

**High Arctic Energy Services Inc.**  
**Management Discussion and Analysis**  
**Three and nine months ended September 30, 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" or "High Arctic") for the three and nine months ended September 30, 2011 as compared to the same periods 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 and nine months ended September 30, 2011 (the "Interim Financial Statements") and the audited financial statements for the year ended December 31, 2010 and annual MD&A of those 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 November 14, 2011.

### **Corporate Profile**

High Arctic is a publicly traded company listed on the Toronto Stock Exchange under the symbol "HWO". The Corporation'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 ("PNG").

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 September 30, 2011 included 21 snubbing units, 10 nitrogen pumpers, 5 nitrogen transports and 3 rack and pinion underbalanced work-over units. High Arctic is active in Papua New Guinea where it provides contract drilling and work-over services and supplies rig matting and drilling support equipment on a rental basis. The Corporation owns and operates the only heli-portable hydraulic workover rig in PNG and is contracted to operate up to three heli-portable drilling rigs owned by a major oil and gas company.

### **Outstanding Share Data**

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

On June 15, 2011, the Corporation completed a consolidation of its common shares on the basis of one (1) new post-consolidation common share for every five (5) pre-consolidated common shares. The 252,183,147 common shares then outstanding were consolidated to 50,436,637 common shares. As at September 30, 2011 and November 10, 2011, there were 49,596,637 issued and outstanding common shares. That number includes 3,620,000 shares held in 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.

The Corporation's common shares trade on the Toronto Stock Exchange under the symbol HWO. The closing price of the shares on November 14, 2011 was \$1.45 per share. Based upon issued common shares on that date of 49,596,637, the Corporation has an approximate market capitalization of \$71.9 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.

Average for the period	2011			2010				2009
	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4
<b>Oil and natural gas prices</b>								
West Texas Intermediate (US \$ /bb)	89.71	\$102.55	\$93.98	\$85.03	\$76.17	\$77.89	\$78.63	\$76.07
AECO (C\$ /Mcf)	\$3.72	\$3.74	\$3.77	\$3.58	\$3.72	\$3.86	\$5.36	\$4.28
<b>Other industry indicators</b>								
Well completions in Western Canada <sup>(1)</sup>	3,861	3,323	4,276	5,352	2,767	2,323	3,133	1,746
Gas well drilling in Western Canada <sup>(1)</sup>	803	980	1,660	2,132	1,124	1,122	1,490	578
Active drilling rigs in Western Canada <sup>(1)</sup>	454	190	534	399	323	154	431	273
Average drilling rig utilization rates <sup>(1)</sup>	57%	24%	68%	50%	41%	19%	54%	32%
Average Canadian/US dollar exchange rate	1.020	1.033	1.015	0.987	0.962	0.973	0.961	0.946

(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 decreased in the third quarter of 2011 by 12.5% (\$12.84 US per barrel) to an average price of \$89.71 US per barrel as compared to the average price at the end of the second quarter of 2011 of \$102.55 US per barrel. Natural gas prices have continued to remain relatively weak. The AECO reference natural gas price averaged \$3.72 CAD per Mcf in the third quarter of 2011, and was essentially flat over the last six quarters. Natural gas prices remain a concern to the industry and may lead to a further reduction in the demand for natural gas drilling activity in western Canada. The current weakness in natural gas prices has led to a shift over the last several quarters towards oil and liquids rich natural gas drilling. Despite the weakness in natural gas prices, the viability and growth of unconventional oil and natural gas development in Canada and the US continues to remain strong.

The Canadian oilfield services sector is subject to seasonality with peak levels in the first and fourth quarters. The CAODC reported 3,861 wells were completed in Canada during the third quarter of 2011; an increase of 40% (1,094 wells) from the 2,767 wells completed in the same period in 2010. Gas well completions in the third quarter of 2011 totalled 803, which was a decrease of 321 (29%) gas wells as compared to the same period in 2010 when 1,124 natural gas wells were completed. High Arctic's Canadian business is primarily dependent on natural gas and liquids rich natural gas well drilling and completions. Despite the 29% drop in gas well completions, High Arctic's overall equipment utilization was 54% in the third quarter compared to 50% in the same quarter of 2010. Additionally, utilization in the snubbing product line was also up in the quarter compared to last year, which is an indication, both that High Arctic has captured a stronger market share in terms of overall natural gas well completions and that the Corporation's services are in higher demand in the unconventional shale gas plays in Canada.

The Corporation has significant international operations in PNG where it provides contract drilling services and work-over 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. Those contracts are denominated in U.S. dollars. The Canadian dollar value rose relative to

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the U.S. dollar by approximately 6% in the third quarter of 2011 compared to the same period in 2010 which negatively impacted the financial results for PNG in the third quarter of 2011 as compared to 2010.

**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"):

	Three Months Ended September 30			Nine Months Ended September 30			Year Ended December 31
	2011	2010	Change	2011	2010	Change	2010
\$ millions (except per share amounts)							
<b>Revenue</b>	<b>29.3</b>	<b>29.0</b>	<b>0.3</b>	<b>90.1</b>	<b>86.0</b>	<b>4.1</b>	<b>119.3</b>
<b>EBITDA<sup>(1)</sup></b>	<b>7.1</b>	<b>8.2</b>	<b>(1.1)</b>	<b>21.3</b>	<b>23.6</b>	<b>(2.3)</b>	<b>33.3</b>
<b>Adjusted EBITDA<sup>(1)</sup></b>	<b>7.9</b>	<b>8.0</b>	<b>(0.1)</b>	<b>22.2</b>	<b>23.9</b>	<b>(1.7)</b>	<b>33.3</b>
<b>Operating earnings from continuing operations</b>	<b>4.2</b>	<b>5.5</b>	<b>(1.3)</b>	<b>14.5</b>	<b>17.2</b>	<b>(2.7)</b>	<b>24.6</b>
<b>Net earnings</b>	<b>3.0</b>	<b>3.0</b>	<b>-</b>	<b>10.2</b>	<b>10.0</b>	<b>0.2</b>	<b>14.5</b>
per share (basic) <sup>(2)</sup>	0.07	0.07	-	0.23	0.35	(0.12)	\$0.46
per share (diluted) <sup>(2)</sup>	0.06	0.07	(0.1)	0.21	0.35	(0.14)	\$0.47
<b>Cash Flows provided by operations<sup>(1)</sup></b>	<b>6.0</b>	<b>5.8</b>	<b>0.2</b>	<b>19.1</b>	<b>11.8</b>	<b>7.3</b>	<b>22.6</b>
<b>Capital expenditures</b>	<b>4.5</b>	<b>1.7</b>	<b>2.8</b>	<b>13.5</b>	<b>4.5</b>	<b>9.0</b>	<b>6.7</b>
<b>Net debt (end of period)<sup>(1)</sup></b>	<b>(3.1)</b>	<b>10.8</b>	<b>13.9</b>	<b>(3.1)</b>	<b>10.8</b>	<b>13.9</b>	<b>4.7</b>
<b>Shares outstanding-basic<sup>(2)</sup></b>	<b>46.0</b>	<b>42.9</b>	<b>3.1</b>	<b>44.7</b>	<b>20.5</b>	<b>24.2</b>	<b>31.8</b>
<b>Shares outstanding-diluted<sup>(2)</sup></b>	<b>49.7</b>	<b>43.1</b>	<b>6.6</b>	<b>48.4</b>	<b>20.6</b>	<b>27.8</b>	<b>30.7</b>

(1) Readers are cautioned that EBITDA, Adjusted EBITDA, Cash Flows provided by operations and net debt do not have standardized meanings prescribed by IFRS – see "Financial Measures".

(2) The Corporation completed a consolidation of its common shares on the basis of one (1) new post consolidation common share for every five (5) pre-consolidated common shares. For comparative purposes, all per share and share outstanding information presented in the table above reflect the share consolidation as if it had occurred prior to all periods presented above.

**Highlights for Third Quarter of 2011**

- Revenue increased by \$0.3 million, or 1%, for the third quarter ended September 30, 2011 compared to the third quarter ended September 30, 2010 as a result of increased activity in Canada. Revenue in that region improved by \$2.0 million, or 21.7%. This was partially offset by a \$1.7 million, or 8.6%, decline in PNG revenue. Canadian activity levels started out slow in July from an extended spring breakup, but rebounded strongly for the remainder of the quarter.
- High Arctic's Canadian business is primarily dependent on natural gas and liquids rich natural gas well drilling and completions. Despite a drop in natural gas well completions in proportion to overall well completions in Canada, High Arctic's equipment utilization and snubbing product line utilization was higher in the third quarter compared to last year, which is indicative both that High Arctic has increased market share in terms of overall natural gas well completions and that the Corporation's services are in higher demand in the unconventional shale gas plays in Canada.

