8	2.0
Share-based compensation	1.5	-
(Gain) on sale of investment	(2.0)	-
<b>EBITDA</b>	<b>10.5</b>	<b>10.0</b>

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**Operating Results for the Three Months Ended March 31, 2011 and 2010**

(Note: amounts below exclude amounts from discontinued operations and are presented in accordance with IFRS)

\$ millions	Three Months Ended March 31			Year ended December 31
	2011	2010	Change	2010
<b>Revenue</b>				
Canada	15.6	12.7	2.9	39.1
Papua New Guinea and other	20.3	21.9	(1.6)	80.2
<b>Total Revenue</b>	<b>35.9</b>	<b>34.6</b>	<b>1.3</b>	<b>119.3</b>
<b>Oilfield services expense</b>	<b>23.4</b>	<b>22.0</b>	<b>(1.4)</b>	<b>77.3</b>
% of Revenue	65.2%	63.6%		64.8%
<b>Oilfield services operating margin</b>	<b>12.5</b>	<b>12.6</b>	<b>(0.1)</b>	<b>42.0</b>
% of Revenue	34.8%	36.4%		35.2%
Equipment utilization in Canada	77%	65%	12%	54%
CAODC drilling utilization	68%	54%	12%	41%

**Operations in Canada**

In Canada, natural gas prices and, to a lesser extent, oil prices are the primary drivers of the Corporation's activity levels as the netbacks expected to be received by its customers heavily influence their drilling and completion plans. Oilfield activity continued to improve throughout 2010 and into the first quarter of 2011. A total of 4,276 wells were completed during the first quarter of 2011 in Western Canada which was an increase of 1,143 (36%) over the 3,133 wells completed in the first quarter of 2010. There continues to be a shift towards more oil well drilling and most of the increase in well completions during the year was due to the oil well drilling. The Corporation's activity in the Canadian market correlates to a greater degree to the number of natural gas wells drilled and the Corporation has equipment that is suited to the longer lateral multi-completion wells. There were 1,660 natural gas wells completed in the first quarter of 2011 (39% of total well completions) as compared to 1,490 natural gas wells completed in the first quarter of 2010 (48% of total well completions). However, the trend in gas well drilling has been to longer lateral multi-completion wells. The increase in overall industry activity levels has resulted in an increase in activity levels and revenue for the Corporation's Canadian operations. Canadian revenue increased by \$2.9 million (23%) to \$15.6 million during the first quarter of 2011, from \$12.7 million generated during the same period in 2010.

The Corporation's overall Canadian equipment utilization rate was 77% for the first quarter of 2011, compared to 54% for the same period of 2010. Equipment utilization is determined by dividing the number of twelve hour days a unit operates by the total number of days in the relevant period.

The Corporation's largest business line in Canada is snubbing services. Utilization rates for the snubbing units for the quarter ended March 31, 2011 was 51% as compared to the quarter ended March 31, 2010 utilization of 41%. The increase in utilization in snubbing services could have been higher, however the Corporation was affected by a shortage of experienced field personnel and the result was that the Corporation had to turn down some work. The largest increase in utilization came from the Corporation's nitrogen services product line. Nitrogen equipment utilization was 135% in the first quarter of 2011; an increase from the 90% utilization in the first quarter of 2010. The utilization rates above 100% was achieved as a result of units often working more than one 12 hour shift in a day.

The Corporation has three 250K UB hydraulic workover units. The increase in drilling activity of deep long reach horizontal wells had allowed the Corporation to activate one of the 250K UB hydraulic workover units in the third quarter of 2010 and it had a 27% utilization rate in the first quarter of 2011, doing work for a single customer. With the continued weak gas prices, it

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is uncertain if or how much the 250K UB rig will be contracted for the remainder of 2011. The Corporation will continue to market the 250K UB rig for the specialized applications involving the deeper shale gas wells.

### **International Operations**

The Corporation's activity in Papua New Guinea accounted for \$20.1 million in revenue for the quarter ended March 31, 2011 as compared to \$21.8 million for the quarter ended March 31, 2010. The decrease was mainly attributable to some pricing concessions in the new contracts for Rig 104 and the drilling support services.

Our main customer in Papua New Guinea owns three heli-portable rigs (Rig 101, 103 and 104) that are managed and operated by High Arctic under operating leases. The revenue includes amounts related to the recovery of lease related costs. The lease cost is included under oilfield services expense. In Papua New Guinea, High Arctic also owns a hydraulic workover rig (Rig 102) and drilling support equipment.

The Corporation has contracts for Rig 104 and the drilling support services that run until December 17, 2013, subject to certain early termination rights. Rig 104 was active for all of the first quarter of 2011 for the Corporation's main customer in Papua New Guinea.

Rig 103 operates under a long term contract signed in 2007 that will expire following the completion of a well during the second quarter of 2011. The rig was used to drill a well for a new customer in the first quarter of 2011 and was moved to another drilling location to drill one well for another customer during the second quarter. High Arctic is negotiating the terms of a new contract for Rig 103 that would include a provision to stack the rig until further drilling work is found.

Rig 101 has not been active since late 2008.

Rig 102, the Corporation's hydraulic workover rig, continued to undergo upgrades and modifications. It will begin a workover program for the Corporation's largest customer with the projected start date to be in early June, 2011.

The Corporation has continued to successfully market its fleet of rental equipment and is adding equipment to meet the market demand.

### **Oilfield Services Expenses and Oilfield Services Operating Margins**

Oilfield services expense includes both fixed and variable costs that, in total, do not increase or decrease by the same proportion as changes in revenue and activity levels. The Corporation maintains a scalable cost infrastructure wherever possible which naturally adjusts to changing activity.

Oilfield services expense as a percentage of revenue, on a consolidated basis, was 65.2% in the quarter ended March 31, 2011, compared to 63.6% in the same period of 2010. Oilfield services expense was \$23.4 million in the three months ended March 31, 2011; an increase of 6% as compared to the three months ended March 31, 2010 where oilfield services expense was \$22.0 million.

The increase in oilfield service expense was due to the the increased activity in the Canadian operations, during the first quarter of 2011 and compared to the first quarter of 2010. The reduction in operating margins can be attributed in part to the impact of the pricing concessions on the new contracts in Papua New Guinea and the change in the product mix in Canada and Papua New Guinea. Management continues to monitor oilfield service expenses and expects to see some wage pressures in the coming periods.

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**Selected Expense Information**

Selected expense information presented below is being reported on a continuing operation basis:

**General and Administrative**

\$ millions	Three Months Ended March 31			
	2011	2010	Change	%
<b>General and administrative</b>	2.0	2.3	0.3	13
<b>% of Revenue</b>	5.6%	6.6%	1.0%	-

General and administrative expenses in the three months ended March 31, 2011 were \$2.3 million; a decrease of \$0.3 million (13%) as compared to the same period of 2010. The decrease in costs was mainly attributable to lower overall personnel costs of \$0.1 million and lower insurance costs of \$0.1 million in the first quarter of 2011 as compared to the first quarter of 2010.

**Share-based Compensation**

\$ millions	Three Months Ended March 31			
	2011	2010	Change	%
<b>Share-based compensation</b>	1.5	-	(1.5)	-
<b>% of Revenue</b>	4.2%	-	4.2%	-

Share-based compensation expense of \$1.4 million for the quarter ended March 31, 2011 was recognized for the executive and director share incentive plan (*see Note 13 of the Interim Financial Statements*). \$0.1 million of share-based compensation expense for the stock option plan was recognized for the three months ended March 31, 2011 (2010 – nil) based on amortizing any expense over the vesting period using the Black-Scholes model.

**Amortization**

\$ millions	Three Months Ended March 31			
	2011	2010	Change	%
<b>Amortization</b>	1.8	2.0	0.2	10
<b>% of Revenue</b>	5.0%	5.8%	0.8%	-

Amortization for the three months ended March 31, 2011 was \$1.8 million, compared to \$2.0 million for the three months ended March 31, 2010 which reflects the slight reduction of the net book values of the Corporation's equipment.

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**Foreign Exchange (Gain) Loss**

\$ millions	Three Months Ended March 31			
	2011	2010	Change	%
<b>Foreign exchange loss</b>	-	0.2	0.2	-
<b>% of Revenue</b>	-	0.6%	0.6%	-

The Corporation has exposure to U.S. dollar revenues and expenses, primarily through its international operations, and to local currencies including the Kina in Papua New Guinea and to the current assets (cash and cash equivalents) and current liabilities held in U.S. dollars held in Canada. In the quarter ended March 31, 2011 the Corporation had offsetting foreign exchange gains and losses resulting in no consolidated foreign exchange amounts

**Interest and Finance Expense**

\$ millions	Three Months Ended March 31			
	2011	2010	Change	%
<b>Interest and finance expense</b>	0.9	2.0	1.1	55
<b>% of Revenue</b>	2.5%	5.8%	3.3%	-

The principal amount of the senior debt (credit facility) was \$23.7 million at March 31, 2011, compared to \$36.5 million at December 31, 2010 and \$50.7 million at March 31, 2010. The interest rate applicable to all loans under the senior debt is based on prime. The interest expense has decreased as the average outstanding principal amount has decreased.

As part of the restructuring transactions on April 30, 2010 (see Note 12 of the Interim Financial Statements) the entire principal amount and all accrued and unpaid interest owing under the convertible debentures was converted into common shares of the Corporation. Therefore, there was no interest expense relating to the convertible debentures in the first quarter of 2011 as compared to \$0.7 million in the first quarter of 2010.

The following table provides details of interest and finance expense for the three months ended March 31:

\$ millions	Three Months Ended March 31			
	2011	2010	Change	%
<b>Interest expense on senior debt</b>	0.9	1.0	0.1	10
<b>Interest expense on convertible debentures</b>	-	0.7	0.7	-
<b>Other interest expense</b>	-	0.2	0.2	-
<b>Financing costs</b>	-	0.1	0.1	-
<b>Total</b>	<b>0.9</b>	<b>2.0</b>	<b>1.1</b>	<b>55</b>

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***Gain on Sale of Investments***

\$ millions	Three Months Ended March 31			
	2011	2010	Change	%
<b>Gain on sale of investments</b>	2.0	-	2.0	-
<b>% of Revenue</b>	5.6%	-	5.6%	-

The Corporation recorded a gain of \$2.0 million in the quarter ended March 31, 2011 (2010 – nil) arising on the sale of 10,000,000 shares of Transeuro Energy Corp. (“Transeuro”). The shares were received as part of a settlement in 2009 of amounts owed to the Corporation by Transeuro. The shares had no carrying value as the debts had previously been deemed uncollectable and written off and the shares had an uncertain value when acquired. As a result, the full amount of the proceeds of sale of \$2.0 million was recognized in income.

***Income Taxes***

\$ millions	Three Months Ended March 31			
	2011	2010	Change	%
<b>Income taxes</b>	1.0	1.5	0.5	33
<b>% of Revenue</b>	2.8%	4.3%	1.5%	-

The income tax expense primarily relates to current taxes payable in Papua New Guinea. The Corporation is not currently taxable in Canada as the result of available tax pools. The Corporation uses the liability method of tax allocation in accounting for income taxes. Under this method, deferred tax assets and liabilities are determined for the income tax consequences attributable to the difference between amounts recorded in the financial statements and their respective tax bases, using a substantially enacted tax rate. 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 Corporation has not recognized any future net benefit associated with unrecognized tax pools due to the uncertainty of the Corporation’s ability to use those tax pools. The Corporation does not expect to be taxable in Canada during 2011 as a result of its available tax pools.

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**Quarterly Financial Review**

*Selected Quarterly Consolidated Financial Information (Three Months Ended)*

The following is a summary of selected financial information of the Corporation for the last eight completed quarters. The quarters after December 31, 2009 have been presented in accordance with IFRS.

	<b>IFRS</b>					<b>Canadian GAAP</b>		
	<b>Mar 31, 2011</b>	<b>Dec 31, 2010</b>	<b>Sep 30, 2010</b>	<b>Jun 30, 2010</b>	<b>Mar 31, 2010</b>	<b>Dec 31, 2009</b>	<b>Sep 30, 2009</b>	<b>Jun 30, 2009</b>
\$ million except per share amounts								
<b>Revenue</b> - continuing operations	35.9	33.3	29.0	22.4	34.6	26.7	22.9	31.2
- discontinued operations	-	-	-	-	-	-	1.2	3.9
- total	<b>35.9</b>	<b>33.3</b>	<b>29.0</b>	<b>22.4</b>	<b>34.6</b>	<b>26.7</b>	<b>24.1</b>	<b>35.1</b>
<b>Net earning (loss) – before discontinued operations</b>	7.3	4.9	3.0	2.5	4.6	(11.7)	(1.1)	(3.1)
per share (basic)	\$0.03	\$0.02	\$0.01	\$0.02	\$0.10	\$(0.26)	\$(0.02)	\$(0.07)
per share (diluted)	\$0.03	\$0.02	\$0.01	\$0.02	\$0.08	\$(0.26)	\$(0.02)	\$(0.07)
<b>Net earning (loss) – discontinued operations</b>	-	(0.7)	(0.1)	(0.1)	(0.1)	0.2	(3.2)	0.5
per share (basic)	-	\$(0.00)	\$0.00	\$0.00	\$0.00	\$0.00	\$(0.07)	\$0.01
per share (diluted)	-	\$(0.00)	\$0.00	\$0.00	\$0.00	\$0.00	\$(0.07)	\$0.01
<b>Net earning (loss)</b>	7.3	4.2	2.9	2.4	4.5	(11.5)	(4.3)	(2.6)
per share (basic)	\$0.03	\$0.02	\$0.01	\$0.02	\$0.10	\$(0.25)	\$(0.09)	\$(0.06)
per share (diluted)	\$0.03	\$0.02	\$0.01	\$0.02	\$0.08	\$(0.25)	\$(0.09)	\$(0.06)

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**Liquidity and Capital Resources**

*Selected Capitalization Data (excluding Discontinued Operations).* All figures presented in accordance with IFRS

\$ millions except financial ratios	IFRS		
	March 31, 2011	December 31, 2010	Change
Current assets <sup>(1)</sup>	39.2	43.4	(4.2)
Current liabilities excluding credit facility	11.9	11.6	(0.3)
Operating working capital <sup>(2)</sup>	27.3	31.8	(4.5)
Operating working capital ratio <sup>(3)</sup>	3.29	3.74	(0.45)
Credit facility	23.7	36.5	(12.8)
Shareholders' equity	49.8	41.8	8.0
Total debt-to-capitalization ratio <sup>(4)</sup>	0.32	0.47	0.15
Cash and cash equivalents	19.4	24.3	(4.9)

**Notes:**

- (1) *Calculated as current assets less the assets held for sale including assets related to discontinued operations in the Middle East.*
- (2) *Calculated as current assets (as defined above) less current liabilities excluding the current portion of the credit facility.*
- (3) *Calculated as current assets (as defined above) divided by current liabilities excluding the current portion of the credit facility.*
- (4) *Calculated as the credit facility divided by the sum of the credit facility and shareholders' equity.*

During the first quarter of 2011, the Corporation continued to focus on reducing its debt leverage and maintaining sufficient liquidity for its operating needs. The Corporation's objective is to have a capital structure that will provide the capital to meet the requirements of its business and instil confidence in investors, creditors and the capital markets. As part of the restructuring transactions completed effective April 30, 2010, the Corporation entered into a one year term loan with its senior lenders under which the outstanding balances under the revolving credit facility and bridge loan were combined into a single term loan that matured on April 30, 2011.

The Corporation generated positive cash flow of \$10.4 million from operations before working capital adjustments during the first quarter of 2011 as described below. The accounts payable and accounts receivable are substantially all current which, together with the cash balance, provides liquidity to meet the Corporation's operating needs. The Corporation had a cash balance of \$19.4 million as at March 31, 2011 and believes it has sufficient cash to meet its cash needs for the foreseeable future.