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- Adjusted EBITDA, which excludes the impact of foreign exchange gain or losses primarily from the translation of intercompany balances, was \$7.9 million versus \$8.0 in the same prior period. The Canadian operations benefited from improved pricing and an overall 54% utilization rate on its equipment in the third quarter, with the Nitrogen and pressure pumping division leading at utilization of 81.3%. PNG operating margins were negatively impacted primarily by the weaker US dollar, pricing concessions on contract extensions, Rig 103 being on warm stack for the entire quarter and startup costs to put the newly refurbished Rig 102 into service. The foreign exchange loss arose primarily on intercompany debt balances owed to foreign operations and is a non-cash charge.
- Cash flows provided by operations during the third quarter of 2011 increased by \$0.2 million to \$6.0 million compared to \$5.8 million in the third quarter of 2010.
- The Corporation's financial position continued to strengthen in the third quarter of 2011 as total debt was reduced by \$1.2 million to \$18.4 million as at September 30, 2011 compared to \$19.6 million at June 30, 2011 and \$36.5 million at December 31, 2010. Operating working capital at September 30, 2011 of \$21.5 million exceeded total debt by \$3.1 million compared to net debt of \$0.6 million at the end of June 30, 2011 and \$4.7 million at December 31, 2010. Total debt to 12-month trailing EBITDA ratio was 0.60 times at September 30, 2011 compared to 1.1 times as at December 31, 2010. As at the end of September 30, 2011, \$10.0 million of the \$30.0 million credit facility remains available.

**Overview of Results for the Three and Nine Months Ended September 30, 2011**

High Arctic generated \$3.0 million (\$0.07 per share basic) of net earnings which was comparable to the same amount of \$3.0 million (\$0.7 per share basic) of net earnings in the third quarter of 2010. Despite a slow start to the quarter from the extended spring breakup, both utilization and average rates in Canada were higher than last year. The combination of these factors, as well as improved pricing and lower maintenance costs, led to improved oilfield services margins in Canada. Results in the PNG division were down in terms of both revenue and oilfield services margin, due to a weaker US dollar, Rig 103 not being active in the quarter, lower day rates on recent contract extensions and normal course Rig 102 startup costs.

On a consolidated basis, the Corporation generated \$29.3 million in revenue during the quarter ended September 30, 2011; an increase of \$0.3 million (1%) from revenue of \$29.0 million in the quarter ended September 30, 2010. Revenue in Canada was 22% higher at \$11.2 million in the quarter compared to \$9.2 million in the same quarter last year. Overall equipment utilization in Canada was 54% in the quarter compared to 50% last year, led by the nitrogen and pressure pumping division. Revenue was down 9% in PNG to \$18.1 million compared to \$19.8 million due to factors previously mentioned.

On a year to date basis, consolidated revenue was up \$4.1 million to \$90.1 million compared to \$86.0 million for the same period last of 2010, representing a \$4.1 million (5%) increase. Of this increase, \$4.2 million was generated by the Canadian operations due to strong first and third quarter performance. Papua New Guinea revenue was essentially flat on a year to date basis in comparison to last year.

The corporation achieved EBITDA of \$7.1 million for the three months ended September 30, 2011 compared to \$8.2 million for the three months ended September 30, 2010, representing a decline of \$1.1 million (13%). On an Adjusted EBITDA basis, which excludes the impact of foreign exchange gains or losses, which arise primarily on the translation of the foreign denominated intercompany loans of the parent company owed to its foreign subsidiaries, High Arctic recorded \$7.9 million, which was essentially flat compared to last year. On a year to date basis in 2011, Adjusted EBITDA was \$22.2 million compared to \$23.3 million for the first three quarters of 2010.

Net earnings for the nine months ended September 30, 2011 were \$10.2 million (\$0.21 per diluted share) compared to \$10.0 million (\$0.23 per diluted share) for the nine months ended September 30, 2010. The 2010 results benefited from a one-time \$2.7 million gain on restructuring transactions. Excluding the impact of that item, net earnings for the nine months ended September 30, 2011 would have been up \$2.9 million in large part due to lower interest expense and financing costs and income taxes.

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**Operating Segment Results for the Three and Nine Months Ended September 30, 2011 and 2010**

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

	Three Months Ended September 30			Nine Months Ended September 30			Year ended December 31
	2011	2010	Change	2011	2010	Change	2010
\$ millions							
<b>Revenue</b>							
Canada	11.2	9.2	2.0	31.2	27.0	4.2	39.1
Papua New Guinea and other international	18.1	19.8	(1.7)	58.9	59.0	(0.1)	80.2
<b>Total Revenue</b>	<b>29.3</b>	<b>29.0</b>		<b>90.1</b>	<b>86.0</b>		<b>119.3</b>
<b>Oilfield services expense</b>	<b>19.6</b>	<b>19.2</b>	<b>(0.4)</b>	<b>62.2</b>	<b>55.9</b>	<b>(6.3)</b>	<b>77.3</b>
% of Revenue	66.9%	66.2%		69.0%	65.0%		64.8%
<b>Oilfield services operating margin</b>	<b>9.7</b>	<b>9.8</b>	<b>(0.1)</b>	<b>27.9</b>	<b>30.1</b>	<b>(2.2)</b>	<b>42.0</b>
% of Revenue	33.1%	33.8%		31.0%	35.0%		35.2%
Equipment utilization in Canada	54%	50%	3%	51%	51%	-	54%
CAODC drilling rig utilization	57%	40%	17%	50%	38%	12%	41%

**Operations in Canada**

The third quarter was a strong quarter in Canada as revenues increased by \$2.0 million to \$11.2 million compared to \$9.2 million in the third quarter of 2010. Activity levels in the quarter started out slowly as the prolonged spring breakup extended into July, but then rebounded strongly for the remainder of the quarter. The Corporation achieved overall equipment utilization of 54% compared to 50% in the same quarter of last year. 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 for the snubbing units went from 22% in July to 47% for both of August and September. Overall snubbing utilization for the quarter ended September 30, 2011 was 39% as compared to 37% for the quarter ended September 30, 2010. The most significant increase in utilization was experienced in the nitrogen services and pressure pumping product line as utilization increased to 81% in the quarter compared to 68% in the same quarter of last year.

For the nine months ended September 30, 2011, Canadian revenue was up \$4.2 million (13%) to \$31.2 million compared to \$27.0 million for the nine months ended September 30, 2010. Total equipment utilization on a year to date basis of 51% was the same as for the nine months ended September 30, 2010. Year to date performance in Canada was strong on both a revenue and utilization level, despite a prolonged spring breakup in the second quarter due to wet weather. Utilization in the second quarter was 16% compared to 29% in the second quarter of 2010. Additional upside in revenue and utilization in snubbing services was available in the third quarter, however the Corporation continued to be affected by a shortage of experienced field personnel and the result was that the Corporation had to turn down some work. Rate increases have been implemented for all business lines in Canada and should the current industry activity levels continue, further improvements in revenue and utilization are anticipated to continue from the levels experienced in the third quarter.

Oilfield activity improved significantly on a quarter over quarter basis in Canada. A total of 3,861 wells were completed in Canada during the third quarter of 2011, an increase of 40% (1,094 wells) from the 2,767 wells completed in the same period in 2010. Although total well completions were up significantly, much of the increased activity was targeted at oil and the number of natural gas well completions markedly declined by 29% compared to the same quarter of 2010. 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. Despite a significant drop in natural gas well completions, equipment utilization in Canada for the Corporation was 54% compared to 50% for the same period last year. Further, as previously mentioned, snubbing equipment utilization was also up in the quarter which is indicative; both that High

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Arctic has kept pace with industry trends towards more liquids rich and unconventional natural gas drilling, and also of the leading market position of the Corporation in the Canadian snubbing industry. The Corporation's has equipment that is suited to the longer lateral multi-completion wells. For the first three quarters of 2011, there were 3,443 natural gas wells completed (30% of total well completions) as compared to 3,736 natural gas wells completed in the first three quarters of 2010 (45% of total well completions). However, the trend in gas well drilling has been to longer horizontal multi-completion wells, which bodes well for High Arctic. The increase in overall industry activity levels has resulted in an increase in activity levels and revenue for the Corporation's Canadian operations.

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. No units were active in the third quarter. The Corporation continues to discuss with customers the potential uses for the 250K UB units, but with continued weak gas prices and challenges in manning all of the equipment, it is uncertain if or how much the 250K UB rig will be contracted over the next 6 months. 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 \$18.1 million in revenue for the quarter ended September 30, 2011 as compared to \$19.8 million for the quarter ended September 30, 2010, representing a decrease of \$1.7 million (9%). Rigs 102 and 104 were active in the quarter, while Rig 103 was on the warm stacking rate throughout the entire quarter in 2011. Rig 103 was also on the warm stack rate for much of the third quarter of 2010, but benefited from a higher stacking rate throughout the quarter with significant mobilization activities in September 2010. Rig 102 was active on its first well beginning in July 2011 and was active for the remainder of the quarter. The upgraded Rig 102 experienced some downtime in the quarter as a result of normal course startup issues. These issues have primarily been addressed and we anticipate more favorable operating margins on that rig moving forward. In the third quarter of 2010, Rig 102 was on a stacking rate with minimal costs.

Our main customer in Papua New Guinea owns two heli-portable rigs (Rigs 103 and 104) that are currently 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.