On May 6, 2011 High Arctic entered into a financing agreement for a new credit facilities to replace the existing credit facilities. The main components of the new credit facilities are a \$20 million, two year committed term loan with a four year amortization, a \$5 million demand revolving operating loan and a \$5 million revolving evergreen loan (*See Subsequent Events*).

**Credit Facility**

As at March 31, 2011, the Corporation owed \$23.7 million on its term loan (December 31, 2010 – \$36.5 million). The interest rate applicable to the term loan commencing May 1, 2010 was prime plus 4.75% provided that prime had a floor amount of 4.75%. As a result, the minimum interest rate was 9.5%. Prior to May 1, 2010 when the then outstanding credit facilities were restructured into the term loan, the interest rate applicable to a portion of the credit facility was prime plus 2% and prime plus 6.25% for the remaining portion.

# **High Arctic Energy Services Inc.**

## **Management Discussion and Analysis**

### **Three months ended March 31, 2011**

The term loan facility had a maturity date of April 30, 2011. On May 6, 2011 the Corporation entered into a financing agreement with a new lender for new credit facilities to replace the term loan that existed as at March 31, 2011 (see *Subsequent Events*).

There were no fixed amortization obligations under the term loan but payments during the term were required if the financial results of the Corporation exceeded the agreed upon projections. Based on the financial results for the three months ended December 31, 2010, the Corporation made a payment in March, 2011 of \$10.5 million that was applied to reduce the principal amount of the term loan. A further \$2.3 million was repaid out of proceeds arising on the sale of assets.

The consolidated leverage ratio ("CLR") was one of the key financial ratio covenants under the term loan and is a key measure used by the Corporation in assessing its leverage. The CLR is defined in the term loan agreement as, in general terms, consolidated total debt, as defined in the term loan agreement, divided by the 12-month trailing adjusted consolidated earnings before interest, depreciation, amortization and taxes. The CLR covenant was applied monthly and the maximum allowable ratio varied from 2.25 to 1.00, to 2.75 to 1.00. As at March 31, 2011, the Corporation had a CLR of approximately 0.7 to 1.0 (see *Note 18 of the Interim Financial Statements*).

The Corporation issued 12,630,740 common shares to the lenders as consideration for the new term loan facility on April 30, 2010. The Corporation valued the shares at \$2.5 million and that amount was expensed as explained in Note 12 of the Interim Financial Statements.

## **Cash Flow**

### **Cash – Operating Activities – Continuing Operations**

For the quarter ended March 31, 2011, cash provided by operating activities was \$10.4 million before reflecting working capital adjustments, compared to cash provided by operating activities of \$6.4 million in the quarter ended March 31, 2010. After working capital adjustments, cash provided by operating activities in the quarter ended March 31, 2011 was \$10.0 million, compared to cash provided by operating activities of \$6.5 million in the quarter ended March 31, 2010.

In the first quarter of 2011, the outstanding accounts receivable balance increased by \$1.1 million while inventory and prepaid expenses decreased by \$0.5 million. Accounts payable and accrued liabilities decreased by \$1.3 million and taxes payable increased by \$1.2 million. The changes in the working capital balances resulted in the net decrease in non-cash working capital of \$0.4 million in the quarter ended March 31, 2011 as compared to a net increase in working capital of \$0.1 million in the same quarter of 2010.

### **Investing Activities – Continuing Operations**

For the quarter ended March 31, 2011, net expenditures to acquire rigs, equipment and other operational assets were \$1.7 million, compared to acquisitions of \$1.1 million for the quarter ended March 31, 2010 (both amounts after the change in accounts payable related to constructing rigs and equipment).

During the quarter ended March 31, 2010 the Corporation sold three rigs. The rigs were not being actively utilized in the business and were classified as assets held for sale. The Corporation received proceeds of \$14.7 million (\$6.6 million from discontinued operations). The proceeds were applied to the senior debt.

### **Financing Activities – Continuing Operations**

During the quarter ended March 31, 2011, the Corporation repaid its credit facility by \$12.8 million compared to the repayment of \$14.7 million in the quarter ended March 31, 2010.

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**Customer Concentration**

The Corporation's account receivables are predominantly with customers who explore for and develop petroleum reserves and are subject to normal industry credit risks. The Corporation assesses the credit worthiness of its customers on an ongoing basis and monitors the amount and age of balances outstanding. The Corporation views the credit risks on these amounts as normal for the industry. The carrying amount of accounts receivable represents the maximum credit exposure on this balance. The Corporation has a wide range of customers comprised of small independent, intermediate and large multinational oil and gas producers. Notwithstanding its large customer base, the Corporation has two significant customers. Services are provided to the first significant customer in Papua New Guinea. That customer represents approximately 36% of the Corporation's revenue for the quarter ended March 31, 2011 and 36% of its accounts receivable at that date. The second significant customer is a major Canadian exploration and production company which represents approximately 16% of the Corporation's revenue for the quarter ended March 31, 2011 and 10% of the Corporation's accounts receivable at that date. The services provided to this customer are distributed within this customer's diverse locations of operations within Canada which management believes limits the risk of concentrating a significant portion of its revenue on this customer. Management has assessed the two customers as creditworthy and the Corporation has had no history of collection issues with either customer.

**Commitments and Contingencies**

**Accounts Receivable**

The Corporation has commenced litigation against a customer with respect to collection of a receivable for services rendered outside Canada. The Corporation believes it has made an adequate provision for the possibility of non-collectable amounts. The customer has made a number of allegations and initiated a counter claim of \$5 million concerning performance issues and the cashing of the letter of credit of \$1.0 million. The Corporation has not recorded an accrual in relation to the counter claim as management believes that the claim is without merit.

**Other**

The Corporation has posted a performance bond of approximately US\$3.5 million, in respect of a contract in the Middle East region, and would be liable if the bond was called as a result of a default by the Corporation in the performance of its obligations under the contract. Under the terms of the contract, the Corporation could be obligated to provide up to five rigs that may not be available if requested. As at March 31, 2011, the Corporation was not providing any services under that contract. The term of the contract ends in August, 2012.

**Contractual Obligations**

In addition to the commitments and contingencies noted above and the related party transactions noted below, in the normal course of business, the Corporation incurs contractual obligations.

The following are the Corporation's contractual obligations as at March 31, 2011:

\$ millions	<b>Payments Due by Period</b>				
	<b>Total</b>	<b>Less than 1 Year</b>	<b>1 – 3 Years</b>	<b>4 – 5 Years</b>	<b>After 5 Years</b>
Credit facility obligations <sup>(1)</sup>	23.7	23.7	-	-	-
Operating lease obligations	1.6	0.5	0.6	0.4	-
Related party operating lease obligations <sup>(2)</sup>	0.1	0.1	-	-	-
<b>Total obligations</b>	<b>25.3</b>	<b>24.3</b>	<b>0.6</b>	<b>0.4</b>	<b>-</b>

(1) On May 6, 2011 High Arctic entered into a financing agreement with a new lender for new credit facilities to replace the existing term loan where the entire principal of the existing term loan was retired and a new \$20 million two year term loan credit facility was put in place (see *Subsequent Events*).

(2) Related party operating lease obligations are for property leases due to a related party (see *Related Party Transactions*).

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**Risk Management and Uncertainties**

The success of the Corporation is dependent to a great extent on the health of the oil and natural gas industry in Canada and internationally which, in turn, is driven in large part by commodity prices. As a service provider to this industry, the Corporation is exposed to various risks, including:

- volatilities in global supply and demand and market prices for oil and natural gas and the effect of these volatilities on the demand for oilfield services generally;
- uncertainties in weather affecting the duration of the service periods and the activities that can be completed, including the seasonality that affects industry activity in Canada;
- reduction in industry activity levels in Western Canada, primarily due to a recent period of lower natural gas prices and impacts (see above);
- changes in legislation and the regulatory environment, including uncertainties with respect to implementing environmental initiatives;
- alternatives to and changing demands for petroleum products;
- the worldwide demand for oilfield services in connection with the underbalanced drilling, workover and completion of oil and gas wells;
- general economic conditions in Canada, the United States and Southeast Asia including variations in currency exchange rates and interest rates;
- liabilities and risks inherent in oil and gas operations, including environmental liabilities and risks arising below ground surface;
- credit risks associated with customers in the oil and gas industry, including the inability of a significant customer to pay for goods and services that have been provided;
- risks inherent in foreign operations, including political and economic risk and the risk of foreign currency controls that could restrict the transfer of funds in or out of countries in which the Corporation operates or result in the imposition of taxes on such transfers; and
- regional and international competition.

These factors may have an impact upon the Corporation's customer base which, in turn, would impact the Corporation's business prospects.

The Corporation is also subject to specific risks.

**Financing Risk**

The Corporation is exposed to risk associated with access to equity capital and debt financing required for business needs and to repay existing debt financing and the risk that necessary capital cannot be acquired on a timely basis, on reasonable terms to the Corporation, or at all. The covenants of the Corporation under its loan agreements could limit its ability to obtain additional financing in the future on a timely basis to take advantage of business opportunities that may arise.

Where additional financing is raised by the issuance of common shares or securities convertible into common shares, control of the Corporation may change and shareholders may suffer dilution to their investment.

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**Liquidity Risk**

Liquidity risk is the risk that the Corporation will not be able to meet its financial obligations as they fall due. The Corporation's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due. The Corporation's processes for managing liquidity risk include preparing and monitoring capital and operating budgets, coordinating and authorizing project expenditures, and authorization of contractual agreements. The Corporation seeks to manage its financing based on the results of these processes.

**Customer Concentration**

Notwithstanding its large customer base, the Corporation has one customer that represents approximately 36% of the Corporation's revenue for the three months ended March 31, 2011 and 36% of its accounts receivable at that date. Services are provided to that customer in Papua New Guinea. Management has assessed this customer as creditworthy and the Corporation has had no history of collection issues with the customer.

**Interest Rate Risk**

Interest rate risk is the risk that the value of a financial instrument will fluctuate as a result of changes in market interest rates. The Corporation is exposed to interest rate risk as the term loan is a floating rate credit facility and fluctuates in response to changes in the prime interest rates. For the three months ended March 31, 2011, a 1% nominal change in the interest charged to the Corporation under its credit facility would have changed interest expense by \$0.1 million.

**Income Tax Risk**

The Corporation has risks for income tax matters, including the unanticipated tax and other expenses and liabilities of the Corporation due to changes in income tax laws.

The Corporation must file tax returns in the foreign jurisdictions in which it operates. The tax laws and the prevailing assessment practices are subject to interpretation and the foreign authorities may disagree with the filing positions adopted by the Corporation.

**Operational Risk and Insurance**

High Arctic's operations are subject to operational risks inherent in the oil and gas services industry. These risks include equipment defects, malfunctions and failures, natural disasters, vehicle accidents, explosions and uncontrollable flows of natural gas or well fluids that can cause personal injury, loss of life, suspension of operations, damage to formations, damage to facilities, business interruptions, and damage to or destruction of property and equipment. High Arctic continuously monitors its activities for quality control and safety in order to reduce the risk. The Corporation has obtained insurance against certain risks; however, such insurance may not be adequate to cover High Arctic's liabilities and may not be available in the future at rates which High Arctic considers reasonable and commercially justifiable.

**Reliance on Key Personnel**

The success of the Corporation is dependent upon its key personnel. Any loss of the services of such persons could have a material adverse effect on the business and operations of the Corporation. The Corporation's ability to provide reliable and quality services is dependent on its ability to hire and retain a dedicated and quality pool of employees. The Corporation strives to retain employees by providing a safe working environment, competitive wages and benefits, and an atmosphere in which all employees are treated equally regarding opportunities for advancement.

**Credit Risk**

The Corporation's accounts receivable are with customers in the oil and gas industry and are subject to normal industry credit risks. During times of weak economic conditions, the risk of increased payment delays and failure to pay increases due to a reduction in customers' cash flow. Failure to collect accounts receivable from customers could have a material adverse effect on the Corporation's business, financial condition, results of operations and cash flows. High Arctic generally grants unsecured credit to its customers; however, it evaluates all new customers as appropriate and analyzes and reviews the financial health of its current customers on an ongoing basis.

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**Risk of Foreign Operations**

The Corporation operates in international locations, including Papua New Guinea, where the political and economic systems differ from those in Canada. Operations in these countries may be subject to a variety of risks including, but not limited to: currency fluctuations, devaluations and exchange controls; inflation; uncertain political and economic conditions resulting in unfavourable government actions such as unfavourable legislation or regulation, trade restrictions, unfavourable tax enforcement or adverse tax policies; the denial of contract rights; and social unrest, acts of terrorism or armed conflict. To attempt to mitigate these risks, the Corporation employs personnel with extensive experience in the international marketplace, supplemented with qualified local staff.

**Foreign Exchange Rate Risk**

Foreign currency risk is the risk that a variation in the exchange rate between Canadian and foreign currencies will affect the Corporation's results. The majority of the Corporation's international revenue and expenses are transacted in U.S. dollars and the Corporation does not actively engage in foreign currency hedging.

For the three months ended March 31, 2011, a 1% nominal change in the value of the Canadian dollar relative to the U.S. dollar would have resulted in a \$0.1 million change in other comprehensive income as a result of changes in foreign exchange.

**Commodity Price Risk**

Commodity price risk is the risk that fluctuations in oil or natural gas prices could materially adversely affect the Corporation's financial condition. The commodity prices affect the levels of drilling activity, particularly with respect to natural gas, which primarily affects the Canadian business. The Corporation mitigates this exposure with its diversification into international operations not dependent on the Canadian oil and gas industry.

**Dependence on Suppliers**

High Arctic sources supplies and materials from a variety of suppliers in Canada and internationally. Failure of suppliers to deliver supplies and materials in a timely and efficient manner would be detrimental to the Corporation's ability to maintain levels of service to its customers. High Arctic attempts to mitigate this risk by maintaining strong relations with key suppliers. However, if the current suppliers are unable to provide the supplies and materials, or otherwise fail to deliver products in the quantities required, any resulting delays in the provision of services to our clients could have a material adverse effect on our results of operations and our financial condition.

**Competition**

The Corporation's continued success partially depends upon developing and implementing technological advances in its equipment and services and the ability to match advances of competitors. The oilfield services industry is highly competitive and the Corporation competes with a substantial number of companies. Reduced levels of activity in the oil and gas industry can intensify competition, which will have an effect on the Corporation's ability to generate revenue and earnings.

**Other**

Additional risk factors relating to the Corporation are also outlined in the Annual Information Form for the year ended December 31, 2010, filed on SEDAR at [www.sedar.com](http://www.sedar.com).

# High Arctic Energy Services Inc.

## Management Discussion and Analysis

### Three months ended March 31, 2011

#### Critical Accounting Estimates

The Corporation's significant accounting policies are described in Note 3 to the Interim Financial Statements for the period ended March 31, 2011. The preparation of the Corporation's Interim Financial Statements in conformity with International Financial Reporting Standards ("IFRS") requires management to make judgments, estimates and assumptions that affect the reported amounts of assets, liabilities and contingent liabilities at the date of the consolidated financial statements and reported amounts of revenues and expenses during the reporting period. Estimates and assumptions are continuously evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. However, actual outcomes can differ from these estimates. The accounting policies and practices that involve the use of estimates that have a significant impact on the Corporation's financial results include the allowance for doubtful accounts, depreciation and amortization, the fair value of financial instruments, income taxes and share-based compensation.

#### Allowance for doubtful accounts

The Corporation performs ongoing credit evaluations of its customers and grants credit based upon a review of historical collection experience, current aging status, financial condition of the customer and anticipated industry conditions. Customer payments are regularly monitored and a provision for doubtful accounts is established based upon specific situations and overall industry conditions.

#### Amortization

Amortization of the Corporation's property and equipment incorporates estimates of useful lives and residual values. These estimates may change as more experience is obtained or as general market conditions change, thereby impacting the value of the Corporation's property and equipment.

#### Fair value of financial instruments

The Corporation's financial instruments that are included in the consolidated statement of financial position are comprised of cash and cash equivalents, accounts receivable, current liabilities including the credit facility. The fair values of financial instruments that are included in the consolidated statement of financial position approximate their carrying amounts due to the short-term maturity of those instruments.

#### Income taxes

Deferred income tax liabilities are recognized for the future tax consequences attributable to differences between the financial statement amounts of existing assets and liabilities and their respective tax bases. The Corporation's calculation of income taxes involves many complex factors as well as the Corporation's interpretation of relevant tax legislation and regulations.

#### Share-based compensation

The fair value of stock options is estimated at the grant date using the Black-Scholes option pricing model, which includes underlying assumptions related to the risk-free interest rate, average expected option life, estimated forfeitures and estimated volatility of the Corporation's shares. The fair value of the shares under the share incentive plan is recognized based on the market value of the Corporation's shares, the vesting period of the plan and the estimated forfeitures.

#### Related Party Transactions

In the normal course of business, during the three months ended March 31, 2011, the Corporation incurred general and administration expenses related to premises rent of \$0.1 million (March 31, 2010 - \$0.1 million) and equipment and vehicle leases payments of nil (March 31, 2010 - \$0.1 million) charged by companies controlled by the person who, prior to the restructuring transactions, controlled almost 40% of the outstanding shares and who was the President and Chief Executive Officer of the Corporation until December 16, 2008 (the "Shareholder"). These transactions are measured at exchange values based on rates charged by arms length persons, which, in the opinion of management, approximate fair value.

The Shareholder also made various loans and advances to the Corporation. Interest expense for the three months ended March 31, 2011 was nil (March 31, 2010 - \$0.1 million) in respect of the amounts that were settled with the Shareholder.

As part of the restructuring transactions completed on April 30, 2010 (*see Note 12 of the Interim Financial Statements*), the Corporation issued 32,968,384 common shares to the Shareholder and companies controlled by him in settlement of the outstanding obligations owing by the Corporation on that date with a recorded amount of approximately \$7.2 million. Mutual releases were signed between the parties settling all outstanding litigation and other claims to April 30, 2010. The Corporation recorded the value of the 32,968,384 common shares as \$6.6 million resulting in a \$0.6 million gain on the settlement of the outstanding obligations that is included in the gain on restructuring transactions.

# High Arctic Energy Services Inc.

## Management Discussion and Analysis

### Three months ended March 31, 2011

#### International Financial Reporting Standards

The Corporation began reporting its financial results in accordance with IFRS on January 1, 2011, the changeover date set by the Canadian Accounting Standards Board (AcSB). IFRS compliant comparative financial information for one year from the changeover date is required including the conversion of the January 1, 2010 (the "Transition Date") opening statement of financial position, the transition date for IFRS. For the quarter ended March 31, 2010, High Arctic restated its operating results as if it had always prepared financial results in accordance with IFRS.

The Corporation's financial statements for the year ending December 31, 2011 will be the first annual financial statements that comply with IFRS. The Interim Financial Statements and this MD&A have been prepared under IFRS as described in Note 3 of the Interim Financial Statements.

IFRS requires that comparative financial information be provided. As a result, the first date at which the Corporation has applied IFRS was January 1, 2010. IFRS 1 requires first-time adopters to retrospectively apply all effective IFRS standards as of the reporting date. However, it also provides for certain optional exemptions and certain mandatory exceptions for first time IFRS adopters.

Following is a summary of the IFRS exemptions adopted by the Corporation:

#### IAS 21 – Foreign Exchange

An election exists under IFRS 1 to reset the accumulated foreign currency amounts to zero. Under the temporal method that has been used under GAAP by High Arctic, all foreign exchange gains or losses have been charged through the statement of income and therefore form part of retained earnings. Thus there have been no separately accumulated foreign currency amounts on the statement of financial position of High Arctic.

On conversion to IFRS, High Arctic will choose the election under IFRS 1 to reset the accumulated foreign currency amounts to zero in order to avoid having to recreate the historic amount of accumulated foreign currency. There will be no effect to the financial statements as a result of this election.

#### Future Accounting Changes

Prior to the adoption of IFRS by the Corporation, the International Accounting Standards Board ("IASB") issued the following new standards which become effective for annual period beginning on or after January 1, 2013:

#### IFRS 9

IFRS 9 amends the classification and measurement criteria for financial instruments included within the scope of IAS 39. Financial assets will be measured at fair value or amortized cost and the available for sale category will be eliminated. If an equity investment is not required to be classified as held for trading, an irrevocable election can be made upon initial recognition to measure at fair value through other comprehensive income. Financial liabilities will be classified at amortized cost except for financial liabilities at fair value through profit and loss, financial guarantee contracts and commitments to provide a loan at a below market interest rate. A fair value option is available for both financial assets and liabilities as an alternative to amortized cost if certain conditions are met. The Corporation is analyzing the impact the new standard will have on its financial assets and liabilities.

#### IFRS 10 & IAS 27

IFRS 10, "Consolidated financial statements", is part of the group of five new standards that address the scope of the reporting entity. IFRS 10 replaces all of the guidance on control and consolidation in IAS 27, "Consolidated and separate financial statements", and SIC-12, "Consolidation – special purpose entities". IAS 27 is renamed "Separate financial statements"; it continues to be a standard dealing solely with separate financial statements. The existing guidance for separate financial statements is unchanged. IFRS 10 changes the definition of control so that the same criteria are applied to all entities to determine control. The changed definition and application guidance is not expected to result in a change in the consolidation decisions made by the Corporation.

#### IFRS 11

IFRS 11, "Joint Arrangements"; changes in the definition for the 'types' of joint arrangements to two: joint operations and joint ventures. The existing policy choice of proportionate consolidation for jointly controlled entities has been eliminated. Equity accounting is mandatory for participants in joint ventures. Entities that participate in joint operations will follow accounting much like that for joint assets or joint operations today. Entities with existing joint arrangements or that plan to enter into new joint arrangements will be affected by the new standard. The Corporation does not have any joint arrangements and does not expect this change to have any impact on its reporting.

# High Arctic Energy Services Inc.

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### Three months ended March 31, 2011

#### **IFRS 12 & IAS 28**

IFRS 12 sets out the required disclosures for entities reporting under the two new standards, IFRS 10, "Consolidated financial statements", and IFRS 11, "Joint arrangements"; it replaces the disclosure requirements currently found in IAS 28, "Investments in associates". The existing guidance and disclosure requirements for separate financial statements are unchanged. The new standard, IFRS 12, requires entities to disclose information that helps financial statement readers to evaluate the nature, risks and financial effects associated with the entity's interests in subsidiaries, associates, joint arrangements and unconsolidated structured entities. The Corporation is analyzing the impact the new standard will have.

#### **Comparative Figures**

Certain comparative figures have been reclassified to conform to the current financial statement presentation.

#### **Disclosure Controls and Procedure**

The Corporation has established disclosure controls and procedures, as defined in National Instrument 52-109, to ensure timely and accurate preparation of financial and other reports. Disclosure controls and procedures are designed to provide reasonable assurance that material information required to be disclosed is recorded, processed, summarized and reported within the time periods specified by securities regulations and that information required to be disclosed is accumulated and communicated to the appropriate members of management and properly reflected in the Corporation's filings. The Chief Executive Officer and the Chief Financial Officer oversee this evaluation process and have concluded that the design and operation of these disclosure controls and procedures are adequate in ensuring that the information required to be disclosed by the Corporation in reports filed with the Canadian Securities Administrators is accurate and complete and filed within the time periods required. The Chief Executive Officer and the Chief Financial Officer have individually signed certifications to this effect.

#### **Internal Controls Over Financial Reporting**

The Corporation's management is responsible for establishing and maintaining adequate Internal Controls over Financial Reporting ("ICFR"). Internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risks that controls become inadequate because of changes in conditions or personnel, or that the degree of compliance with the policies or procedures may deteriorate.

The Corporation has adopted the Committee of Sponsoring Organizations of the Treadway Commission framework to design ICFR. With the assistance of external consultants, throughout 2009, the Corporation reviewed the design and effectiveness of its ICFR. External consultants and senior management personnel conducted process review, design and development processes to ensure that controls were designed appropriately. In the fourth quarter of 2010, the Corporation with the assistance of external consultants performed testing to ensure that processes and controls were operating effectively. Based upon their evaluation of the ICFR, the Chief Executive Officer and the Chief Financial Officer have satisfied themselves that the ICFR are effective to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. While the Corporation is continually improving its ICFR, no material changes were made during the three month period ended March 31, 2011 that would materially affect or are reasonably likely to materially affect the Corporation's ICFR.

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## **Outlook**

Canadian exploration and development activity in the unconventional natural gas and oil plays gained further momentum in the first quarter of 2011 with continued focus on the use of horizontal wells incorporating multi-stage completions. The shift towards oil and liquids-rich gas completions activity became more prominent due to the strong oil and natural gas liquids prices. Overall, the price of crude oil and natural gas liquids is anticipated to remain strong. These favourable market conditions in Canada should help to improve the day rates and other pricing for the Corporations services.

High Arctic's activity levels are impacted to a much greater degree by natural gas drilling than oil well drilling. Management is not anticipating a meaningful increase in the price of natural gas during 2011 which will continue to hamper natural gas well drilling activity, especially in the conventional natural gas areas. However, overall stronger demand for the Corporation's services in Canada is supported by the Petroleum Services Association of Canada's drilling forecast of 12,950 wells to be drilled across western Canada in 2011, of which an increasing proportion is projected to be the deeper horizontal wells. Completions activity in the Montney and deep basin plays of northwest Alberta and northeast British Columbia is expected to remain robust in 2011 as these regions are amongst the most economic natural gas plays in North America and are generally rich in natural gas liquids.

The Corporation is in a relatively strong position given its relationships and first call commitments with some of the natural gas industry's most active operators. The Corporation also has equipment that is well suited for the deeper horizontal wells. Management hopes to maintain the recent gains in market share and remains focused on maintaining a competitive cost structure, improving operating efficiencies and increasing its workforce to activate underutilized equipment.

In Papua New Guinea, High Arctic has recently signed new contracts with its major customer for Rig 102 and Rig 104 along with the related drilling support contracts that run into late 2013, subject to certain cancelation rights. Those contracts provide a significant base level of activity to support the operations in the country. Rig 104 is expected to operate continuously throughout 2011. Rig 102 is being substantially upgraded and should be ready to commence operations in June, 2011. The Corporation is also providing drilling services with Rig 103 to other customers in Papua New Guinea on a well to well basis, having completed one well during the first quarter and recently completing one well for another customer. The rig is currently being moved off that location. The Corporation hopes to negotiate a renewal contract for Rig 103, though it is likely the rig will be stacked following completion of the well being drilled during the second quarter.

High Arctic provides drilling support equipment on a rental basis to several other customers in Papua New Guinea. The Corporation sees opportunities to expand that business line through additions to its rental fleet.

## **Forward-Looking Statements**

This MD&A contains forward-looking statements. When used in this document, the words "may", "would", "could", "will", "intend", "plan", "anticipate", "believe", "seek", "propose", "estimate", "expect", and similar expressions are intended to identify forward-looking statements. Such statements reflect the Corporation's current views with respect to future events and are subject to certain risks, uncertainties and assumptions. Many factors could cause the Corporation's actual results, performance or achievements to vary from those described in this MD&A. Should one or more of these risks or uncertainties materialize, or should assumptions underlying forward-looking statements prove incorrect, actual results may vary materially from those described in this MD&A as intended, planned, anticipated, believed, estimated or expected.

Specific forward-looking statements in this MD&A include, among others, statements pertaining to the following:

- expectations regarding the Corporation's ability to raise capital and manage its debt obligations (including the Corporation's ability to obtain any required waivers and extensions relating to the credit facilities);
- commodity prices and the impact that they have on industry activity;
- estimated capital expenditure programs for fiscal 2011 and subsequent periods;
- projections of market prices and costs;
- factors upon which the Corporation will decide whether or not to undertake a specific course of operational action or expansion;

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- worldwide supply and demand for oilfield services;
- treatment under governmental regulatory regimes; and
- general economic conditions.

With respect to forward-looking statements contained in this MD&A, the Corporation has made assumptions regarding, among other things, its ability to:

- obtain equity and debt financing on satisfactory terms;
- market successfully to current and new customers;
- obtain equipment from suppliers;
- construct property and equipment according to anticipated schedules and budgets;
- remain competitive in all of its operations; and
- attract and retain skilled employees.

The Corporation's actual results could differ materially from those anticipated in these forward-looking statements as a result of the risk factors set forth above and elsewhere in this MD&A, along with the risk factors set out in the Annual Information Form for the year ended December 31, 2010, filed on SEDAR at [www.sedar.com](http://www.sedar.com).

The forward-looking statements contained in this MD&A are expressly qualified in their entirety by this cautionary statement. These statements speak only as of the date of this MD&A. The Corporation does not assume any obligation to update these forward-looking statements to reflect new information, subsequent events or otherwise, except as required by law.

## **Subsequent Events**

On or about May 15, 2011 High Arctic made loans to certain directors and officers of the Corporation in the total aggregate amount of \$1,110,398. The purpose of the loans was to assist the directors and officers with the payment of Canadian income taxes arising on the issuance of Common Shares ("Incentive Shares") pursuant to the Corporation's executive and director share incentive plan (the "Plan") (see *Note 13 of the Interim Financial Statements*). The amount of each loan was a maximum of 50% of the estimated amount of such taxes payable by the borrower. The participants of the Plan are subject to taxation immediately upon issuance of the Incentive Shares despite the shares being held by a trustee as part of a three year vesting arrangement under the Plan. The principal amount of each loan bears interest at an annual rate of 2%. Each loan is fully payable on the earlier of (i) thirty days after the date that a Borrower ceases to be an employee or director of the Corporation and (ii) April 15, 2014.

On May 6, 2011 High Arctic entered into a financing agreement with a new lender for new credit facilities to replace the existing term loan. The main components of the new credit facilities are a \$20 million, two year committed term loan with a four year amortization, a \$5 million demand revolving operating loan and a \$5 million revolving evergreen loan. The \$20 million term loan was advanced to the Corporation on May 6, 2011. The credit facilities are secured by all of the assets of High Arctic and by unlimited guarantees of its foreign subsidiaries.

The funds from the \$20 million term loan, together with a cash payment of \$3.7 million, were used to repay High Arctic's existing term loan (see *Note 11 of the Interim Financial Statements*). The Corporation is required to make quarterly principal payments on the term loan of \$1.25 million beginning September 30, 2011. The term loan carries an annual interest rate of the bank's prime interest rate plus 1.75% and has a maturity date of June 30, 2013.

**High Arctic Energy Services Inc.**  
**Management Discussion and Analysis**  
**Three months ended March 31, 2011**

**Non-GAAP Terms**

EBITDA (being earnings before the deduction of depreciation, amortization, interest and financing costs, share-based compensation, gain on sale of investment and income taxes), "Oilfield Services Operating Margin", "Oilfield Services Operating Margin %", "Operating Earnings", "Operating working capital", Operating working capital ratio", "market capitalization", "debt to capitalization ratio", "Consolidated total debt" and "CLR" are not recognized measures under GAAP. Management believes that, in addition to net earnings, EBITDA is a useful supplemental measure of the Corporation's performance prior to consideration of how operations are financed or how results are taxed. Investors are cautioned that EBITDA should not be construed as an alternative to net earnings determined in accordance with GAAP as an indicator of the Corporation's performance. The Corporation's method of calculating EBITDA and other non-GAAP items may differ from the methods used by other issuers and, accordingly, they may not be comparable to similarly titled measures used by other issuers.