Both Rig 103 and Rig 104 and the related drilling support services are contracted until December 2013. During the third quarter, High Arctic agreed to a contract extension for Rig 103 to extend the term for approximately 2 ½ years to December 17, 2013, which coincides with the term of Rig 104 and the related drilling support services contract. Rig 103 is currently being prepared for mobilization to a new drilling location for further work expected to begin later in the fourth quarter. However, it is planned that the crews from Rig 104 will man the rig meaning that operations of Rig 104 will be suspended during that time. The term for Rig 102 runs until May 2014 and most recent indications from our principal customer are that the rig will continue to be active throughout the next few quarters. Long-term contracts on Rigs 102, 103 and 104 are anticipated to provide cash flow stability due to their long term nature and the less seasonal operations in PNG.

For the first three quarters of 2011, PNG revenue was essentially flat at \$58.9 million compared to \$59.0 million in the same period of 2010. Although margins have compressed somewhat due to the impact of a lower US dollar and changes in rates and startup costs on Rig 102, the Corporation has continued to successfully market its fleet of rental equipment and is adding equipment to meet the market demand. Moving into the remainder of 2011 and the first half of 2012, we are anticipating improving margins for Rig 102 due to reduced downtime and additional revenue and profitability as new matting and equipment rental contracts come on stream in the fourth quarter of 2011 and into 2012.

### **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 adjusts to changing activity.

Oilfield services expense as a percentage of revenue, on a consolidated basis, was 66.9% in the quarter ended September 30, 2011, compared to 66.2% in the same period of 2010. Oilfield services expense was \$19.6 million in the three months ended September 30, 2011; an increase of 2% as compared to the three months ended September 30, 2010 during which oilfield services expense was \$19.2 million.

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The increase in oilfield service expense, as a percentage of revenue, for the nine months ended September 30, 2011 was primarily due to higher operating costs in PNG combined with pricing concessions and startup issues on Rig 102, in addition to repair and maintenance costs in the Canadian operations as a percentage of revenue. The Corporation undertook a maintenance and refurbishment program during the downtime of the second quarter which should benefit future quarters.

Oilfield services operating margin was \$9.7 million, or 33.1% of revenue, compared to \$9.8 million, or 33.8% of revenue, in the third quarter of 2011 compared to the third quarter of 2010. Operating margins in Canada improved compared to the same quarter of last year as a result of improved utilization and pricing, combined with cost reduction and lower repair costs in Canada. These improvements were offset by the additional costs in PNG as previously mentioned, together with the pricing concessions on contract renewals.

Operating margins for the first three quarters, as a percentage of revenue, were 31.0% and 35.0% for 2011 and 2010, respectively. Operating margins, as a percentage of revenue, are anticipated to improve as implemented pricing increases combined with anticipated strong activity levels continue in Canada and in PNG as operational efficiency improves on Rig 102 and new matting and rolling stock rental contracts commence. Management continues to monitor oilfield service expenses and expects to see some wage pressures in the coming periods as the demand for qualified personnel continues to intensify.

### Selected Expense Information

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

#### General and Administrative

	Three Months Ended September 30			Nine Months Ended September 30		
	2011	2010	Change	2011	2010	Change
\$ millions						
<b>General and administrative</b>	1.8	1.7	(0.1)	5.7	5.9	0.2
<b>% of Revenue</b>	6.1%	5.9%		6.3%	6.8%	

General and administrative expenses (G&A) for the three months ended September 30, 2011 were \$1.8 million compared to \$1.7 million for the three months ended September 30, 2010. G&A costs were up by \$0.1 million due to higher facility costs, although partially offset by personnel costs. For the nine months ended September 30, 2011, G&A was \$5.7 million compared to \$5.9 million for the nine months ended September 30, 2010, representing a decrease of \$0.2 million (3%). This decrease in costs was mainly attributable to lower facility, insurance and legal costs.

#### Share-based Compensation

	Three Months Ended September 30			Nine Months Ended September 30		
	2011	2010	Change	2011	2010	Change
\$ millions						
<b>Share-based compensation</b>	0.4	0.7	0.3	2.3	0.7	1.6
<b>% of Revenue</b>	1.3%	2.4%		2.5%	1.0%	

Share-based compensation expense of \$0.3 million (2010 – 0.7 million) for the three months ended September 30, 2011 and \$2.1 million (2010 \$0.7 million) for the nine months ended September 30, 2011 was recognized for the executive and director share incentive plan (see Note 13 of the Interim Financial Statements). In addition to that, \$0.1 million of share-based compensation expense for the stock option plan was recognized for the three months ended September 30, 2011 (2010 – nil)

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and \$0.2 million for the nine months ended September 30, 2011 (2010 – nil) based on amortizing any expense over the vesting period using the Black-Scholes model.

**Amortization**

	Three Months Ended September 30			Nine Months Ended September 30		
	2011	2010	Change	2011	2010	Change
\$ millions						
<b>Amortization</b>	2.5	2.0	(0.5)	6.5	5.9	(0.6)
<b>% of Revenue</b>	8.5%	6.9%		7.2%	6.9%	

Amortization for the three and nine months ended September 30, 2011 was higher than the comparable periods in 2010 as a result of the capital expenditures in 2011 in addition to additional amortization required under IFRS for the transfer of assets held for sale from current to long-term assets. Under IFRS, amortization is required to be recorded from the date the assets were originally moved to classification as held for sale until the present date. This resulted in an increase in amortization of \$0.4 million for the third quarter of 2011. Excluding this adjustment, amortization was consistent with the prior year on a percentage of revenue basis.

**Foreign Exchange Loss**

	Three Months Ended September 30			Nine Months Ended September 30		
	2011	2010	Change	2011	2010	Change
\$ millions						
<b>Foreign exchange (gain) loss</b>	0.8	(0.2)	(1.0)	0.9	0.3	(0.6)
<b>% of Revenue</b>	2.7%	(0.1%)		1%	0.3%	

The Corporation has exposure to US dollar revenues and expenses, primarily through its international operations, and to local currencies including the Kina in PNG and to the current assets (cash and cash equivalents) and current liabilities denominated in U.S. dollars held in Canada. The functional currency of the corporation is the Canadian dollar. The translation of foreign operations with a functional currency different from that of the Corporation is translated into Canadian dollars and resulting changes are recognized in other comprehensive income as cumulative translation adjustments. However, gains and losses must be recognized by the Canadian entities on any US dollar denominated intercompany balances in the statement of operations despite the offsetting amount recognized by the foreign subsidiary being recorded as a cumulative translation adjustment. Such gains and losses are non-cash items as they are purely intercompany offsetting amounts. For the three months ended September 30, 2011, the Corporation had net foreign exchange losses of \$0.8 million compared to a \$0.2 million gain for the three months ended September 30, 2010. These losses arose primarily on the translation of the U.S. dollar denominated intercompany debt owed by the Canadian parent corporation to its foreign subsidiaries and were largely triggered by a spike in the US dollar late in the third quarter. On a year to date basis, foreign exchange losses of \$0.9 million were recorded compared to a loss of \$0.3 million for the three months ended September 30, 2010.

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**Interest and Finance Expenses**

\$ millions	Three Months Ended September 30			Nine Months Ended September 30		
	2011	2010	Change	2011	2010	Change
<b>Interest and finance expense:</b>						
Interest expense on credit facilities/long term debt	0.4	1.0	0.6	1.8	3.1	1.3
Interest expense on convertible debentures	-	-	-	-	0.9	0.9
Other interest expense	-	-	-	(0.3)	0.2	0.5
Financing costs	-	-	-	-	0.1	0.1
<b>Total</b>	<b>0.4</b>	<b>1.0</b>	<b>0.6</b>	<b>1.5</b>	<b>4.3</b>	<b>2.8</b>
<b>% of Revenue</b>	<b>1.4%</b>	<b>3.4%</b>		<b>1.7%</b>	<b>5.0%</b>	

The principal amount of the senior debt was \$18.8 million at September 30, 2011 (prior to netting of debt transaction costs of \$0.4 million), compared to \$36.5 million at December 31, 2010 and \$41.8 million at September 30, 2010. The interest rate applicable to all loans under the senior debt is based on the prime rate plus a spread. The interest expense has decreased due to the decline in the average outstanding principal amount in addition to the lower interest rates applicable to the new credit facility entered into in May, 2011 (see "Liquidity and Capital Resources - *Credit Facility*" below).

As part of a series of transactions completed on April 30, 2010 (see *Note 12 to 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 third quarter and first three quarters of 2011 compared to Nil and \$0.9 million, respectively, in the same periods of 2010.

**Gain on Sale of Investments**

\$ millions	Three Months Ended September 30			Nine Months Ended September 30		
	2011	2010	Change	2011	2010	Change
<b>Gain on sale of investments</b>	-	-	-	2.0	-	2.0
<b>% of Revenue</b>	-	-		<b>2.2%</b>	-	

The Corporation recorded a gain of \$2.0 million during the first quarter of 2011 (2010 – nil) arising on the sale of 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.