**Additional Information**

Additional information on the Corporation, including the Annual Information Form for the year ended December 31, 2010, can be found on SEDAR at [www.sedar.com](http://www.sedar.com).

# High Arctic Energy Services Inc.

## Consolidated Statement of Financial Position

As at March 31, 2011, December 31, 2010 and January 1, 2010

(Canadian \$ Million - Unaudited)

	Notes	March 31, 2011	December 31, 2010	January 1, 2010
<b>Assets</b>				
<b>Current assets</b>				
Cash and cash equivalents		19.4	24.3	27.6
Accounts receivable	7	17.1	16.0	14.5
Inventories		2.4	2.5	2.8
Prepaid expenses		0.3	0.6	1.1
Assets held for sale including assets related to discontinued operations in the Middle East	9	1.7	1.7	14.6
Assets related to Middle East discontinued operations	22	-	-	0.6
		<u>40.9</u>	<u>45.1</u>	<u>61.2</u>
<b>Non-current assets</b>				
Assets held for sale including assets related to discontinued operations in the Middle East	9	-	-	2.0
Property and equipment	8	45.0	45.5	47.3
		<u>85.9</u>	<u>90.6</u>	<u>110.5</u>
<b>Liabilities</b>				
<b>Current liabilities</b>				
Accounts payable and accrued liabilities	10	10.0	11.2	14.9
Income taxes payable		1.6	0.4	0.4
Deferred revenue		0.3	-	-
Due to related parties	14	-	-	7.0
Credit facility	11	23.7	36.5	65.4
Liabilities related to Middle East discontinued operations	22	-	-	0.3
Convertible debentures	11	-	-	27.9
		<u>35.6</u>	<u>48.1</u>	<u>115.9</u>
<b>Non-current liabilities</b>				
Deferred income tax liabilities		0.5	0.7	0.7
		<u>36.1</u>	<u>48.8</u>	<u>116.6</u>
<b>Shareholders' equity (deficiency)</b>				
	12	<u>49.8</u>	<u>41.8</u>	<u>(6.1)</u>
<b>Total liabilities and equity</b>				
		<u>85.9</u>	<u>90.6</u>	<u>110.5</u>
Commitments and contingencies	17, 20			

See accompanying notes to these consolidated Interim Financial Statements.

Approved on behalf of the Corporation by:

(signed) "Michael Binnion" Director

(signed) "Christopher Warren" Director

# High Arctic Energy Services Inc.

## Consolidated Statement of Income

For the three months ended March 31, 2011 and 2010

(Canadian \$ Million, except per share amounts - Unaudited)

	Notes	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
<b>Continuing operations</b>			
<b>Revenue</b>	21	35.9	34.6
<b>Expenses</b>			
Oilfield services	15	23.4	22.0
General and administration	15	2.0	2.3
Share-based compensation	13	1.5	-
Amortization	8	1.8	2.0
Gain on sale of investments	16	(2.0)	-
Foreign exchange loss		-	0.2
		<u>26.7</u>	<u>26.5</u>
<b>Operating earnings from continuing operations</b>		<b>9.2</b>	<b>8.1</b>
Interest and finance expense		0.9	2.0
<b>Net earnings before income taxes</b>		<b>8.3</b>	<b>6.1</b>
Income taxes		1.0	1.5
<b>Net earnings from continuing operations</b>		<b>7.3</b>	<b>4.6</b>
<b>Discontinued operations</b>			
Middle East discontinued operations	22	-	(0.1)
		<u>7.3</u>	<u>4.5</u>
<b>Net earnings for the period</b>		<b>7.3</b>	<b>4.5</b>
<b>Earnings per share:</b>			
Basic	12	0.03	0.10
Diluted		0.03	0.08
<b>Earnings per share from continuing operations:</b>			
Basic	12	0.03	0.10
Diluted		0.03	0.08

See accompanying notes to these consolidated Interim Financial Statements.

# High Arctic Energy Services Inc.

## Consolidated Statement of Comprehensive Income

For the three months ended March 31, 2011 and 2010

(Canadian \$ Million - Unaudited)

	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
<b>Net earnings for the period</b>	<b>7.3</b>	<b>4.5</b>
<b><i>Other comprehensive income</i></b>		
Foreign currency translation differences for foreign operations	(0.8)	(1.1)
<b>Total comprehensive income for the period</b>	<b>6.5</b>	<b>3.4</b>

See accompanying notes to these consolidated Interim Financial Statements.

# High Arctic Energy Services Inc.

## Consolidated Statement of Changes in Equity (Deficiency)

(Canadian \$ Million - Unaudited)

Notes	Share capital	Contributed surplus	Warrants	Convertible debentures	Accumulated other comprehensive income (loss)	Retained earnings (deficit)	Total equity (deficiency)
<b>Balance at December 31, 2010</b>	165.4	6.3	-	-	(2.3)	(127.6)	41.8
Net earnings	-	-	-	-	-	7.3	7.3
Other comprehensive income - foreign currency translation differences	-	-	-	-	(0.8)	-	(0.8)
Share-based payment transactions	1.4	0.1	-	-	-	-	1.5
<b>Balance at March 31, 2011</b>	<b>166.8</b>	<b>6.4</b>	<b>-</b>	<b>-</b>	<b>(3.1)</b>	<b>(120.3)</b>	<b>49.8</b>

See accompanying notes to these consolidated Interim Financial Statements.

Notes	Share capital	Contributed surplus	Warrants	Convertible debentures	Accumulated other comprehensive income (loss)	Retained earnings (deficit)	Total equity (deficiency)
<b>Balance at January 1, 2010</b>	126.9	4.6	1.7	2.8	-	(142.1)	(6.1)
Net earnings	-	-	-	-	-	4.5	4.5
Other comprehensive income - foreign currency translation differences	-	-	-	-	(1.1)	-	(1.1)
<b>Balance at March 31, 2010</b>	<b>126.9</b>	<b>4.6</b>	<b>1.7</b>	<b>2.8</b>	<b>(1.1)</b>	<b>(137.6)</b>	<b>(2.7)</b>

# High Arctic Energy Services Inc.

## Consolidated Statement of Cash Flow

For the three months ended March 31, 2011 and 2010

(Canadian \$ Million - Unaudited)

	Notes	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
<b>Operating activities</b>			
Net earnings for the period		7.3	4.5
Adjustments for:			
Amortization	8	1.8	2.0
Deferred income taxes		(0.2)	(0.1)
Share-based compensation	13	1.5	-
		<u>10.4</u>	<u>6.4</u>
Changes in items of working capital			
Accounts receivable	7	(1.1)	(3.5)
Inventory and prepaid expenses		0.4	0.2
Accounts payable and accrued liabilities	10	(1.2)	1.9
Deferred revenue		0.3	-
Income taxes payable		1.2	1.5
		<u>(0.4)</u>	<u>0.1</u>
<b>Net cash generated from operating activities</b>		<u>10.0</u>	<u>6.5</u>
<b>Investing activities</b>			
Property and equipment under construction		(3.2)	(1.0)
Reimbursable cost recovery for equipment upgrades		1.5	-
Proceeds on sale of property and equipment		-	8.1
<b>Net cash generated from investing activities</b>		<u>(1.3)</u>	<u>7.1</u>
<b>Financing activities</b>			
Advances from related parties		-	0.1
Change in credit facility	11	(12.8)	(14.7)
<b>Net cash used in financing activities</b>		<u>(12.8)</u>	<u>(14.6)</u>
<b>Net change in cash from continuing operations</b>		(4.5)	(1.0)
<b>Cash flow from discontinued operations</b>			
Proceeds on sale of property and equipment		-	6.6
<b>Effect of exchange rate changes</b>		(0.4)	(1.1)
<b>Net change in cash and cash equivalents</b>		(4.9)	4.5
<b>Cash and cash equivalents – Beginning of period</b>		<u>24.3</u>	<u>27.6</u>
<b>Cash and cash equivalents – End of period</b>		<u>19.4</u>	<u>32.1</u>

See accompanying notes to these consolidated Interim Financial Statements.

# High Arctic Energy Services Inc.

## Notes to the Consolidated Interim Financial Statements

For the three months ended March 31, 2011 and 2010

(Canadian \$ Million - Unaudited)

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### 1 Authorization of Financial Statements & Statement of Compliance with IFRS

The consolidated interim financial statements ("Interim Financial Statements") of High Arctic Energy Services Inc. ("High Arctic" or the "Corporation") for the period ended March 31, 2011 were authorized by the Board of Directors on June 1, 2011.

High Arctic Energy Services Inc. is incorporated under the laws of Alberta, Canada. High Arctic is a publicly traded company and listed on the Toronto Stock Exchange under the symbol "HWO". The head office of the Corporation is located at 8112 Edgar Industrial Drive, Red Deer, Alberta, Canada, T4P 3R2. High Arctic's principal focus is to provide contract drilling and work over services and other oilfield services to the oil and gas industry in Canada and Papua New Guinea.

The Interim Financial Statements of the Corporation have been prepared in accordance with IAS 34 Interim Financial Reporting and IFRS 1 *First Time Adoption of International Financial Reporting Standards* as issued by the International Accounting Standards Board ("IASB"). The Interim Financial Statements do not include all the information and disclosures required in the consolidated annual financial statements, and should be read in conjunction with the Corporation's consolidated annual financial statements as at December 31, 2010.

### 2 Basis of Preparation

For all periods up to and including the year ended December 31, 2010, the Corporation prepared its financial statements in accordance with pre-changeover Canadian generally accepted accounting principles (pre-change-over Canadian GAAP). The Interim Financial Statements for the three months ended March 31, 2011, are the first High Arctic is required to prepare in accordance with International Financial Reporting Standards ("IFRS").

These Interim Financial Statements have been prepared in accordance with IFRS applicable to the preparation of Interim Financial Statements, including IAS 34 and IFRS 1. Subject to certain transition elections disclosed in Note 6, the Corporation has consistently applied the same accounting policies in its opening IFRS statement of financial position at January 1, 2010 and throughout all periods presented, as if these policies had always been in effect. Note 6 discloses the impact of the transition to IFRS on the Corporation's reported financial position, financial performance and cash flows, including the nature and effect of significant changes in accounting policies from those used in the Corporation's consolidated financial statements for the year ended December 31, 2010.

The policies applied in these condensed Interim Financial Statements are based on IFRS issued and outstanding as of June 1, 2011. Any subsequent changes to IFRS that are given effect in the Corporation's annual consolidated financial statements for the year ending December 31, 2011 could result in restatement of these Interim Financial Statements, including the transition adjustments recognized on change-over to IFRS.

Note 3 discloses significant IFRS accounting policies for the quarter ended March 31, 2011 that is material to an understanding of these Interim Financial Statements.

These Interim Financial Statements are presented in Canadian dollars.

# High Arctic Energy Services Inc.

## Notes to the Consolidated Interim Financial Statements

For the three months ended March 31, 2011 and 2010

(Canadian \$ Million - Unaudited)

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### 3 Significant Accounting Policies

#### Basis of measurement

These Interim Financial Statements have been prepared on the historical cost basis except for the assets held for sale. The Corporation's assets held for sale are carried at their fair market value less estimated costs to sell.

#### Use of estimates and judgements

The preparation of the Corporation's Interim Financial Statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the reported amounts of assets, liabilities and contingent liabilities as at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates and assumptions are continuously evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. However, actual outcomes can differ from these estimates. The accounting policies and practices that involve the use of estimates that have a significant impact on the Corporation's financial results include the allowance for doubtful accounts, depreciation and amortization, the fair value of financial instruments, impairment of property and equipment, income taxes and share-based compensation.

#### Allowance for doubtful accounts

The Corporation performs ongoing credit evaluations of its customers and grants credit based upon a review of historical collection experience, current aging status, financial condition of the customer and anticipated industry conditions. Customer payments are regularly monitored and a provision for doubtful accounts is established based upon specific situations and overall industry conditions.

#### Amortization

Amortization of the Corporation's property and equipment incorporates estimates of useful lives and residual values. These estimates may change as more experience is obtained or as general market conditions change, thereby impacting the value of the Corporation's property and equipment.

#### Fair value of financial instruments

The Corporation's financial instruments that are included in the consolidated statement of financial position are comprised of cash and cash equivalents, accounts receivable, current liabilities including the credit facility. The fair values of financial instruments that are included in the consolidated statement of financial position approximate their carrying amounts due to the short-term maturity of those instruments.

#### Impairment of property and equipment

Property and equipment are tested for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable. Long-lived assets that are not amortized are subject to an annual impairment test. For the purpose of measuring recoverable amounts, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units or CGUs). The recoverable amount is the higher of an asset's fair value less costs to sell and value in use (being the present value of the expected future cash flows of the relevant asset or CGU). An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount.

#### Income taxes

Deferred income tax liabilities are recognized for the future tax consequences attributable to differences between the financial statement amounts of existing assets and liabilities and their respective tax bases. The Corporation's calculation of income taxes involves many complex factors as well as the Corporation's interpretation of relevant tax legislation and regulations.

#### Share-based compensation

The fair value of stock options is estimated at the grant date using the Black-Scholes option pricing model, which includes underlying assumptions related to the risk-free interest rate, average expected option life, estimated forfeitures and estimated volatility of the Corporation's shares. The fair value of the shares under the share incentive plan is recognized based on the market value of the Corporation's shares, the vesting period of the plan and the estimated forfeitures.

# High Arctic Energy Services Inc.

## Notes to the Consolidated Interim Financial Statements

For the three months ended March 31, 2011 and 2010

(Canadian \$ Million - Unaudited)

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### Principles of consolidation

The consolidated financial statements comprise the financial statements of the Corporation and its subsidiaries. Subsidiaries are entities over which the Corporation has control, where control is defined as the power to govern financial and operating policies of an entity so as to obtain benefit from its activities. The Corporation has several subsidiaries. Subsidiaries are fully consolidated from the date control is transferred to the Corporation, and are de-consolidated from the date control ceases.

Intercompany transactions between subsidiaries are eliminated on consolidation.

### Foreign currency

#### a) Functional and presentation currency

Items included in the Interim Financial Statements of each consolidated entity of the Corporation are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The Interim Financial Statements are presented in Canadian dollars, which is the Corporation's functional currency.

The financial statements of entities that have a functional currency different from that of the Corporation ("foreign operations") are translated into Canadian dollars as follows:

- assets and liabilities – at the closing rate at the date of the statement of financial position, and
- income and expenses – at the average rate of the period (where it approximates to the rates at the date of transaction).

All resulting changes are recognized in other comprehensive income as cumulative translation adjustments.

#### b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Generally, foreign exchange gains and losses resulting from the settlement of foreign currency transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in currencies other than an operation's functional currency are recognized in the consolidated statement of income.

### Cash and cash equivalents

Cash and cash equivalents include cash on hand, deposits held with banks, and other short-term highly liquid investments with original maturities of three months or less.

### Financial instruments

Financial assets and liabilities are recognized when the Corporation becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Corporation has transferred substantially all risks and rewards of ownership.

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously.

#### Initial measurement

Financial instruments are accounted for based on one of five classifications: fair value through profit or loss, held-to-maturity, other financial liabilities, available-for-sale investments and loans and receivables. The classification of a financial instrument depends on its characteristics and the purpose for which it was acquired.

#### a) Fair value through profit or loss

Fair value through profit or loss financial instruments are financial assets or financial liabilities that are purchased with the intention of selling or repurchasing in the near term. A derivative is classified as held for trading unless designated as and considered an effective hedge. Fair value through profit or loss financial instruments are recorded at fair value with any subsequent gains or losses from changes in the fair value included in earnings.

# High Arctic Energy Services Inc.

## Notes to the Consolidated Interim Financial Statements

### For the three months ended March 31, 2011 and 2010

(Canadian \$ Million - Unaudited)

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A derivative is a financial instrument whose value changes in response to a specified variable, requires little or no net investment and is settled at a future date. An embedded derivative is a derivative that is part of a non-derivative contract and not directly related to that contract. Embedded derivatives that are not closely related to the host contract must be accounted for as a separate financial instrument. A non-financial derivative is a contract that can be settled net in cash or another financial instrument. Fair values are based upon quoted market prices available from active markets or are otherwise determined using a variety of valuation techniques and models using quoted market prices.

The Corporation may enter into derivative contracts in order to manage risks. These contracts are marked to market at each reporting interval, with the change in estimated fair value recorded as a gain or loss in the period. The Corporation does not use derivative contracts for speculative or hedging purposes at this time. Currently, the Corporation has no qualifying hedging instruments, but in the future may designate any qualifying hedging instrument as a hedge for accounting purposes.

b) Held-to-maturity

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and a fixed maturity that the Corporation has the intent and ability to hold to maturity. These financial assets are measured at amortized cost using the effective interest method. Any gains or losses arising from the sale of a held-to-maturity investment are included in earnings.

c) Other financial liabilities

Items classified as other financial liabilities on the Corporation's financial statements are accounted for at amortized cost using the effective interest method. Any gains or losses in the realization of other financial liabilities are included in earnings. The fair value of accounts payable and accrued liabilities and the demand portion of any amounts due to related parties approximate their carrying values due to the short-term nature of these instruments. The fair value of the credit facility or the term loan and the interest bearing amount due to related parties are recorded at values that estimate the fair value as the interest payable reflects market rates.

Financial liabilities are classified as current liabilities if payment is due within twelve months. Otherwise they are presented as non-current liabilities.

d) Available-for-sale investments

Available-for-sale investments are non-derivatives that are either designated in this category or not classified in any of the other categories. The Corporation's available-for-sale assets comprise marketable equity securities. Available-for-sale investments are recognized initially at fair value plus transaction costs and are subsequently carried at fair value. Gains or losses arising from changes in fair value are recognized in other comprehensive income. Available-for-sale investments are classified as non-current, unless the investment matures within twelve months, or management expects to dispose of them within twelve months. Dividends on available-for-sale equity instruments are recognized in the statement of income as part of other gains and losses when the Corporation's right to receive payment is established. When an available-for-sale investment is sold or impaired, the accumulated gains or losses are moved from accumulated other comprehensive income to the statement of income and are included in other gains and losses.

e) Loans and receivables

All of the Corporation's cash equivalents are designated as loans and receivables. The fair value of cash and cash equivalents approximate their carrying value due to their short-term nature. Other items classified as loans and receivables in the Corporation's financial statements are accounted for at amortized cost using the effective interest method. Any gains or losses on the realization of loans and receivables are included in earnings. The fair value of accounts and other receivables and the demand portion of any amounts due from related parties approximate their carrying values due to the short-term nature of these instruments.

# High Arctic Energy Services Inc.

## Notes to the Consolidated Interim Financial Statements

For the three months ended March 31, 2011 and 2010

(Canadian \$ Million - Unaudited)

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### Subsequent measurement

The Corporation derecognizes a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the Corporation is recognized as a separate asset or liability.

Financial liabilities within the scope of IAS 39 are classified as financial liabilities at fair value through profit or loss, loans and receivables, or as derivatives designated as hedging instruments in an effective hedge, as appropriate. The Corporation determines the classification of its financial liabilities at initial recognition.

All financial liabilities are recognized initially at fair value and in the case of loans and borrowings, plus directly attributable transaction costs.

The measurement of financial liabilities depends on their classification as follows:

a) Derecognition

A financial liability is derecognized when the obligation under the liability is discharged or cancelled or expires. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognized in the income statement.

b) Offsetting of financial instruments

Financial assets and financial liabilities are offset and the net amount reported in the consolidated statement of financial position if, and only if, there is a currently enforceable legal right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the assets and settle the liabilities simultaneously.

c) Compound financial instruments (debentures)

Compound financial instruments issued by the Corporation comprise convertible debentures that can be converted to share capital at the option of the holder, and the number of shares to be issued does not vary with changes in their fair value.

The liability component of a compound financial instrument is recognized initially at the fair value of a similar liability that does not have an equity conversion option. The equity component is recognized initially at the difference between the fair value of the compound financial instrument as a whole and the fair value of the liability component. Any directly attributable transaction costs are allocated to the liability and equity components in proportion to their initial carrying amounts.

Subsequent to initial recognition, the liability component of a compound financial instrument is measured at amortised cost using the effective interest method. The equity component of a compound financial instrument is not re-measured subsequent to initial recognition except on conversion or expiry.

### Disposal of long-lived assets and discontinued operations

Long-lived assets are classified as held for sale if the carrying amount will be recovered principally through a sale transaction rather than through continued use and such sale is considered highly probable. The criteria for classification as held for sale include a firm decision by management or the Board of Directors to dispose of a business or a group of selected assets and the expectation that such disposal will be completed within a 12 month period. Assets held for sale are measured at the lower of their carrying amounts or their fair value less costs to sell and are no longer depreciated. Assets held for sale are classified as discontinued operations if the operations and cash flows can be clearly distinguished, operationally and for financial reporting purposes from the rest of the Corporation and they:

# High Arctic Energy Services Inc.

## Notes to the Consolidated Interim Financial Statements

For the three months ended March 31, 2011 and 2010

(Canadian \$ Million - Unaudited)

- represent a separate major line of business or geographical area of operations;
- are part of a single coordinated plan to dispose of a separate major line of business or geographical area of operations; or
- are a subsidiary acquired exclusively with a view to resale.

### Property and equipment

Property and equipment are stated at cost less accumulated depreciation and accumulated impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset. Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Corporation and the cost can be measured reliably. The carrying amount of a replaced asset is derecognized when replaced. Repairs and maintenance costs are charged to the statement of income during the period in which they are incurred.

Depreciation is calculated on the depreciable amount which is the carrying cost of an asset less its residual value.

Depreciation is recognized in profit and loss using the declining balance method over the estimated useful lives of the assets at the following rates:

Light vehicles	30%
Heavy trucks	15% - 20%
Office equipment and computer hardware	20% - 30%
Computer software	50% - 100%
Equipment – support and shop	20%
Equipment – drilling support	12.5% - 20%
Equipment – hydraulic workover and UB rigs	12.5% - 15%
Equipment – snubbing	15% - 17.5%
Equipment – nitrogen	17.5%
Leasehold improvements	Lease term or five years

The Corporation allocates the amount initially recognized in respect of an item of property and equipment to its significant parts and depreciates separately each such part. Residual values, method of amortization and useful lives of the assets are reviewed annually and adjusted if appropriate.

Gains and losses on disposals of property and equipment are determined by comparing the proceeds with the carrying amount of the asset and are included as part of other gains and losses in the statement of income.

### Assets-held-for-sale

The Corporation's assets-held-for-sale assets are comprised of property and equipment that is no longer active in the continuing operations of the Corporation. Property and equipment are tested for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable. Long-lived assets that are not amortized are subject to an annual impairment test. For the purpose of measuring recoverable amounts, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units or CGUs). The recoverable amount is the higher of an asset's fair value less costs to sell and value in use (being the present value of the expected future cash flows of the relevant asset or CGU). An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount.

### Inventories

Inventory consists primarily of operating supplies and spare parts not held for sale and are valued at the lower of average cost and net realizable value. Cost includes the cost of purchase as well as any costs of transport.

Net realizable value is the estimated selling price in the ordinary course of business, less estimated selling costs. A regular review is undertaken to determine the extent of any provision for obsolescence.

# High Arctic Energy Services Inc.

## Notes to the Consolidated Interim Financial Statements

### For the three months ended March 31, 2011 and 2010

(Canadian \$ Million - Unaudited)

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#### **Impairment of financial assets**

At each reporting date, the Corporation assesses whether there is objective evidence that a financial asset is impaired. If such evidence exists, the Corporation recognizes an impairment loss, as follows:

- a) Financial assets carried at amortized cost: The loss is the difference between the amortized cost of the loan or receivable and the present value of the estimated future cash flows, discounted using the instrument's original effective interest rate. The carrying amount of the asset is reduced by this amount either directly or indirectly through the use of an allowance account.
- b) Available-for-sale financial assets: The impairment loss is the difference between the original cost of the asset and its fair value at the measurement date, less any impairment losses previously recognized in the statement of income. This amount represents the cumulative loss in accumulated other comprehensive income that is reclassified to net income.

Impairment losses on financial assets carried at amortized cost are reversed in subsequent periods if the amount of the loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized. Impairment losses on available-for-sale equity instruments are not reversed through profit and loss.

#### **Impairment of non-financial assets**

Property and equipment are assessed for impairment when indicators of such impairment exist. If any indication of impairment exists an estimate of the asset's recoverable amount is calculated. The recoverable amount for an individual asset is determined as the higher of the fair value less costs to sell for the asset and the asset's value in use.

In some cases, the recoverable amount cannot be determined on an individual asset basis. In these cases, the recoverable amounts are estimated for groups of assets by determining the value in use of the group of assets. This is done by determining the value of the discounted cash inflows less the discounted cash outflows of the group of assets. For the purposes of assessing impairment on groups of assets, the individual assets are grouped together into cash generating units ("CGUs"). Such CGUs represent the lowest level for which there are separately identifiable cash inflows that are largely independent of the cash flows from other assets or other Corporation's assets.

If the carrying amount of the asset exceeds its recoverable amount, the asset is impaired and an impairment loss is charged to the statement of income so as to reduce the carrying amount to its recoverable amount.

A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. If this is the case, the carrying amount of the asset is increased to its recoverable amount. The increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in the statement of income.

#### **Impairment of non-current assets held for sale**

Non-current assets that are expected to be recovered primarily through sale rather than through continuing use, are classified as held for sale. Immediately before classification as held for sale, the assets are measured in accordance with the Corporation's accounting policies. Thereafter, the assets are measured at the lower of their carrying value and fair value less cost to sell. Impairment losses on initial classification as held for sale and subsequent gains or losses on re-measurements are recognized in profit or loss. Gains are not recognized in excess of cumulative impairment loss.

#### **Employee benefits**

- a) Pension obligations - defined contribution pension plan  
A defined contribution pension plan is a pension plan under which the Corporation pays fixed contributions into a separate entity. The Corporation has no legal or constructive obligations relating to future payments to employees.

# High Arctic Energy Services Inc.

## Notes to the Consolidated Interim Financial Statements

For the three months ended March 31, 2011 and 2010

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b) Bonus plans

The Corporation recognizes a liability and an expense for bonuses based on various formulae that take into consideration net earnings, EBITDA and other factors attributable to the financial and operational performance of the Corporation. The Corporation recognizes a provision where contractually obligated or where there is a past practice that has created a constructive obligation.

c) Share-based plans

The Corporation has a stock option plan that provides incentive for directors, management and employees. Options granted are measured at the fair value of the equity instruments at the grant date. Details regarding the determination of the fair value of stock options are set out in the share-based payment note.

The fair value determined at the grant date of the stock options is recognized as an employee benefit expense, with a corresponding increase in other reserve equity, over the vesting period based on the Corporation's estimate of equity instruments that will eventually vest. At the end of each reporting period, the Corporation revises its estimate of the number of equity instruments expected to vest. The impact of the revision of the original estimates, if any, is recognized immediately.

### Provisions

Provisions for legal claims and other obligations, where applicable, are recognized in accrued liabilities when the Corporation has a present legal or constructive obligation as a result of past events, it is more likely than not that an outflow of resources will be required to settle the obligation, and the amount can be reliably estimated. Provisions are measured at management's best estimate of the expenditure required to settle the obligation at the end of the reporting period, and are discounted to present value where the effect is material.

### Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable, net of estimated returns and discounts, and after eliminating intercompany sales. The Corporation bases its estimates on historical results, taking into consideration the type of customer, the type of transaction and the specifics of each arrangement.

Revenue from the rendering of services is recognized when the following criteria are met:

- the amount of revenue can be measured reliably;
- the stage of completion can be measured reliably;
- the receipt of economic benefits is probable; and
- costs incurred and to be incurred can be measured reliably.

In addition to the above general principles, the Corporation applies the following specific revenue recognition policies:

a) Mobilization revenue

The Corporation may receive payments from its customers for services yet to be rendered. The Corporation follows a policy of recognizing this revenue on a completion of service basis. As service is provided to the customer and the Corporation incurs expenses the Corporation recognizes revenue for the value of the service provided to that point in time.

### Interest and finance costs

Interest and finance costs comprise interest payable on borrowings calculated using the effective interest rate method as well as foreign currency gains and losses reported on a net basis as well as foreign currency gains and losses reported on a net basis.

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale.

# High Arctic Energy Services Inc.

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Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalisation. All other borrowing costs are recognized in profit or loss in the period in which they are incurred.

#### **Income tax**

Income tax expense comprises current and deferred tax. Current tax and deferred tax are recognized in profit or loss except to the extent that it relates to the items recognized directly in equity or in other comprehensive income.

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date.

Deferred tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized for temporary differences relating to investments in subsidiaries to the extent that it is probable that they will not reverse in the foreseeable future. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

A deferred tax asset is recognized for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

#### **Discontinued operations**

A discontinued operation is a component of the Corporation's business that represents a separate major line of business or geographical area of operations that has been disposed of or is held for sale. Classification as a discontinued operation occurs upon disposal or when the operation meets the criteria to be classified as held for sale, if earlier. When an operation is classified as a discontinued operation, the comparative statement of comprehensive income is presented as if the operation had been discontinued from the start of the comparative period.

#### **Share capital**

Common shares are classified as equity. Incremental costs directly attributable to the issuance of shares are recognized as a deduction from equity.

#### **Dividends**

Dividends, if declared, on common shares are recognized in the Corporation's financial statements in the period in which the dividends are approved by the Board of Directors of the Corporation.

#### **Earnings per share**

The Corporation presents basic and diluted earnings per share ("EPS") data for its common shares. Basic EPS is calculated by dividing the net earnings or loss attributable to common shareholders of the Corporation by the weighted average number of common shares outstanding during the period. Diluted EPS is determined by adjusting the net earnings or loss attributable to common shareholders and the weighted average number of common shares outstanding, adjusted for own shares held, for the effects of all dilutive potential common shares, which comprise convertible debentures, warrants, restricted incentive shares and share options granted to employees.

# High Arctic Energy Services Inc.

## Notes to the Consolidated Interim Financial Statements

### For the three months ended March 31, 2011 and 2010

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#### **Segment reporting**

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. The Corporation has determined that reportable business segments are as follows:

- a) the operations in Canada, and
- b) the operations in Papua New Guinea and other.

#### **4 Future Accounting Policies**

Prior to the adoption of IFRS by the Corporation, the IASB issued the following new standards which become effective for annual period beginning on or after January 1, 2013:

##### **IFRS 9**

IFRS 9 amends the classification and measurement criteria for financial instruments included within the scope of IAS 39. Financial assets will be measured at fair value or amortized cost and the available for sale category will be eliminated. If an equity investment is not required to be classified as held for trading, an irrevocable election can be made upon initial recognition to measure at fair value through other comprehensive income. Financial liabilities will be classified at amortized cost except for financial liabilities at fair value through profit and loss, financial guarantee contracts and commitments to provide a loan at a below market interest rate. A fair value option is available for both financial assets and liabilities as an alternative to amortized cost if certain conditions are met. The Corporation is analyzing the impact the new standard will have on its financial assets and liabilities.