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**Income Taxes**

	Three Months Ended September 30			Nine Months Ended September 30		
	2011	2010	Change	2011	2010	Change
\$ millions						
<b>Income taxes</b>	0.8	1.4	0.6	2.8	5.3	2.5
<b>% of Revenue</b>	<b>2.7%</b>	<b>4.8%</b>		<b>3.1%</b>	<b>6.2%</b>	

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 based on 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 in Canada 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.

**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.

	IFRS				Canadian GAAP			
	Sep 30, 2011	Jun 30, 2011	Mar 31, 2011	Dec 31, 2010	Sep 30, 2010	Jun 30, 2010	Mar 31, 2010	Dec 31, 2009
\$ million except per share amounts								
<b>Revenue</b>	<b>29.3</b>	<b>24.9</b>	<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>Net earnings (loss) – before discontinued operations</b>	3.0	(0.1)	7.3	4.9	3.0	2.5	4.6	(11.7)
per share (basic)	0.07	\$(0.00)	\$0.17	\$0.12	\$0.06	\$0.08	\$0.51	\$(1.29)
per share (diluted)	0.06	\$(0.00)	\$0.14	\$0.12	\$0.06	\$0.08	\$0.42	\$(0.86)
<b>Net earnings (loss) – discontinued operations</b>	-	-	-	(0.7)	(0.1)	(0.1)	(0.1)	0.2
per share (basic)	-	-	-	\$(0.01)	\$0.00	\$0.00	\$(0.01)	\$0.02
per share (diluted)	-	-	-	\$(0.01)	\$0.00	\$0.00	\$(0.01)	\$0.01
<b>Net earnings (loss)</b>	3.0	(0.1)	7.3	4.2	2.9	2.4	4.5	(11.5)
per share (basic)	0.07	\$(0.00)	\$0.17	\$0.11	\$0.06	\$0.08	\$0.50	\$(1.27)
per share (diluted)	0.06	\$(0.00)	\$0.14	\$0.11	\$0.06	\$0.08	\$0.41	\$(0.85)

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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		
	September 30, 2011	December 31, 2010	Change
Current assets <sup>(1)</sup>	32.4	43.4	(11.0)
Current liabilities <sup>(2)</sup>	10.9	11.6	(0.7)
Operating working capital <sup>(3)</sup>	21.5	31.8	(10.3)
Operating working capital ratio <sup>(4)</sup>	2.97	3.74	(0.77)
Total debt (including current portion)	18.4	36.5	(18.1)
Net debt	(3.1)	4.7	7.8
Total debt-to-capitalization ratio <sup>(5)</sup>	0.24	0.47	(0.23)
Cash and cash equivalents	9.3	24.3	(15.0)

**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 liabilities excluding the current portion of long-term debt and the credit facility*
- (3) *Calculated as current assets (as defined above) less current liabilities (as defined above)*
- (4) *Calculated as current assets (as defined above) divided by current liabilities (as defined above)*
- (5) *Calculated as total debt divided by the sum of total debt and shareholders' equity.*

The Corporation manages its capital structure so as to provide the capital to meet the requirements of its business and instill confidence in investors, creditors and the capital markets. Total debt to 12-month trailing EBITDA was 0.60 suggesting a capacity for further borrowing to provide the flexibility for growth in the business. On May 6, 2011, the Corporation entered into a new \$30.0 million financing agreement to replace the former term loan (see "Credit Facility" below) out of which up to \$10.0 million is available to be drawn on a revolving basis.

The Corporation generated net cash from operating activities before working capital adjustments of \$6.0 million during the third quarter of 2011 compared to \$5.8 million in the third quarter of 2010. For the first three quarters of 2011, the Corporation generated net cash from operating activities before working capital adjustments of \$19.1 million compared to \$11.8 million in the first three quarters of 2010. The accounts payable and accounts receivable balances at September 30, 2011 are substantially all current which, together with the cash balance and available undrawn credit facilities, provide adequate liquidity to meet the Corporation's current operating needs. The Corporation had a cash balance of \$9.3 million as at September 30, 2011 and believes it has sufficient cash to meet its cash needs for the foreseeable future.

**Credit Facility**

On May 6, 2011, the Corporation entered into a \$30.0 million financing agreement with a new lender for new credit facilities to replace the former one year term loan. The main components of the new credit facilities are a two year \$20.0 million committed capital loan with a four year amortization, a two year \$5.0 million committed revolving evergreen loan and a \$5 million demand revolving operating loan. The credit facilities are secured by all the assets of High Arctic and by unlimited guarantees of its foreign subsidiaries.

The new term loan is subject to interest at prime rate plus 1.75% and has a maturity date of June 30, 2013. The prime rate is currently 3.0% meaning the interest rate on the new term loan is currently running at an equivalent annual rate of 4.75%. The corporation is required to make quarterly principal payments on the term loan of \$1.3 million at the end of each quarter and made its first payment on September 30, 2011.

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The \$5.0 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 1/48th of each advance drawn on the facility commencing in the month following the month the advance is drawn. The maturity date is June 30, 2013. The interest rate for this facility is the bank's prime interest rate plus 1.25%. As at September 30, 2011, the Corporation did not have any amounts drawn against the evergreen loan.

The \$5.0 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 September 30, 2011, the Corporation did not have any amounts drawn against the revolving operating loan.

As at the end of September 30, 2011, only \$18.7 million (prior to the netting of debt transaction costs) of capital loan was outstanding of the full \$30.0 million credit facility, and \$10.0 million of revolving capacity is available for future operations and growth. Total net debt (see "Financial Measures") at September 30, 2011 was a negative \$3.1 million compared to \$4.7 million at December 31, 2010.

The new credit facility is subject to the following financial covenants calculated at the end of each fiscal quarter:

Ratio	Threshold	Ratio September 30, 2011
Funded Debt to EBITDA <sup>(1)</sup>	2.00:1 Maximum	0.60
Debt to Tangible Net Worth <sup>(2)</sup>	2.50:1 Maximum	0.51
Current Ratio <sup>(3)</sup>	1.50:1 Minimum	3.13
Fixed Charge Coverage Ratio <sup>(4)</sup>	1.25:1 Minimum	10.72

- (1) Funded Debt to EBITDA means the ratio of consolidated Funded Debt to the aggregate EBITDA for the trailing 4 quarters. Funded Debt is defined generally as indebtedness and liabilities which constitute debt in accordance with IFRS but excluding accounts payable, other short-term non-interest bearing liabilities and future income taxes. EBITDA is defined generally as net Income plus interest expense, cash taxes payable, depreciation, amortization, future income taxes, stock based compensation and less gains from the sale of assets, all calculated on a consolidated basis.
- (2) Debt to Tangible Net Worth means the ratio of total liabilities less postponed loans and subordinated debt and future income tax liabilities to shareholders' equity less intangible assets, deferred charges and shareholder advances
- (3) Current Ratio means, the ratio of consolidated current assets to consolidated net current liabilities (excluding the current portion of long term debt and other debt, if any).
- (4) Fixed Charge Coverage Ratio is defined as EBITDA less cash taxes, dividends and unfunded capital expenditures divided by the total of principal payments on long term debt and capital leases plus interest, all calculated on a consolidated basis for the trailing 4 quarters. Most of the capital expenditures from May 1, 2011 to September 1, 2011 are considered as funded.

## Cash Flow

### Cash – Operating Activities – Continuing Operations

For the third quarter ended September 30, 2011, cash provided by operating activities was \$6.0 million before reflecting working capital adjustments, compared to cash provided by operating activities before working capital adjustments of \$5.8 million in the third quarter ended September 30, 2010. After working capital adjustments, cash provided by (used in) operating activities in the third quarter ended September 30, 2011 was (\$2.6) million, compared to cash provided by (used in) operating activities of \$5.8 million in the second quarter ended September 30, 2010. This reflects a large increase in accounts receivable due to the significant increase in activity in Canada after a prolonged spring breakup in the second quarter of this year. The Corporation's accounts receivable balance at September 30, 2011 was \$18.3 million of which \$0.4 million was greater than 90 days overdue. The risks associated with the Corporation's accounts receivable are viewed as normal for the industry and management assesses the creditworthiness of its customers on an ongoing basis.

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Net cash generated from operating activities for the nine months ended September 30, 2011 was much improved at \$14.4 million compared \$7.9 million for the nine months ended September 30, 2010. This is reflective of improved cash from operations before the changes in working capital and the cash restructuring costs in operating cash flows in 2010.

**Investing Activities – Continuing Operations**

For the quarter ended September 30, 2011, net capital expenditures to acquire rigs, equipment and other operational assets were \$4.5 million, compared to net expenditures of \$1.7 million for the quarter ended September 30, 2010 (both amounts after the change in accounts payable related to constructing rigs and equipment). Total capital expenditures during the first three quarters of 2011 were \$12.0 million (net of a \$1.5 million reimbursement) compared to \$4.5 million during the first three quarters of 2010. Most of the capital expenditures in 2011 were directed at new equipment purchases for Papua New Guinea. During the first three quarters of 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 related to discontinued operations).

**Financing Activities – Continuing Operations**

The Corporation has made significant repayments of its credit facility, reducing the outstanding principal balance by \$1.3 million during the third quarter of 2011 and by \$17.7 million for the first three quarters of 2011.