##### **IFRS 10 & IAS 27**

IFRS 10, "Consolidated financial statements", is part of the group of five new standards that address the scope of the reporting entity. IFRS 10 replaces all of the guidance on control and consolidation in IAS 27, "Consolidated and separate financial statements", and SIC-12, "Consolidation – special purpose entities". IAS 27 is renamed "Separate financial statements";. The existing guidance for separate financial statements is unchanged. IFRS 10 changes the definition of control so that the same criteria are applied to all entities to determine control. The changed definition and application guidance is not expected to result in a change in the consolidation decisions made by the Corporation

##### **IFRS 11**

IFRS 11, "Joint Arrangements"; changes in the definition for the 'types' of joint arrangements to two: joint operations and joint ventures. The existing policy choice of proportionate consolidation for jointly controlled entities has been eliminated. Equity accounting is mandatory for participants in joint ventures. Entities that participate in joint operations will follow accounting much like that for joint assets or joint operations today. Entities with existing joint arrangements or that plan to enter into new joint arrangements will be affected by the new standard. The Corporation does not have any joint arrangements and does not expect this change to have any impact on its reporting.

##### **IFRS 12 & IAS 28**

IFRS 12 sets out the required disclosures for entities reporting under the two new standards, IFRS 10, "Consolidated financial statements", and IFRS 11, "Joint arrangements"; it replaces the disclosure requirements currently found in IAS 28, "Investments in associates". The new standard, IFRS 12, requires entities to disclose information that helps financial statement readers to evaluate the nature, risks and financial effects associated with the entity's interests in subsidiaries, associates, joint arrangements and unconsolidated structured entities. The Corporation is analyzing the impact the new standard will have.

#### **5 Key Sources of Estimation Uncertainty**

The preparation of the Interim Financial Statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates. Estimates and judgments used are based on management's experience and the assumptions used are believed to be reasonable given the circumstances that exist at the time the Interim Financial Statements are

# High Arctic Energy Services Inc.

## Notes to the Consolidated Interim Financial Statements

For the three months ended March 31, 2011 and 2010

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prepared. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected. The most significant of these are the estimates used for provisions for impairment of accounts receivable, depreciation and amortization, share-based compensation and deferred income tax assets and liabilities. The effect on the Interim Financial Statements of changes in such estimates in future years could be material.

### 6 Transition to IFRS

The Corporation's financial statements for the year ending December 31, 2011 will be the first annual financial statements that comply with IFRS. These Interim Financial Statements have been prepared under IFRS as described in Note 3.

IFRS requires that comparative financial information be provided. As a result, the first date at which the Corporation has applied IFRS was January 1, 2010 (the "Transition Date"). IFRS 1 requires first-time adopters to retrospectively apply all effective IFRS standards as of the reporting date. However, it also provides for certain optional exemptions and certain mandatory exceptions for first time IFRS adopters.

Following is a summary of the IFRS exemptions adopted by the Corporation:

#### IAS 21 – Foreign Exchange

The Corporation determined that the functional currency of its largest foreign operation (Papua New Guinea) to be the United States dollar. The Corporation had previously applied the temporal method where the property and equipment assets were measured at historical rates. Under IFRS, these assets are re-measured at the period ending rate upon consolidation of the financial statements. Through the retroactive application, the Corporation determined that a cumulative translation amount existed. An election exists under IFRS 1 to reset accumulated foreign currency translation amounts to zero. On conversion to IFRS, High Arctic chose the election under IFRS 1 to reset the accumulated foreign currency translation amounts to zero. There is no overall impact on the consolidated Interim Financial Statements as a result of this election because the changes affected only components of equity with an overall zero impact.

#### Reconciliations of Canadian GAAP to IFRS

The tables on the following pages provide reconciliations of the effect of the transition to IFRS.

The adoption of IFRS has had no impact on the net cash flows of the Corporation. The changes made to the consolidated statements of financial position and consolidated statements of comprehensive income have resulted in reclassifications of various amounts on the consolidated statements of cash flows, however as there have been no changes to the net cash flows, no reconciliations have been presented.

# High Arctic Energy Services Inc.

Notes to the Consolidated Interim Financial Statements  
For the three months ended March 31, 2011 and 2010

(Canadian \$ Million - Unaudited)

## Reconciliation of the Consolidated Statement of Equity as previously reported under Canadian GAAP to IFRS

	January 1, 2010			March 31, 2010			December 31, 2010		
	Previous CDN GAAP	Effect of transition to IFRS	IFRS	Previous CDN GAAP	Effect of transition to IFRS	IFRS	Previous CDN GAAP	Effect of transition to IFRS	IFRS
<b>Assets</b>									
<b>Current assets</b>									
Cash and cash equivalents	27.6	-	27.6	32.1	-	32.1	24.3	-	24.3
Accounts receivable	14.5	-	14.5	18.0	-	18.0	16.0	-	16.0
Inventories	2.8	-	2.8	3.0	-	3.0	2.5	-	2.5
Prepaid expenses	1.1	-	1.1	0.6	-	0.6	0.6	-	0.6
Assets held for sale including assets related to discontinued operations in the Middle East	16.6	-	16.6	-	-	-	1.7	-	1.7
Assets related to Middle East discontinued operations	0.6	-	0.6	0.4	-	0.4	-	-	-
	63.2	-	63.2	54.1	-	54.1	45.1	-	45.1
<b>Non-current assets</b>									
Property and equipment (Note 6a)	47.6	(0.3)	47.3	47.1	(0.7)	46.4	46.4	(0.9)	45.5
Assets held for sale including assets related to discontinued operations in the Middle East	-	-	-	2.0	-	2.0	-	-	-
	110.8	(0.3)	110.5	103.2	(0.7)	102.5	91.5	(0.9)	90.6



# High Arctic Energy Services Inc.

## Notes to the Consolidated Interim Financial Statements

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### Reconciliation of comprehensive income as previously reported under Canadian GAAP to IFRS

	Notes	Three months ended			Year ended		
		March 31, 2010			December 31, 2010		
		CDN GAAP	Adj	IFRS	CDN GAAP	Adj	IFRS
<b>Continuing operations</b>							
<b>Revenue</b>		34.6	-	34.6	119.3	-	119.3
<b>Expenses</b>							
Oilfield services		22.0	-	22.0	77.3	-	77.3
General and administration		2.3	-	2.3	7.7	-	7.7
Share-based compensation		-	-	-	1.9	-	1.9
Amortization		2.0	-	2.0	7.8	-	7.8
Gain on restructuring costs		-	-	-	(2.6)	-	(2.6)
Foreign exchange (gain) loss	6a	0.9	(0.7)	0.2	1.8	(1.8)	-
		27.2	(0.7)	26.5	93.9	(1.8)	92.1
<b>Operating earnings from continuing operations</b>		<b>7.4</b>	<b>0.7</b>	<b>8.1</b>	<b>25.4</b>	<b>1.8</b>	<b>27.2</b>
Interest and finance expense		2.0	-	2.0	5.3	-	5.3
<b>Net earnings before income taxes</b>		<b>5.4</b>	<b>0.7</b>	<b>6.1</b>	<b>20.1</b>	<b>1.8</b>	<b>21.9</b>
Income taxes		1.5	-	1.5	6.4	-	6.4
<b>Net earnings from continuing operations</b>		<b>3.9</b>	<b>0.7</b>	<b>4.6</b>	<b>13.7</b>	<b>1.8</b>	<b>15.5</b>
Discontinued operations		0.1	-	0.1	0.9	0.1	1.0
<b>Net earnings for the period</b>		<b>3.8</b>	<b>0.7</b>	<b>4.5</b>	<b>12.8</b>	<b>1.7</b>	<b>14.5</b>
<b>Other comprehensive income (loss)</b>							
Foreign currency translation differences for foreign operations	6a	-	(1.1)	(1.1)	-	(2.3)	(2.3)
<b>Total comprehensive income for the period attributable to equity holders of the Corporation</b>		<b>3.8</b>	<b>(0.4)</b>	<b>3.4</b>	<b>12.8</b>	<b>(0.6)</b>	<b>12.2</b>

See Notes to the Reconciliations below.

# High Arctic Energy Services Inc.

## Notes to the Consolidated Interim Financial Statements

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### Notes to the Reconciliations

#### a) Foreign Currency Translation

In accordance with IFRS 1, the Corporation has elected to deem all foreign currency translation differences that arose prior to the date of transition to be nil at the date of transition. Under GAAP, the Corporation had previously charged all foreign currency differences to profit and loss and they therefore form part of retained earnings. After transition, the cumulative foreign currency translation differences will be accumulated in a separate component of equity under IFRS rather than forming part of retained earnings.

Under IFRS, all assets and liabilities of foreign subsidiaries will be translated using the end of period exchange rate. The Corporation had previously used the temporal method under GAAP whereby the property and equipment had been translated at their historical rates. There are no income tax effects in the consolidated Interim Financial Statements as these temporary differences have already been accounted for in the the financial statements of the Corporation's subsidiaries.

The impact arising from the changes is summarized as follows:

#### Consolidated Statement of Financial Position

	Property and Equipment	Accumulated Amortization	Net Property and Equipment	Cumulative Translation Account	Retained Earnings (deficiency)
Balance – January 1, 2010 (GAAP)	109.7	(62.1)	47.6	-	(141.8)
Currency translation	(0.8)	0.5	(0.3)	-	(0.3)
Balance - January 1, 2010 (IFRS)	<u>108.9</u>	<u>(61.6)</u>	<u>47.3</u>	<u>-</u>	<u>(142.1)</u>
Balance – March 31, 2010 (GAAP)	111.2	(64.1)	47.1	-	(138.0)
Currency translation	(1.3)	0.6	(0.7)	(1.1)	0.4
Balance – March 31, 2010 (IFRS)	<u>109.9</u>	<u>(63.5)</u>	<u>46.4</u>	<u>(1.1)</u>	<u>(137.6)</u>
Balance – December 31, 2010 (GAAP)	116.4	(70.0)	46.4	-	(129.0)
Currency translation	(1.9)	1.0	(0.9)	(2.3)	1.4
Balance – December 31, 2010 (IFRS)	<u>114.5</u>	<u>(69.0)</u>	<u>45.5</u>	<u>(2.3)</u>	<u>(127.6)</u>

#### Consolidated Statement of Comprehensive Income

	Net earnings	Other comprehensive income account	Total comprehensive income
Balance – March 31, 2010 (GAAP)	3.8	-	3.8
Currency translation	0.7	(1.1)	(0.4)
Balance - March 31, 2010 (IFRS)	<u>4.5</u>	<u>(1.1)</u>	<u>3.4</u>
Balance – December 31, 2010 (GAAP)	12.8	-	12.8
Currency translation	1.7	(2.3)	(0.6)
Balance – December 31, 2010 (IFRS)	<u>14.5</u>	<u>(2.3)</u>	<u>12.2</u>

# High Arctic Energy Services Inc.

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### 7 Accounts Receivable

The aging of accounts receivables is as follows. The allowance for doubtful debts provision is based on an individual account by account analysis and the customer's prior credit history.

	<b>March 31, 2011</b>	<b>December 31, 2010</b>	<b>January 1, 2010</b>
Less than 31 days	12.4	8.2	11.2
31 to 60 days	3.8	5.5	2.8
61 to 90 days	0.8	1.3	0.8
Greater than 90 days	0.6	1.7	0.4
Allowances for doubtful debts	(0.5)	(0.7)	(0.7)
<b>Total</b>	<b>17.1</b>	<b>16.0</b>	<b>14.5</b>

The Corporation's accounts receivables are denominated in the following currencies

	<b>March 31, 2011</b>	<b>December 31, 2010</b>	<b>January 1, 2010</b>
Canadian dollar	10.0	7.7	4.9
United States dollar	7.1	8.3	9.6
<b>Total</b>	<b>17.1</b>	<b>16.0</b>	<b>14.5</b>

# High Arctic Energy Services Inc.

## Notes to the Consolidated Interim Financial Statements

### For the three months ended March 31, 2011 and 2010

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#### 8 Property and Equipment

The following table reconciles the property and equipment opening balances and the effects of foreign currency translation on the opening balances.

Cost	Light vehicles	Heavy trucks	Computer software	Equipment support and shop	Equipment drilling support	Equipment hydraulic workover and UB rigs	Equipment snubbing	Equipment nitrogen	Leasehold improvements	Computer hardware and office equipment	Work-in-progress	Total
<b>Balance January 1, 2010</b>	1.8	19.4	0.9	10.6	9.6	21.9	32.6	9.8	0.5	1.0	0.8	108.9
Additions	0.5	-	-	-	5.0	-	0.5	-	-	0.1	1.4	7.5
Disposals	-	-	-	-	-	-	-	-	-	-	-	-
Effect of foreign currency exchange	-	(0.1)	-	-	(1.4)	(0.4)	-	-	-	-	-	(1.9)
<b>Balance December 31, 2010</b>	2.3	19.3	0.9	10.6	13.2	21.5	33.1	9.8	0.5	1.1	2.2	114.5
Additions	0.6	-	0.2	-	1.8	-	-	-	0.1	-	0.5	3.2
Reimbursable cost recoveries for upgrade of equipment	-	-	-	-	-	-	-	-	-	-	(1.5)	(1.5)
Disposals	(0.7)	-	-	-	-	-	-	-	-	(0.2)	-	(0.9)
Effect of foreign currency exchange	-	-	-	-	(0.4)	(0.3)	-	-	-	-	-	(0.7)
<b>Balance March 31, 2011</b>	2.2	19.3	1.1	10.6	14.6	21.2	33.1	9.8	0.6	0.9	1.2	114.6

# High Arctic Energy Services Inc.

## Notes to the Consolidated Interim Financial Statements

### For the three months ended March 31, 2011 and 2010

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Accumulated amortization and impairments	Equipment										Total	
	Light vehicles	Heavy trucks	Computer software	Equipment support and shop	Equipment drilling support	Equipment hydraulic workover and UB rigs	Equipment snubbing	Equipment nitrogen	Leasehold improvements	Computer hardware and office equipment		Work-in-progress
<b>Balance January 1, 2010</b>	1.1	12.6	0.7	0.8	4.8	13.4	22.1	5.4	-	0.7	-	<b>61.6</b>
Amortization for the period	0.3	1.1	0.1	0.1	0.4	2.6	2.9	0.8	0.1	0.1	-	8.5
Disposals	-	-	-	-	-	-	-	-	-	-	-	-
Effect of foreign currency exchange	(0.1)	-	-	-	(0.7)	(0.2)	(0.1)	-	-	-	-	(1.1)
<b>Balance December 31, 2010</b>	<b>1.3</b>	<b>13.7</b>	<b>0.8</b>	<b>0.9</b>	<b>4.5</b>	<b>15.8</b>	<b>24.9</b>	<b>6.2</b>	<b>0.1</b>	<b>0.8</b>	<b>-</b>	<b>69.0</b>
Amortization for the period	0.1	0.2	-	0.2	0.5	0.1	0.6	0.1	-	-	-	1.8
Disposals	(0.7)	-	-	-	-	-	-	-	-	(0.2)	-	(0.9)
Effect of foreign currency exchange	-	-	-	-	(0.1)	(0.2)	-	-	-	-	-	(0.3)
<b>Balance March 31, 2011</b>	<b>0.7</b>	<b>13.9</b>	<b>0.8</b>	<b>1.1</b>	<b>4.9</b>	<b>15.7</b>	<b>25.5</b>	<b>6.3</b>	<b>0.1</b>	<b>0.6</b>	<b>-</b>	<b>69.6</b>
<b>Carrying amounts</b>												
At January 1, 2010	0.7	6.8	0.2	9.8	4.8	8.5	10.5	4.4	0.5	0.3	0.8	47.3
At December 31, 2010	1.0	5.6	0.1	9.7	8.7	5.7	8.2	3.6	0.4	0.3	2.2	45.5
At March 31, 2011	1.5	5.4	0.3	9.5	9.7	5.5	7.6	3.5	0.5	0.3	1.2	45.0

# High Arctic Energy Services Inc.

## Notes to the Consolidated Interim Financial Statements

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### 9 Assets Held for Sale

In addition to the value held in property and equipment at March 31, 2011, the Corporation had property and equipment classified and recorded as assets held for sale of \$1.7 million (December 31, 2010 - \$1.7 million) which includes assets related to discontinued operations. The following amounts are included in the balance:

<b>Assets held for sale including assets related to discontinued operations</b>	<b>Balance as at March 31, 2011</b>
<b>Balance January 1, 2010</b>	16.6
Disposals in quarter ended March 31, 2010	(14.9)
Balance as at March 31, 2010	1.7
Disposals from April 1, 2010 through December 31, 2010	-
Balance as at December 31, 2010	1.7
Disposals in quarter ended March 31, 2011	-
Balance as at March 31, 2011	1.7

The Corporation sold equipment classified as assets held for sale on January 13, 2010. No gain or loss on the sale was recognized. The equipment sold included two drilling rigs and a hydraulic workover rig.

### 10 Accounts Payable and Accrued Liabilities

	<b>March 31, 2011</b>	<b>December 31, 2010</b>	<b>January 1, 2010</b>
Accounts payable	4.7	4.5	2.9
Accrued liabilities	2.4	5.1	10.7
Accrued payroll	2.9	1.6	1.3
<b>Total</b>	<b>10.0</b>	<b>11.2</b>	<b>14.9</b>

# High Arctic Energy Services Inc.

## Notes to the Consolidated Interim Financial Statements

### For the three months ended March 31, 2011 and 2010

(Canadian \$ Million - Unaudited)

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## 11 Interest-bearing Loans and Borrowings

### Credit Facility

The Corporation has a term loan with a maturity date of April 30, 2011. As at March 31, 2011, the Corporation owed \$23.7 million on the term loan (December 31, 2010 – \$36.5 million). The interest rate applicable to the term loan facility commencing May 1, 2010 was prime plus 4.75% provided that prime had a floor amount of 4.75%. As a result, the minimum interest rate was 9.5%. Prior to May 1, 2010, the interest rate applicable to a portion of the former credit facility that was replaced by the term loan was prime plus 2% and prime plus 6.25% for the remaining portion.

On May 6, 2011 the Corporation entered into a financing agreement with a new lender for new credit facilities to replace the term loan that existed as at March 31, 2011 (see Note 23, Subsequent Events).

There were no fixed amortization obligations under the term loan but payments during the term were required if the financial results of the Corporation exceeded the agreed upon projections. Based on the financial results for the three months ended December 31, 2010, the Corporation made a payment in March, 2011 of \$10.5 million that was applied to reduce the principal amount of the term loan. A further \$2.3 million was repaid during the quarter out of proceeds arising from the sale of assets. The obligations under the term loan facility were secured by, among other things, the pledge of accounts receivable and the eligible equipment pursuant to debentures under which the Corporation and its subsidiaries granted security over all of their respective assets.

The consolidated leverage ratio ("CLR") was one of the key financial ratio covenants under the term loan and is a key measure used by the Corporation in assessing the progress made to reduce its leverage. The CLR is defined in the term loan facility agreement as, in general terms, consolidated total debt, as defined, divided by the 12-month trailing adjusted consolidated earnings before interest, depreciation, amortization and taxes. The CLR covenant was applied monthly and the maximum allowable ratio varied from 2.25 to 1.00, to 2.75 to 1.00. As at March 31, 2011, the Corporation had a CLR of approximately 0.7 to 1.0 (see Note 18).

The Corporation issued 12,630,740 common shares to the lenders as consideration for the new term loan on April 30, 2010. The Corporation valued the shares at \$2.5 million and that amount was expensed as explained in Note 12.

### Convertible Debentures

In November 2007, the Corporation issued \$27.9 million principal amount of unsecured convertible debentures (the "Debentures") with a maturity date of December 31, 2012. Costs related to the issuance of the Debentures were \$1.9 million, of which \$1.7 million was deducted against the related debt and amortized. The costs related to the issuance of the Debentures were fully amortized as at December 31, 2009.

As part of restructuring transactions completed on April 30, 2010 (see Note 12), the entire principal amount and all accrued and unpaid interest owing under the Debentures was converted into 123,681,133 common shares of the Corporation. The principal amount of \$27.9 million was converted into 111,592,000 common shares in full settlement of all outstanding principal owing plus 12,089,133 common shares were issued in full settlement of all accrued interest owing to the holders of the Debentures. The Corporation had accrued interest of \$3.7 million up to completion of the restructuring transactions on April 30, 2010.

Share capital of 123,681,133 common shares issued in settlement of the principal and interest was recorded at the estimated market value of \$24.7 million resulting in a gain on settlement of \$6.9 million recognized during the second quarter of 2010 (See Note 12).

Prior to the restructuring transactions, the Debentures were considered a compound financial instrument and the liability and equity components were presented separately. The Debentures had been accounted for using the residual method, resulting in an equity element stemming from the call option in the amount of \$2.8 million, net of related issue costs of \$0.2 million, being credited to shareholders' equity. The liability was valued using an estimated borrowing rate of 16% and was fully accreted as at December 31, 2009.

# High Arctic Energy Services Inc.

## Notes to the Consolidated Interim Financial Statements

For the three months ended March 31, 2011 and 2010

(Canadian \$ Million - Unaudited)

### 12 Share Capital and Other Components of Equity

#### (a) Details of Shareholders equity (deficiency)

##### Reconciliation of equity

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

	March 31, 2011	December 31, 2010	January 1, 2010
Retained earnings (deficit) – opening	(120.3)	(127.6)	(142.1)
Common shares (b)	166.8	165.4	126.9
Convertible debentures, equity portion	-	-	2.8
Warrants	-	-	1.7
Contributed surplus (c)	6.4	6.3	4.6
Accumulated other comprehensive income	(3.1)	(2.3)	-
<b>Total equity (deficiency)</b>	<b>49.8</b>	<b>41.8</b>	<b>(6.1)</b>

#### (b) Changes in Issued Shares

	March 31, 2011		December 31, 2010	
	Shares	\$	Shares	\$
Opening balance	215,418,722	163.6	45,442,325	126.9
Issuance of shares	-	-	696,140	0.1
Issuance of shares on restructuring transactions	-	-	169,280,257	36.6
Common shares outstanding	215,418,722	163.6	215,418,722	163.6
Restricted shares outstanding	35,500,000	3.2	-	-
Restricted shares issued under the Share Incentive Plan	1,000,000	0.0	35,500,000	1.8
Total common and restricted shares outstanding	251,918,722	166.8	250,918,722	165.4

#### Restructuring transactions

On April 30, 2010 the Corporation completed a series of restructuring transactions to reduce debt levels and to meet the requirements for an extension of the credit facilities (see Note 11). Under the restructuring transactions, the Corporation:

- issued 32,968,384 common shares in settlement of all outstanding indebtedness and claims owing by the Corporation to related parties (see Note 14);
- converted the Corporation's outstanding Debentures into 111,592,000 common shares in full settlement of all outstanding principal of \$27,898,000 plus 12,089,133 common shares in full settlement of all accrued interest owed to the holders of the Debentures (see Note 11); and
- issued 12,630,740 common shares to its senior lenders as consideration for a one year term loan to refinance the existing senior credit facilities (see Note 11).

The Corporation issued a total of 169,280,257 common shares as part of the restructuring transactions. The shares were issued at a nominal value of \$0.25 per share. The amount recorded in share capital for the 169,280,257 common shares is the estimated market value of \$33.8 million determined as the trading price of \$0.20 per share at the closing date.

# High Arctic Energy Services Inc.

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### Restricted shares issued under the Share incentive Plan

On March 14, 2011 the Corporation issued 1,000,000 shares under the Share Incentive Plan (Note 13) to a trustee for the benefit of designated senior managers. The number of shares has been reflected under the total issued and outstanding common shares while the value of these shares will be included in the common share capital amount as they vest over the 3 year vesting period. These shares vest to each designated beneficiary over a 3 year period and a share capital amount of \$0.21 per share will be recorded as the related stock based compensation expense is recognized.

On September 1, 2010, the Corporation issued 35,500,000 shares under the Share Incentive Plan (Note 13) to a trustee for the benefit of designated directors and executive management. These shares also vest over a 3 year period to each designated beneficiary and a share capital amount of \$0.165 per share will be recorded as the related stock based compensation expense is recognized.

The designated beneficiaries of the restricted common shares held in trust have full voting, liquidity, dividend and other related rights similar to the holders of the unrestricted issued shares. The shares are not freely tradable prior to vesting and any shares that do meet the vesting conditions will be returned by the trustee to the Corporation for cancellation.

### c) Contributed Surplus

	Three months ended March 31, 2011	Year ended December 31, 2010
Opening Balance	6.3	4.6
Expiry of warrants	-	1.7
Share-based compensation (Note 13)	0.1	-
Closing Balance	6.4	6.3

### (d) Per Share Amounts

The following table summarizes the weighted average number of common shares used in calculating basic and diluted earnings per share. All potentially dilutive instruments such as options, the Executive and Director Share Incentive Plan, warrants and the convertible debentures are considered. The warrants and convertible debentures are anti-dilutive. Earnings (loss) from discontinued operations have no material effect on the earnings per share calculations.

	March 31, 2011		March 31, 2010	
	Number of Shares	Earnings per Share	Number of Shares	Earnings per Share
Weighted average number of common shares used in basic earnings per share	215,418,722	\$0.03	45,442,325	\$0.10
<b>Adjustments for:</b>				
Convertible debentures	-		17,220,988	
Stock options	-		598,769	
Restricted shares	35,688,889		-	
Weighted average number of common shares used in diluted earnings per share	251,107,611	\$0.03	63,262,082	\$0.08

## 13 Share-based Compensation

# High Arctic Energy Services Inc.

## Notes to the Consolidated Interim Financial Statements

For the three months ended March 31, 2011 and 2010

(Canadian \$ Million - Unaudited)

### Stock Option Plan

The Corporation has a Stock Option Plan under which options to purchase common shares may be granted to directors, management and key employees. A total of 25,191,872 options (being 10% of all outstanding shares) are available for grants.

At March 31, 2011, a total of 5,546,500 options are outstanding and expire at various dates up to 2016, at amounts that range from \$0.13 to \$12.61 per share. These options are exercisable over a term of 5 years and are subject to a three year vesting period with 40% exercisable by the holder after the first anniversary date, 70% after the second anniversary date and 100% after the third anniversary date. The options have an average remaining contractual life of 3.79 years and 1,834,125 options are currently vested and eligible to be exercised.

	Number of Options	Weighted Average Exercise Price \$/Share
<b>Total Outstanding January 1, 2010</b>	3,210,550	0.79
Granted	3,087,500	0.20
Exercised	(71,140)	0.15
Expired	(59,500)	10.53
Forfeited	(440,010)	1.15
<b>Total Outstanding December 31, 2010</b>	<b>5,727,400</b>	<b>0.35</b>
Granted	117,500	0.21
Forfeited	(294,900)	0.80
Expired	(3,500)	12.61
<b>Total Outstanding March 31, 2011</b>	<b>5,546,500</b>	<b>0.32</b>

Exercise Price Range	Options Outstanding			Exercisable Options	
	Number of Options	Remaining Contractual Life (Years)	Weighted Average Exercise Price (\$)	Number of Options	Weighted Average Exercise Price (\$)
\$0.13 to \$1.99	5,423,150	3.86	0.19	1,710,775	0.19
\$2.00 to \$3.99	55,350	1.01	2.75	55,350	2.75
\$4.00 to \$6.99	27,000	0.71	6.03	27,000	6.03
\$7.00 to \$9.99	30,500	0.51	9.71	30,500	9.71
\$10.00 to \$12.61	10,500	0.44	11.57	10,500	11.57
<b>Total Outstanding March 31, 2011</b>	<b>5,546,500</b>	<b>3.79</b>	<b>0.32</b>	<b>1,834,125</b>	<b>0.58</b>

Shared-based compensation is a non-cash item and is measured in accordance with a prescribed formula. Share-based compensation expense of \$0.1 million for the stock option plan was recorded by the Corporation for the three months ended March 31, 2011 (2010 – nil) based on amortizing any expense over the vesting period using the Black-Scholes model. The options measured prior to December 31, 2007 used an average risk-free interest rate of 4.2%; average expected life of 5 years; expected volatility of 40% to September 30, 2007 and 75% thereafter and a weighted average estimate of distribution yield of nil. The 2008 options were measured using an average risk-free interest rate of 3.4%; average expected life of 5 years; expected volatility of 67.3% and an expected annual dividend yield of nil. The options in 2009 were measured with a weighted average expected volatility of 117.1%, a risk free interest rate of 1.11%, expected annual dividend yield of 0.0% and an expected life of 5 years. The options in 2010 were measured with a weighted average expected

# High Arctic Energy Services Inc.

## Notes to the Consolidated Interim Financial Statements

### For the three months ended March 31, 2011 and 2010

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volatility of 138.5%, a risk free interest rate of 1.84%, expected annual dividend yield of 0.0% and an expected life of 5 years. The options in 2011 were measured with a weighted average expected volatility of 142.4%, a risk free interest rate of 1.77%, expected annual dividend yield of 0.0% and an expected life of 5 years.

#### Share Incentive Plan

On June 29, 2010, the shareholders approved an Executive and Director Share Incentive Plan. The maximum number of common shares reserved for issuance by the Corporation under the plan is 37,892,220 common shares. On August 17, 2010, 35,500,000 shares were granted to executives and directors of the Corporation. These incentive shares have a three year vesting period with 40% vesting on April 1, 2011, 30% on September 1, 2012 and 30% on September 1, 2013.

On March 14, 2011 a further 1,000,000 shares were granted to senior managers of the Corporation. These incentive shares have a three year vesting period with 40% vesting on December 31, 2011, 30% on December 31, 2012 and 30% on December 31, 2013.

A share-based compensation amount for the common shares issued under the plan is measured as the number of common shares multiplied by the trading price of the Corporation's shares at the time of the grant and that amount is amortized over the vesting period. Each vesting period is treated as a separate tranche for measurement of the non-cash share-based compensation expense. The share-based compensation for each tranche is expensed based on the vesting date for that tranche resulting in a proportionally greater amount being recognized in the earlier periods. An expense of \$1.4 million was recorded for the quarter ended March 31, 2011 (\$1.8 million has been recorded for the year ended December 31, 2010) and an amount of up to \$2.9 million (before recognizing a reduction for any future forfeitures of common shares) remains to be amortized in future periods in respect of the 36,500,000 common shares issued to date.

#### 14 Related Party Transactions

In the normal course of business, during the three months ended March 31, 2011, the Corporation incurred general and administration expenses related to premises rent of \$0.1 million (March 31, 2010 - \$0.1 million) and equipment and vehicle leases payments of nil (March 31, 2010 - \$0.1 million) charged by companies controlled by the person who, prior to the restructuring transactions, controlled almost 40% of the outstanding shares and who was the President and Chief Executive Officer of the Corporation until December 16, 2008 (the "Shareholder"). These transactions are measured at exchange values based on rates charged by arms length persons, which, in the opinion of management, approximate fair value.

The Shareholder also made various loans and advances to the Corporation. Interest expense for the three months ended March 31, 2011 was nil (March 31, 2010 - \$0.1 million) in respect of the amounts that were settled with the Shareholder.

As part of the restructuring transactions completed on April 30, 2010 (see Note 12), the Corporation issued 32,968,384 common shares to the Shareholder and companies controlled by him in settlement of the outstanding obligations owing by the Corporation on that date with a recorded amount of approximately \$7.2 million. Mutual releases were signed between the parties settling all outstanding litigation and other claims to April 30, 2010. The Corporation recorded the value of the 32,968,384 common shares as \$6.6 million resulting in a \$0.6 million gain on the settlement of the outstanding obligations that is included in the gain on restructuring transactions.