**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 57% of the Corporation's revenue for the quarter ended September 30, 2011 (48% for the nine months ended September 30, 2011) and 53% of its accounts receivable at September 30, 2011. The second significant customer is a major Canadian exploration and production company which represents approximately 10% of the Corporation's revenue for the quarter ended September 30, 2011 (12% for the nine months ended September 30, 2010) and 3% 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 highly 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.

**Inventory**

The Corporation has been supplied with an inventory of spare parts with a value of US\$5.2 million by a customer in Papua New Guinea. The inventory is owned by the customer and has not been recorded on the books of High Arctic. At the end of the contract, the Corporation must return an equivalent inventory to the customer. The Corporation believes it currently has sufficient inventory on hand to meet that obligation and accordingly no provision has been made for any potential shortfall.

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**Other**

The Corporation has posted a performance bond of approximately US\$3.8 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 September 30, 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 September 30, 2011:

\$ millions	Payments Due by Period				
	Total	Less than 1 Year	1 – 3 Years	4 – 5 Years	After 5 Years
Credit facility obligations <sup>(1)</sup>	18.8	5.0	10.0	3.8	-
Operating lease obligations	1.4	0.5	0.7	0.2	-
<b>Total obligations</b>	<b>20.2</b>	<b>5.5</b>	<b>10.7</b>	<b>4.0</b>	<b>-</b>

(1) Excludes debt transaction costs of \$0.4 million

**Outlook**

While the third quarter started slowly in July, domestic activity levels rebounded strongly through the remainder of the third quarter and have continued to remain strong moving into the fourth quarter. The Canadian oilfield services industry is experiencing both a limited supply of certain specialized equipment and a shortage of qualified field personnel. This situation has led to increases in the industry day rates, but has also placed inflationary pressures on wages for experienced personnel and other operating costs. Exploration and development activity in the unconventional natural gas and oil plays is anticipated to maintain its momentum with continued focus on drilling horizontal wells incorporating multi-stage completions. The Petroleum Services Association of Canada's (PSAC) most recent forecast for 2012 is for a 10% increase in the number of wells released over 2011. The emphasis on oil and liquids-rich gas completions activity is expected to continue 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 have resulted in improved day rates and other pricing for the Corporation's 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 and throughout 2012. However, growth in the unconventional shale gas plays which are typically horizontal and deeper in nature has continued to gain in momentum. Technology that has typically been used on the unconventional shale gas development is now being used to revisit mature natural gas areas. The Corporation expects to benefit from the strong levels of drilling activity aimed at the liquids rich natural gas fields. As a result, demand for snubbing and well servicing operations is expected to remain solid despite the low natural gas prices. The completions activity in the Montney, and other deep basin plays of northwest Alberta and northeast British Columbia are expected to remain robust in 2012 as those regions are amongst the most economic natural gas plays in North America especially those rich in natural gas liquids. The Corporation's equipment is well suited for the longer lateral multi-completion wells. Continued concerns about global economic conditions may temper activity somewhat, particularly if accompanied by a drop in oil prices.

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. Management remains focused on maintaining a competitive cost structure, improving operating efficiencies and increasing its workforce to activate underutilized equipment. Attracting and retaining qualified field personnel is expected to be an ongoing challenge moving into the busy winter months. The Corporation's goal is to maintain and add additional operating crews to keep pace with the anticipated demand for its equipment.

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The benefits of High Arctic's geographic diversification have continued to be evident throughout the year. Operations in PNG have added stability to cash flows for the Corporation as Rigs 103 and Rig 104 have been contracted until December 2013 and Rig 102 is contracted until May 2014. Those contracts provide a significant base level of activity to support the operations in the country. It is expected that only one of Rig 104 and Rig 103 will be drilling at any one time for the remainder of 2011 and into 2012 with crews shared between the rigs. Efforts are being made to find additional work to utilize both of those drilling rigs as the oil companies operating in the country firm up their drilling plans beyond 2011. Rig 102 commenced workover operations in July, 2011 following completion of an upgrade during the first half of the year, which should offset the drop in the activity of the drilling rigs. The Corporation expects that Rig 102 will remain active through to at least June 2012. While Rig 102, a workover rig, has a lower day rate than Rig 103, a drilling rig, High Arctic does not incur a lease expense on Rig 102 allowing it to earn better margins on the Rig 102 operations. The US dollar has shown some recent strength which will benefit the Corporation if the strength holds.

A recent 18 month contract award for rig matting and related support to a major oil and gas operator is anticipated to add to future revenue and profitability and demonstrates the opportunity for future service expansion of that product line. High Arctic provides drilling support equipment on a rental basis to a number of customers in Papua New Guinea. The Corporation will continue to pursue opportunities to expand that business line and increase its rental fleet. During the first nine months of 2011, High Arctic had net capital expenditures of \$12.0 million of which \$9.3 million related to the purchase of rental equipment in Papua New Guinea. These equipment additions should add to revenue and profitability for the PNG operation somewhat in the fourth quarter and particularly into 2012 as they are put fully into service.

## **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:

- volatility 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.

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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 and security granted under its credit facility 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.

**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 57% and 48% of consolidated revenue for the three and nine months ended September 30, 2011, respectively and 53% of its accounts receivable at September 30, 2011. 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 nine months ended September 30, 2011, a 1% nominal change in the interest charged to the Corporation under its credit facility would have changed interest expense by \$0.3 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.

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**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.

**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 nine months ended September 30, 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 good 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.

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**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).

**Critical Accounting Estimates**

The Corporation's significant accounting policies are described in Note 3 to the Interim Financial Statements for the period ended September 30, 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 and 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**

On or about May 15, 2011 High Arctic made loans to certain directors and officers of the Corporation in the total aggregate amount of \$1.1 million. 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 to 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.

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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. As at June 30, 2011, the total amount outstanding related to these loans was \$0.8 million.

An individual who, prior to April 30, 2010, controlled almost 40% of the outstanding shares and who was a director and officer of the Corporation until December 16, 2008 (the "Shareholder") made various loans and advances to the Corporation. Interest expense for the nine months ended September 30, 2010 includes \$0.2 million accrued to March 31, 2010. As part of the restructuring transactions completed on April 30, 2010, the Corporation issued 6,593,677 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.

## **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 quarters ended March 31, 2010, June 30, 2010, and September 30, 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, "Financial Instruments" 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.

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**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.

**IFRS 12 & IAS 28**

IFRS 12, "Disclosure of Interests in Other Entities", 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 on its consolidated financial statements.

**IFRS 13**

IFRS 13, "Fair Value Measurement", defines fair value, sets out in a single IFRS framework for measuring fair value and requires disclosures about fair value measurements. The IFRS 13 applies to IFRS standards that require or permit fair value measurements or disclosures about fair value measurements (and measurements, such as fair value less costs to sell, based on fair value or disclosures about those measurements), except in specified circumstances. IFRS 13 is to be applied for annual periods beginning on or after January 1, 2013. Earlier application is permitted. The Corporation is currently evaluating the impact of this standard on its consolidated financial statements.

**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

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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 nine month period ended September 30, 2011 that would materially affect or are reasonably likely to materially affect the Corporation's ICFR.

### **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 ;
- 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;
- 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.

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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

There have been no material events subsequent to September 30, 2011 up to the date of this report.

### Financial Measures

This MD&A contains references to certain financial measures that do not have any standardized meaning prescribed by IFRS and previous Canadian GAAP and may not be comparable to other companies. High Arctic uses these financial measures to assess performance and believes these measures provide useful supplemental information to investors. These financial measures are computed on a consistent basis for each reporting period and include the following:

#### EBITDA

Management believes that, in addition to net earnings (loss) reported in the consolidated statement of income, EBITDA is a useful supplemental measure of the Corporation's performance prior to consideration of how operations are financed or how results are taxed or how depreciation and amortization or share-based compensation affects results. EBITDA is not intended to represent net earnings calculated in accordance with IFRS.

The following tables provide a quantitative reconciliation of net earnings to EBITDA for the three and nine months ended September 30, 2011 and 2010 and includes the impact of discontinued operations.

	<b>IFRS</b>	
	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010
<b>Net earnings</b>	3.0	3.0
<b>Add (deduct)</b>		
Interest and finance expenses	0.4	1.0
Income taxes	0.8	1.4
Amortization	2.5	2.0
Share-based compensation	0.4	0.7
Loss on sale of property and equipment	-	0.1
<b>EBITDA</b>	<b>7.1</b>	<b>8.2</b>
<b>Add (deduct)</b>		
Foreign exchange (gain) loss	0.8	(0.2)
<b>Adjusted EBITDA</b>	<b>7.9</b>	<b>8.0</b>

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	<b>IFRS</b>	
	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
<b>Net earnings</b>	10.2	10.0
<b>Add (deduct)</b>		
Interest and finance expenses	1.5	4.3
Income taxes	2.8	5.3
Amortization	6.5	5.9
Share-based compensation		0.7
(Gain) on restructuring transactions	-	(2.7)
Loss on sale of property plant and equipment	-	0.1
(Gain) on sale of investments	(2.0)	-
<b>EBITDA</b>	<b>21.3</b>	<b>23.6</b>
<b>Add (deduct)</b>		
Foreign exchange gain (loss)	0.9	0.3
<b>Adjusted EBITDA</b>	<b>22.2</b>	<b>23.9</b>

**Adjusted EBITDA**

This measure is used by management and investors to analyze EBITDA (as defined above) prior to the effect of foreign exchange gains or losses, and is not intended to represent net earnings as calculated in accordance with IFRS

**Operating Earnings**

Management believes that in addition to net earnings, operating earnings reported in the Consolidated Statement of Income is a useful supplemental measure as it provides an indication of the results generated by High Arctic's principal business activities prior to consideration of how those activities are financed or how the results are taxed. Operating earnings is not intended to represent net earnings calculated in accordance with IFRS.

**Oilfield Services Operating Margin**

Oilfield services operating margin is used by management and investors to analyze overall and segment operating performance. Oilfield services operating margin is not intended to represent operating income nor should it be viewed as an alternative to net earnings or other measures of financial performance calculated in accordance with IFRS. Oilfield services operating margin is calculated as revenue less oilfield services expense.

**Oilfield Services Operating Margin %**

Oilfield services operating margin % is used by management and investors to analyze overall and segment operating performance. Oilfield services operating margin % is calculated as oilfield services operating margin divided by revenue.

**Cash Flow Provided by Operations**

Management believes that, in addition to net cash generated from operating activities as reported in the Consolidated Statement of Cash Flow, cash flow from operating activities before working capital adjustments is a useful supplemental measure as it provides an indication of the funds generated by High Arctic's principal business activities prior to consideration of changes in working capital.

**Operating working capital**

Operating working capital is used by management and the investment community as another measure to analyze the operating liquidity available to the Corporation. It is defined as current assets (excluding assets held for sale and assets related to discontinued operations) less current liabilities (excluding the current portion of the long-term debt or the credit facility).

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**Net debt**

Net debt is used by management and the investment community to analyze the amount of total debt that would be remaining after liquid working capital balances are collected. It is calculated as total debt (including current portion) less operating working capital (as calculated above).

**Market capitalization**

Market capitalization is used by management and the investment community to calculate the approximate fair value of the Corporation's equity and is calculated as the total number of shares outstanding multiplied by the Corporation's share price

**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 September 30, 2011, December 31, 2010 and January 1, 2010

(Canadian \$ Million - Unaudited)

	Notes	September 30, 2011	December 31, 2010	January 1, 2010
<b>Assets</b>				
<b>Current assets</b>				
Cash and cash equivalents		9.3	24.3	27.6
Accounts receivable	7	18.3	16.0	14.5
Inventories		3.0	2.5	2.8
Prepaid expenses		1.0	0.6	1.1
Income tax receivable		0.8	-	-
Assets held for sale	9	-	1.7	14.6
Assets related to Middle East discontinued operations	22	-	-	0.6
		<u>32.4</u>	<u>45.1</u>	<u>61.2</u>
<b>Non-current assets</b>				
Loans receivable	14	0.8	-	-
Assets held for sale including assets related to discontinued operations in the Middle East	9	-	-	2.0
Property and equipment	8	<u>53.7</u>	<u>45.5</u>	<u>47.3</u>
<b>Total assets</b>		<u><b>86.9</b></u>	<u><b>90.6</b></u>	<u><b>110.5</b></u>
<b>Liabilities</b>				
<b>Current liabilities</b>				
Accounts payable and accrued liabilities	10	10.9	11.2	14.9
Income taxes payable		-	0.4	0.4
Due to related parties	14	-	-	7.0
Current portion of long-term debt	11	4.8	-	-
Credit facility	11	-	36.5	65.4
Liabilities related to Middle East discontinued operations	22	-	-	0.3
Convertible debentures	11	-	-	27.9
		<u>15.7</u>	<u>48.1</u>	<u>115.9</u>
<b>Non-current liabilities</b>				
Long-term debt	11	13.6	-	-
Deferred income taxes payable		0.8	0.7	0.7
<b>Total liabilities</b>		<u><b>30.1</b></u>	<u><b>48.8</b></u>	<u><b>116.6</b></u>
<b>Shareholders' equity (deficiency)</b>	12	<u><b>56.8</b></u>	<u><b>41.8</b></u>	<u><b>(6.1)</b></u>
<b>Total liabilities and equity</b>		<u><b>86.9</b></u>	<u><b>90.6</b></u>	<u><b>110.5</b></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 and nine months ended September 30, 2011 and 2010

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

	Notes	Three Months Ended		Nine Months Ended	
		September 30		September 30	
		2011	2010	2011	2010
<b>Continuing operations</b>					
<b>Revenue</b>	21	29.3	29.0	90.1	86.0
<b>Expenses</b>					
Oilfield services	15	19.6	19.2	62.2	55.9
General and administration	15	1.8	1.7	5.7	5.9
Share-based compensation	13	0.4	0.7	2.3	0.7
Amortization	8	2.5	2.0	6.5	5.9
Gain on sale of investments	16	-	-	(2.0)	-
Loss on sale of property and equipment		-	0.1	-	0.1
Foreign exchange loss (gain)		0.8	(0.2)	0.9	0.3
		<u>25.1</u>	<u>23.5</u>	<u>75.6</u>	<u>68.8</u>
<b>Operating earnings from continuing operations</b>		<b>4.2</b>	<b>5.5</b>	<b>14.5</b>	<b>17.2</b>
Interest and finance expense		0.4	1.0	1.5	4.3
Gain on restructuring transactions	12	-	-	-	(2.7)
<b>Net earnings before income taxes</b>		<b>3.8</b>	<b>4.5</b>	<b>13.0</b>	<b>15.6</b>
Income taxes		0.8	1.4	2.8	5.3
<b>Net earnings from continuing operations</b>		<b>3.0</b>	<b>3.1</b>	<b>10.2</b>	<b>10.3</b>
<b>Discontinued operations</b>					
Middle East discontinued operations	22	-	0.1	-	0.3
<b>Net earnings for the period</b>		<b>3.0</b>	<b>3.0</b>	<b>10.2</b>	<b>10.0</b>
<b>Earnings per share:</b>					
Basic	12	0.07	0.07	0.23	0.35
Diluted		0.06	0.07	0.21	0.35
<b>Earnings per share from continuing operations:</b>					
Basic		0.07	0.07	0.23	0.36
Diluted		0.06	0.07	0.21	0.36

See accompanying notes to these consolidated Interim Financial Statements.

# High Arctic Energy Services Inc.

## Consolidated Statement of Comprehensive Income

For the three and nine months ended September 30, 2011 and 2010

(Canadian \$ Million - Unaudited)

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	Three Months Ended September 30		Nine Months Ended September 30	
	2011	2010	2011	2010
<b>Net earnings for the period</b>	<b>3.0</b>	<b>3.0</b>	<b>10.2</b>	<b>10.0</b>
<b>Other comprehensive income</b>				
Foreign currency translation gains/(losses) for foreign operations	3.8	(0.8)	2.5	(0.8)
<b>Total comprehensive income for the period</b>	<b>6.8</b>	<b>2.2</b>	<b>12.7</b>	<b>9.2</b>

See accompanying notes to these consolidated Interim Financial Statements.

# High Arctic Energy Services Inc.

## Consolidated Statement of Changes in Equity (Deficiency)

For the periods ended September 30, 2011 and 2010

(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		-	-	-	-	-	10.2	10.2
Other comprehensive income - foreign currency translation differences		-	-	-	-	2.5	-	2.5
Share-based payment transactions	13	2.1	0.2	-	-	-	-	2.3
<b>Balance at September 30, 2011</b>		<b>167.5</b>	<b>6.5</b>	<b>-</b>	<b>-</b>	<b>0.2</b>	<b>(117.4)</b>	<b>56.8</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		-	-	-	(2.8)	-	10.0	7.2
Restructuring transactions	12	36.6	0.6	-	-	-	-	37.2
Other comprehensive income - foreign currency translation differences	6	-	-	-	-	(0.8)	-	(0.8)
<b>Balance at September 30, 2010</b>		<b>163.5</b>	<b>5.2</b>	<b>1.7</b>	<b>-</b>	<b>(0.8)</b>	<b>(132.1)</b>	<b>37.5</b>

# High Arctic Energy Services Inc.

## Consolidated Statement of Cash Flow

For the three and nine months ended September 30, 2011 and 2010

(Canadian \$ Million - Unaudited)