# High Arctic Energy Services Inc.

## Notes to the Consolidated Interim Financial Statements

For the three months ended March 31, 2011 and 2010

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### 15 Expenses

#### Operating expenses by nature

	March 31, 2011	March 31, 2010
Personnel costs and personnel related costs	11.5	10.0
Drilling rig rental cost	5.8	4.3
Material and supplies cost	3.5	5.5
Equipment operating and maintenance costs	2.2	1.6
Other	0.4	0.6
<b>Total</b>	<b>23.4</b>	<b>22.0</b>

#### General and administrative expenses

	March 31, 2011	March 31, 2010
Personnel costs and personnel related costs	1.1	1.3
Professional, legal and consulting fees	0.3	0.2
Facility costs	0.5	0.6
Other	0.1	0.2
<b>Total</b>	<b>2.0</b>	<b>2.3</b>

### 16 Gain on Sale of Investments

The Corporation recorded a gain of \$2.0 million in the quarter ended March 31, 2011 (2010 – nil) arising on the sale of 10,000,000 shares of Transeuro Energy Corp. ("Transeuro"). The shares were received as part of a settlement in 2009 of amounts owed to the Corporation by Transeuro. The shares had no carrying value as the debts had previously been deemed uncollectable and written off and the shares had an uncertain value when acquired. As a result, the full amount of the proceeds of sale of \$2.0 million was recognized in operating earnings..

### 17 Contingent Liabilities and Contingent Assets

#### Accounts Receivable

The Corporation has commenced litigation against a customer with respect to collection of a receivable for services rendered outside Canada. The Corporation believes it has made an adequate provision for the possibility of non-collectable amounts. The customer has made a number of allegations and initiated a counter claim of \$5 million concerning performance issues and the cashing of the letter of credit of \$1.0 million. The Corporation has not recorded an accrual in relation to the counter claim as management believes that the claim is without merit.

# High Arctic Energy Services Inc.

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### Other

The Corporation has posted a performance bond of approximately US\$3.5 million, in respect of a contract in the Middle East region, and would be liable if the bond was called as a result of a default by the Corporation in the performance of its obligations under the contract. Under the terms of the contract, the Corporation could be obligated to provide up to five rigs that may not be available if requested. As at March 31, 2011, the Corporation was not providing any services under that contract. The term of the contract ends in August, 2012.

## 18 Capital Disclosures

The Corporation's capital structure is comprised of shareholders' equity (deficiency), described in Note 12, and the credit facility and convertible debentures described in Note 11 less cash and cash equivalents.

	March 31, 2011	December 31, 2010	January 1, 2010
Shareholders' equity (deficiency)	49.8	41.8	(6.1)
Convertible debentures	-	-	27.9
Credit facility	23.7	36.5	65.4
Cash and cash equivalents	(19.4)	(24.3)	(27.6)
<b>Total Capitalization</b>	<b>54.1</b>	<b>54.0</b>	<b>59.6</b>

The Corporation's goal is to have a capital structure that will provide the capital to meet the needs of its business and instil confidence with investors, creditors and capital markets. The Corporation has been focused on reducing its debt levels and increasing the shareholders' equity to reduce its leverage ratios and provide adequate financial flexibility to meet its financial obligations, both current and long term.

Future equity financings are a possibility to further reduce debt and raise capital for new business opportunities. Financing decisions for the foreseeable future will be governed largely by the requirement to manage the credit facility. Longer term, financing decisions will be based on the timing and extent of expected operating and capital cash outlays.

The Corporation monitors its debt levels and ability to service the debt using non-GAAP financial metrics with the primary one being the Consolidated Leverage Ratio or CLR. The CLR is defined in the term loan agreement as, in general terms, consolidated total debt, as defined in the loan agreement, divided by the 12-month trailing adjusted consolidated earnings before interest, depreciation, amortization and taxes (EBITDA). The Corporation's CLR level on March 31, 2011 was 0.7 to 1.0 which was in compliance with the covenant under the terms of the credit facility.

# High Arctic Energy Services Inc.

## Notes to the Consolidated Interim Financial Statements

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### Consolidated Leverage Ratio Calculation

	Twelve Months Ended March 31, 2011	Twelve Months Ended December 31, 2010
Consolidated Total Debt	23.7	36.5
Total net earnings	17.3	14.5
<b>Add (deduct):</b>		
Interest and financing	4.2	5.3
Income tax	5.9	6.4
Amortization	7.7	7.8
Gain on sale of investments	(2.0)	-
Gain on restructuring transactions	(2.6)	(2.6)
Share-based compensation	3.4	1.9
<b>Adjusted EBITDA (Twelve Month)</b>	<b>33.9</b>	<b>33.3</b>
<b>Consolidated Leverage Ratio</b>	<b>0.7</b>	<b>1.1</b>

## 19 Financial Instruments and Risk Management

### Fair Value of Financial Assets and Liabilities

The Corporation's cash and cash equivalents are designated as loans and receivables and are measured at carrying value, which approximates fair value due to the short term nature of these instruments. Accounts receivable are designated as loans and receivables and recorded at amortized cost, which approximates fair value due to the short term nature of the instrument. Accounts payable and accrued liabilities and the credit facility are designated as other liabilities and are recorded at cost.

### Financial Risks

The Corporation is exposed to financial risks arising from its financial assets and liabilities. The financial risks include market risk relating to interest rates, foreign currency risk, commodity price risk, credit risk and liquidity risk.

#### Market Risk

Market risk is the risk that the fair value or future cash flows of financial assets or liabilities will fluctuate due to movements in market rates of interest, foreign currency exchange rates and commodity prices.

#### Interest Rate Risk

Interest rate risk is the risk that the value of a financial instrument will fluctuate as a result of changes in market interest rates. The Corporation is exposed to interest rate risk as the term loan is a floating rate credit facility and fluctuates in response to changes in the prime interest rates. For the three months ended March 31, 2011, a 1% nominal change in the interest charged to the Corporation under its credit facility would have changed interest expense by \$0.1 million (2010 - \$0.1 million).

# High Arctic Energy Services Inc.

## Notes to the Consolidated Interim Financial Statements

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### **Foreign Currency Risk**

Foreign currency risk is the risk that a variation in the exchange rate between Canadian and foreign currencies will affect the Corporation's results. The majority of the Corporation's international revenue and expenses are transacted in U.S. dollars and the Corporation does not actively engage in foreign currency hedging.

For the three months ended March 31, 2011, a 1% nominal change in the value of the Canadian dollar relative to the U.S. dollar would have resulted in a \$0.1 million (2010 - \$0.2 million) change in other comprehensive income as a result of changes in foreign exchange.

### **Commodity Price Risk**

Commodity price risk is the risk that fluctuations in oil or natural gas prices could materially adversely affect the Corporation's financial condition. The commodity prices affect the levels of drilling activity, which affects certain segments of the Corporation's business, particularly with respect to natural gas. The Corporation mitigates this exposure with its diversification into international operations not dependent on the Canadian oil and gas industry.

### **Risk of Foreign Operations**

The Corporation operates in international locations, including Papua New Guinea, where the political and economic systems differ from those in Canada. Operations in these countries may be subject to a variety of risks including, but not limited to: currency fluctuations, devaluations and exchange controls; inflation; uncertain political and economic conditions resulting in unfavourable government actions such as unfavourable legislation or regulation, trade restrictions, unfavourable tax enforcement or adverse tax policies; the denial of contract rights; and social unrest, acts of terrorism or armed conflict. To attempt to mitigate these risks, the Corporation employs personnel with extensive experience in the international marketplace, supplemented with qualified local staff.

### **Credit Risk**

Credit risk is the risk of a financial loss occurring as a result of a default by a counter party on its obligation to the Corporation. The Corporation's financial instruments that are exposed to credit risk consist primarily of accounts receivable and cash balances held in banks. The Corporation mitigates credit risk by regularly monitoring its accounts receivable position and depositing cash in properly capitalized banks. The Corporation also institutes detailed credit reviews prior to commencement of contractual arrangements and where practical uses export credit insurance provided by Export Development Canada (see Note 7).

### **Customers**

The Corporation's account receivables are predominantly with customers who explore for and develop petroleum reserves and are subject to normal industry credit risks. The Corporation assesses the credit worthiness of its customers on an ongoing basis and monitors the amount and age of balances outstanding. The Corporation views the credit risks on these amounts as normal for the industry. The carrying amount of accounts receivable represents the maximum credit exposure on this balance. The Corporation has a wide range of customers comprised of small independent, intermediate and large multinational oil and gas producers. Notwithstanding its large customer base, the Corporation has two significant customers. Services are provided to the first significant customer in Papua New Guinea. That customer represents approximately 36% of the Corporation's revenue for the quarter ended March 31, 2011 and 36% of its accounts receivable at that date. The second significant customer is a major Canadian exploration and production company which represents approximately 16% of the Corporation's revenue for the quarter ended March 31, 2011 and 10% of the Corporation's accounts receivable at that date. The services provided to this customer are distributed within this customer's diverse locations of operations within Canada, which management believes limits the risk of concentrating a significant portion of its revenue on this customer. Management has assessed the two customers as creditworthy and the Corporation has had no history of collection issues with either customer.

# High Arctic Energy Services Inc.

## Notes to the Consolidated Interim Financial Statements

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### Liquidity Risk

Liquidity risk is the risk that the Corporation will not be able to meet its financial obligations as they fall due. The Corporation's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due. The Corporation's processes for managing liquidity risk include preparing and monitoring capital and operating budgets, coordinating and authorizing project expenditures, and authorization of contractual agreements. The Corporation seeks to manage its financing based on the results of these processes.

The following are the contractual maturities of financial liabilities in the future fair value amounts:

	<b>1 Year</b>	<b>2-3 Years</b>	<b>4-5 Years</b>	<b>Beyond 5 Years</b>	<b>Total</b>
Accounts payable	10.0	-	-	-	10.0
Credit facility	23.7	-	-	-	23.7
<b>Total</b>	<b>33.7</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>33.7</b>

## 20 Operating Lease Arrangements

### **Lease Obligations**

The Corporation has entered into long-term premises leases for operating facilities in Canada. These leases are operating leases and the length of the lease terms are up to four years. All the premises leases in Canada have renewal terms which allow the Corporation to renew the lease for various lengths at the market rates negotiated at the time of renewal.

The minimum lease payments for the next five years as at March 31, 2011 are:

	<b>1 Year</b>	<b>2-3 Years</b>	<b>4-5 Years</b>	<b>Beyond 5 Years</b>	<b>Total</b>
Facility lease commitments	0.6	0.6	0.4	-	1.6
<b>Total lease commitments</b>	<b>0.6</b>	<b>0.6</b>	<b>0.4</b>	<b>-</b>	<b>1.6</b>

# High Arctic Energy Services Inc.

## Notes to the Consolidated Interim Financial Statements

For the three months ended March 31, 2011 and 2010

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### 21 Operating Segments

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

\$ millions	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
Revenue		
Canada	15.6	12.7
Papua New Guinea and other	20.3	21.9
<b>Total</b>	<b>35.9</b>	<b>34.6</b>
Oilfield services expense	23.4	22.0
<b>Oilfield services margin</b>	<b>12.5</b>	<b>12.6</b>
General and administration	2.0	2.3
Share-based compensation	1.5	-
Amortization	1.8	2.0
Gain on sale of investments	(2.0)	-
Foreign exchange loss	-	0.2
<b>Operating earnings from continuing operations</b>	<b>9.2</b>	<b>8.1</b>
Assets		
Canada	49.2	57.8
Papua New Guinea and other	36.7	44.7
<b>Total</b>	<b>85.9</b>	<b>102.5</b>
Liabilities		
Canada	27.7	96.4
Papua New Guinea and other	8.4	8.8
<b>Total</b>	<b>36.1</b>	<b>105.2</b>

# High Arctic Energy Services Inc.

## Notes to the Consolidated Interim Financial Statements

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### 22 Discontinued Operations

i) Middle East Region discontinued operations

A decision was made during 2008 to discontinue operations in the Middle East region, including Tunisia and India, due to ongoing losses. The Corporation has divested of assets through sales and has used the proceeds on sales to reduce its debt.

Comparative figures have been adjusted to remove activities in the Middle East region and to report those amounts as a discontinued operation. The following amounts have been included in the March 31, 2011, December 31, 2010 and January 1, 2010 Consolidated Statement of Financial Position.

	March 31, 2011	December 31, 2010	January 1, 2010
Current assets related to discontinued operations			
Accounts receivable	-	-	0.6
<b>Total current assets</b>	<b>-</b>	<b>-</b>	<b>0.6</b>
Non-current assets related to discontinued operations			
Assets held for sale related to discontinued operations	-	-	7.0
<b>Discontinued assets held for sale (Note 9)</b>	<b>-</b>	<b>-</b>	<b>7.0</b>
Current liabilities related to discontinued operations			
Accounts payable and accrued liabilities	-	-	0.3
<b>Total current liabilities</b>	<b>-</b>	<b>-</b>	<b>0.3</b>

The following amounts have been included in the Consolidated Statement of Comprehensive Income:

	Three months ended March 31, 2011	Three months ended March 31, 2010
<b>Revenue</b>	-	-
<b>Expenses</b>		
Oilfield services	-	0.1
	-	0.1
<b>Loss before income taxes</b>	-	(0.1)
<b>Income taxes</b>	-	-
<b>Discontinued Operations, net of tax</b>	<b>-</b>	<b>(0.1)</b>

# High Arctic Energy Services Inc.

## Notes to the Consolidated Interim Financial Statements

### For the three months ended March 31, 2011 and 2010

(Canadian \$ Million - Unaudited)

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#### 23 Subsequent Events

On or about May 15, 2011 High Arctic made loans to certain directors and officers of the Corporation in the total aggregate amount of \$1,110,398. The purpose of the loans was to assist the directors and officers with the payment of Canadian income taxes arising on the issuance of common shares of the Corporation ("Incentive Shares") pursuant to the Corporation's executive and director share incentive plan (the "Plan") (see Note 13). The amount of each loan was a maximum of 50% of the estimated amount of such taxes payable by the Borrower. The participants of the Plan are subject to taxation immediately upon issuance of the Incentive Shares despite the shares being held by a trustee as part of a three year vesting arrangement under the Plan.

The principal amount of each loan bears interest at an annual rate of 2%. Each loan is fully payable on the earlier of (i) thirty days after the date that a Borrower ceases to be an employee or director of the Corporation and (ii) April 15, 2014.

On May 6, 2011 High Arctic entered into a financing agreement with a new lender for credit facilities to replace the term loan. The main components of the new credit facilities are a \$20 million, two year committed term loan with a four year amortization, a \$5 million demand revolving operating loan and a \$5 million revolving evergreen loan. The \$20 million term loan was advanced to the Corporation on May 6, 2011. The credit facilities are secured by all of the assets of High Arctic and by unlimited guarantees of its foreign subsidiaries.

The funds from the \$20 million term loan, together with a cash payment of \$3.7 million, were used to repay High Arctic's existing term loan (see Note 11). The Corporation is required to make quarterly principal payments on the term loan of \$1.25 million beginning September 30, 2011. The term loan carries an annual interest rate of the bank's prime interest rate plus 1.75% and has a maturity date of June 30, 2013.

The \$5 million demand revolving operating loan facility may be drawn to a maximum of 75% of the eligible Canadian accounts receivable, less certain priority claims, and 90% of the eligible foreign accounts receivable insured by a lender approved insurer. The annual interest rate for this facility is the bank's prime interest rate plus 1.25%. As at the date these statements were approved by the Board of Directors, the Corporation does not have any amounts drawn against the revolving operating loan.

The \$5 million revolving evergreen loan can be used for the acquisition of equipment to be purchased and held in Canada. The evergreen loan requires monthly principal payments equal to 1/48<sup>th</sup> of each advance drawn on the facility commencing in the month following the month the advance is drawn. The interest rate for this facility is the bank's prime interest rate plus 1.25%. As at the date these statements were approved by the Board of Directors, the Corporation does not have any amounts drawn against the evergreen loan. The maturity date is June 30, 2013.