	Notes	Three Months Ended		Nine Months Ended	
		September 30		September 30	
		2011	2010	2011	2010
<b>Operating activities</b>					
Net earnings for the period		3.0	3.0	10.2	10.0
Adjustments for:					
Amortization	8	2.5	2.0	6.5	5.9
Deferred income taxes		0.1	-	0.1	0.1
Gain on restructuring transactions	12	-	-	-	(5.0)
Loss on sale of property and equipment		-	0.1	-	0.1
Share-based compensation	13	0.4	0.7	2.3	0.7
		6.0	5.8	19.1	11.8
Changes in items of working capital					
Accounts receivable	7	(6.2)	(2.5)	(2.3)	(3.4)
Inventory and prepaid expenses		(0.2)	0.2	(0.9)	0.2
Accounts payable and accrued liabilities	10	(0.5)	1.6	(0.3)	(2.0)
Deferred revenue		(0.4)	(0.3)	-	0.7
Income taxes payable		(1.3)	1.0	(1.2)	0.6
		(8.6)	-	(4.7)	(3.9)
<b>Net cash generated from (used in) operating activities</b>		(2.6)	5.8	14.4	7.9
<b>Investing activities</b>					
Property and equipment		(4.5)	(1.7)	(13.5)	(4.5)
Reimbursable cost recovery for equipment		-	-	1.5	-
Proceeds on sale of property and equipment		-	-	-	8.1
<b>Net cash generated from (used in) investing activities</b>		(4.5)	(1.7)	(12.0)	3.6
<b>Financing activities</b>					
Advances from related parties		-	-	-	0.2
Loans receivable	14	-	-	(0.8)	-
Advance of long-term debt	11	-	-	20.0	-
Repayment of long-term debt	11	(1.3)	-	(1.3)	-
Debt transaction costs	11	0.1	-	(0.3)	-
Repayment of credit facility	11	-	(2.1)	(36.5)	(23.6)
<b>Net cash used in financing activities</b>		(1.2)	(2.1)	(18.9)	(23.4)
<b>Net change in cash from continuing operations</b>		(8.3)	2.0	(16.5)	(11.9)
<b>Cash flow from discontinued operations</b>					
Operating activities		-	(0.1)	-	(0.2)
Proceeds on sale of property and equipment		-	-	-	6.6
<b>Effect of exchange rate changes</b>		2.2	(0.8)	1.5	(1.1)
<b>Net change in cash and cash equivalents</b>		(6.1)	1.1	(15.0)	(6.6)
<b>Cash and cash equivalents – Beginning of period</b>		15.4	19.9	24.3	27.6
<b>Cash and cash equivalents – End of period</b>		9.3	21.0	9.3	21.0

See accompanying notes to these consolidated Interim Financial Statements.

# High Arctic Energy Services Inc.

## Notes to the Consolidated Interim Financial Statements

### For nine months ended September 30, 2011 and 2010

(Canadian \$ Million - Unaudited)

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#### 1 Authorization of Financial Statements

The consolidated interim financial statements (“Interim Financial Statements”) of High Arctic Energy Services Inc. (“High Arctic” or the “Corporation”) for the period ended September 30, 2011 were authorized by the Board of Directors on November 10, 2011.

High Arctic is incorporated under the laws of Alberta, Canada and is a publicly traded company 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, work over services and other oilfield services to the oil and gas industry in Canada and Papua New Guinea.

#### 2 Basis of Preparation and Adoption of IFRS

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).

These Interim Financial Statements have been prepared in accordance with International Financial Reporting standards (“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 and for the three and nine month periods ending September 30, 2010.

The policies applied in these condensed Interim Financial Statements are based on IFRS issued and outstanding as of November 10, 2011, the date the Board of Directors approved the statements. 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.

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 and with the consolidated interim financial statements for the three months ended March 31, 2011.

Note 3 discloses significant IFRS accounting policies for the quarter ended September 30, 2011 that are 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 nine months ended September 30, 2011 and 2010

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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 and current liabilities including the credit facility and long term debt. 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

# High Arctic Energy Services Inc.

## Notes to the Consolidated Interim Financial Statements

### For nine months ended September 30, 2011 and 2010

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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.

#### 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 statement of financial position 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

# High Arctic Energy Services Inc.

## Notes to the Consolidated Interim Financial Statements

### For nine months ended September 30, 2011 and 2010

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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.

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, long-term debt 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

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### For nine months ended September 30, 2011 and 2010

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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.

#### **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 earnings 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, 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 statement of income.

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, whereby the number of shares to be issued does not vary with changes in their fair value.

Compound financial instruments are comprised of both an equity and liability portion. 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

# High Arctic Energy Services Inc.

## Notes to the Consolidated Interim Financial Statements

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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:

- 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 the statement of earnings 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.

# High Arctic Energy Services Inc.

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### For nine months ended September 30, 2011 and 2010

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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.

#### **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

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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 operating earnings 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.

The Corporation has an Executive and Director Share Incentive Plan that provides incentive for directors and executives. 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.

### 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:

Mobilization revenue:

The Corporation may receive payments from its customers for services yet to be rendered. 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 are comprised of interest payable on borrowings calculated using the effective interest rate method, foreign currency gains and losses reported on a net basis as well as foreign currency gains and losses reported on a net basis.

# High Arctic Energy Services Inc.

## Notes to the Consolidated Interim Financial Statements

### For nine months ended September 30, 2011 and 2010

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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. 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.

Debt transaction costs incurred in connection with entering into new credit facility agreements are amortized over the term of the debt using the effective interest rate method. All other borrowing costs are recognized in earnings in the period in which they are incurred.

#### **Income tax**

Income tax expense is comprised of current and deferred tax. Current tax and deferred tax are recognized in earnings 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 under IFRS 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 nine months ended September 30, 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 it has one reportable business segment of providing oilfield services to customers.

## 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, "Financial Instruments", 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, "Disclosure of Interests in Other Entities", 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 on its consolidated financial statements.

### IFRS 13

IFRS 13, "Fair Value Measurement", defines fair value, sets out in a single IFRS framework for measuring fair value and requires disclosures about fair value measurements. The IFRS 13 applies to IFRS standards that require or permit fair value measurements or disclosures about fair value measurements (and measurements, such as fair value less costs to sell, based on fair value or disclosures about those measurements), except in specified circumstances. IFRS 13 is to be applied for annual periods beginning on or after January 1, 2013. Earlier application is permitted. The Corporation is currently evaluating the impact of this standard on its consolidated financial statements.

# High Arctic Energy Services Inc.

## Notes to the Consolidated Interim Financial Statements

### For nine months ended September 30, 2011 and 2010

(Canadian \$ Million - Unaudited)

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#### 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 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 and upon conversion to IFRS, High Arctic chose this election. 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 nine months ended September 30, 2011 and 2010

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

	January 1, 2010			September 30, 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	21.0	-	21.0	24.3	-	24.3
Accounts receivable	14.5	-	14.5	18.1	-	18.1	16.0	-	16.0
Inventories	2.8	-	2.8	2.8	-	2.8	2.5	-	2.5
Prepaid expenses	1.1	-	1.1	0.9	-	0.9	0.6	-	0.6
Assets held for sale including assets related to discontinued operations in the Middle East	14.6	-	14.6	2.0	-	2.0	1.7	-	1.7
Assets related to Middle East discontinued operations	0.6	-	0.6	0.4	-	0.4	-	-	-
	61.2	-	61.2	45.2	-	45.2	45.1	-	45.1
<b>Non-current assets</b>									
Property and equipment (Note 6a)	47.6	(0.3)	47.3	46.0	(0.4)	45.6	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	91.2	(0.4)	90.8	91.5	(0.9)	90.6

# High Arctic Energy Services Inc.

## Notes to the Consolidated Interim Financial Statements

For nine months ended September 30, 2011 and 2010

(Canadian \$ Million - Unaudited)

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

	January 1, 2010			September 30, 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>Liabilities</b>									
<b>Current liabilities</b>									
Accounts payable and accrued liabilities	14.9	-	14.9	8.8	-	8.8	11.2	-	11.2
Income taxes payable	0.4	-	0.4	1.0	-	1.0	0.4	-	0.4
Deferred Revenue				0.7		0.7			
Due to related parties	7.0	-	7.0	-	-	-	-	-	-
Credit facility	65.4	-	65.4	41.8	-	41.8	36.5	-	36.5
Liabilities related to Middle East discontinued operations	0.3	-	0.3	0.2	-	0.2	-	-	-
Convertible debentures	27.9	-	27.9	-	-	-	-	-	-
<b>Total current liabilities</b>	<b>115.9</b>	<b>-</b>	<b>115.9</b>	<b>52.5</b>	<b>-</b>	<b>52.5</b>	<b>48.1</b>	<b>-</b>	<b>48.1</b>
<b>Non-current liabilities</b>									
Deferred income taxes payable	0.7	-	0.7	0.8	-	0.8	0.7	-	0.7
<b>Total liabilities</b>	<b>116.6</b>	<b>-</b>	<b>116.6</b>	<b>53.3</b>	<b>-</b>	<b>53.3</b>	<b>48.8</b>	<b>-</b>	<b>48.8</b>
<b>Equity</b>									
Share capital	126.9	-	126.9	163.5	-	163.5	165.4	-	165.4
Contributed surplus	4.6	-	4.6	5.2		5.2	4.6	1.7	6.3
Convertible debenture	2.8	-	2.8	-	-	-	-	-	-
Warrants	1.7	-	1.7	1.7	-	1.7	1.7	(1.7)	-
Accumulated other comprehensive income (loss) (Note 6a)	-	-	-	-	(0.8)	(0.8)	-	(2.3)	(2.3)
Retained earnings (deficit) (Note 6a)	(141.8)	(0.3)	(142.1)	(132.5)	0.4	(132.1)	(129.0)	1.4	(127.6)
<b>Shareholders' equity (deficiency)</b>	<b>(5.8)</b>	<b>(0.3)</b>	<b>(6.1)</b>	<b>37.9</b>	<b>(0.4)</b>	<b>37.5</b>	<b>42.7</b>	<b>(0.9)</b>	<b>41.8</b>
<b>Total liabilities and equity</b>	<b>110.8</b>	<b>(0.3)</b>	<b>110.5</b>	<b>91.2</b>	<b>(0.4)</b>	<b>90.8</b>	<b>91.5</b>	<b>(0.9)</b>	<b>90.6</b>

See Notes to the Reconciliations below.

# High Arctic Energy Services Inc.

## Notes to the Consolidated Interim Financial Statements

For nine months ended September 30, 2011 and 2010

(Canadian \$ Million - Unaudited)

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

	Notes	Three months ended September 30, 2010			Nine months ended September 30, 2010			Year ended December 31, 2010		
		CDN GAAP	Adj	IFRS	CDN GAAP	Adj	IFRS	CDN GAAP	Adj	IFRS
<b>Continuing operations</b>										
<b>Revenue</b>		29.0	-	29.0	86.0	-	86.0	119.3	-	119.3
<b>Expenses</b>										
Oilfield services		19.2	-	19.2	55.9	-	55.9	77.3	-	77.3
General and administration		1.7	-	1.7	5.9	-	5.9	7.7	-	7.7
Share-based compensation		0.7	-	0.7	0.7	-	0.7	1.9	-	1.9
Amortization		2.0	-	2.0	5.9	-	5.9	7.8	-	7.8
Loss on sale of fixed assets		0.1	-	0.1	0.1	-	0.1	-	-	-
Foreign exchange (gain) loss	6a	0.6	(0.8)	(0.2)	1.1	(0.8)	0.3	1.8	(1.8)	-
		24.3	(0.8)	23.5	69.6	(0.8)	68.8	96.5	(1.8)	94.7
<b>Operating earnings from continuing operations</b>		<b>4.7</b>	<b>0.8</b>	<b>5.5</b>	<b>16.4</b>	<b>0.8</b>	<b>17.2</b>	<b>22.8</b>	<b>1.8</b>	<b>24.6</b>
Interest and finance expense		1.0	-	1.0	4.3	-	4.3	5.3	-	5.3
Gain on restructuring costs		-	-	-	(2.7)	-	(2.7)	(2.6)	-	(2.6)
<b>Net earnings before income taxes</b>		<b>3.7</b>	<b>0.8</b>	<b>4.5</b>	<b>14.8</b>	<b>0.8</b>	<b>15.6</b>	<b>20.1</b>	<b>1.8</b>	<b>21.9</b>
Income taxes		1.4	-	1.4	5.3	-	5.3	6.4	-	6.4
<b>Net earnings from continuing operations</b>		<b>2.3</b>	<b>0.8</b>	<b>3.1</b>	<b>9.5</b>	<b>0.8</b>	<b>10.3</b>	<b>13.7</b>	<b>1.8</b>	<b>15.5</b>
Discontinued operations		0.1	-	0.1	0.3	-	0.3	0.9	0.1	1.0
<b>Net earnings for the period</b>		<b>2.2</b>	<b>0.8</b>	<b>3.0</b>	<b>9.2</b>	<b>0.8</b>	<b>10.0</b>	<b>12.8</b>	<b>1.7</b>	<b>14.5</b>
<b>Other comprehensive income</b>										
Foreign currency translation differences for foreign operations	6a	-	-	-	-	-	-	-	(2.3)	(2.3)
<b>Total comprehensive income for the period attributable to equity holders of the Corporation</b>		<b>2.2</b>	<b>0.8</b>	<b>3.0</b>	<b>9.2</b>	<b>0.8</b>	<b>10.0</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

For nine months ended September 30, 2011 and 2010

(Canadian \$ Million - Unaudited)

### 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 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)	108.9	(61.6)	47.3	-	(142.1)
Balance – September 30, 2010 (GAAP)	114.1	(68.1)	46.0	-	(132.5)
Currency translation	(1.2)	0.7	(0.5)	(0.8)	0.4
Balance – September 30, 2010 (IFRS)	112.9	(67.4)	45.5	(0.8)	(132.1)
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)	114.5	(69.0)	45.5	(2.3)	(127.6)

#### Consolidated Statement of Comprehensive Income

	Net earnings	Other comprehensive income account	Total comprehensive income
Balance – September 30, 2010 (GAAP)	9.2	-	9.2
Currency translation	0.8	(0.8)	-
Balance – September 30, 2010 (IFRS)	10.0	(0.8)	9.2
Balance – December 31, 2010 (GAAP)	12.8	-	12.8
Currency translation	1.7	(2.3)	(0.6)
Balance – December 31, 2010 (IFRS)	14.5	(2.3)	12.2

# High Arctic Energy Services Inc.

## Notes to the Consolidated Interim Financial Statements

For nine months ended September 30, 2011 and 2010

(Canadian \$ Million - Unaudited)

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### 7 Accounts Receivable

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

	<b>September 30, 2011</b>	<b>December 31, 2010</b>	<b>January 1, 2010</b>
Less than 31 days	11.2	8.2	11.2
31 to 60 days	5.2	5.5	2.8
61 to 90 days	1.9	1.3	0.8
Greater than 90 days	0.4	1.7	0.4
Allowances for doubtful accounts	(0.4)	(0.7)	(0.7)
<b>Total</b>	<b>18.3</b>	<b>16.0</b>	<b>14.5</b>

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

	<b>September 30, 2011</b>	<b>December 31, 2010</b>	<b>January 1, 2010</b>
Canadian dollar	7.6	7.7	4.9
United States dollar	10.7	8.3	9.6
<b>Total</b>	<b>18.3</b>	<b>16.0</b>	<b>14.5</b>

# High Arctic Energy Services Inc.

## Notes to the Consolidated Interim Financial Statements

For nine months ended September 30, 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	Oil Field Equipment	Leasehold improvements	Computer hardware and office equipment	Work-in-progress	Total
<b>Balance January 1, 2010</b>	<b>1.8</b>	<b>19.4</b>	<b>0.9</b>	<b>84.5</b>	<b>0.5</b>	<b>1.0</b>	<b>0.8</b>	<b>108.9</b>
Additions	0.5	-	-	5.5	-	0.1	1.4	7.5
Disposals	-	-	-	-	-	-	-	-
Effect of foreign currency exchange	-	(0.1)	-	(1.8)	-	-	-	(1.9)
<b>Balance December 31, 2010</b>	<b>2.3</b>	<b>19.3</b>	<b>0.9</b>	<b>88.2</b>	<b>0.5</b>	<b>1.1</b>	<b>2.2</b>	<b>114.5</b>
Additions	0.6	0.2	0.2	7.8	0.1	-	4.6	13.5
Additions from assets held for sale	-	0.1	-	1.6	-	-	-	1.7
Reimbursable cost recoveries for upgrade of equipment	-	-	-	(1.5)	-	-	-	(1.5)
Disposals	(0.8)	-	-	(0.4)	-	(0.2)	-	(1.4)
Effect of foreign currency exchange	-	-	-	1.4	-	-	0.3	1.7
<b>Balance September 30, 2011</b>	<b>2.1</b>	<b>19.6</b>	<b>1.1</b>	<b>97.1</b>	<b>0.6</b>	<b>0.9</b>	<b>7.1</b>	<b>128.5</b>

# High Arctic Energy Services Inc.

## Notes to the Consolidated Interim Financial Statements

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Accumulated amortization and impairments	Light vehicles	Heavy trucks	Computer software	Oil Field Equipment	Leasehold improvements	Computer hardware and office equipment	Work-in-progress	Total
<b>Balance January 1, 2010</b>	1.1	12.6	0.7	46.5	-	0.7	-	61.6
Amortization for the period	0.3	1.0	0.1	7.0	0.1	-	-	8.5
Disposals	-	-	-	-	-	-	-	-
Effect of foreign currency exchange	(0.1)	-	-	(1.0)	-	-	-	(1.1)
<b>Balance December 31, 2010</b>	1.3	13.6	0.8	52.5	0.1	0.7	-	69.0
Amortization for the period	0.3	0.7	0.1	4.8	0.1	0.1	-	6.1
Amortization on assets held for sale added to fixed assets	-	-	-	0.4	-	-	-	0.4
Disposals	(0.7)	-	-	(0.5)	-	(0.2)	-	(1.4)
Effect of foreign currency exchange	-	-	-	0.7	-	-	-	0.7
<b>Balance September 30, 2011</b>	0.9	14.3	0.9	57.9	0.2	0.6	-	74.8
<b>Carrying amounts</b>								
At January 1, 2010	0.7	6.8	0.2	9.8	0.5	0.3	0.8	47.3
At December 31, 2010	1.0	5.6	0.1	9.7	0.4	0.3	2.2	45.5
<b>At September 30, 2011</b>	1.2	5.3	0.2	39.2	0.4	0.3	7.1	53.7

# High Arctic Energy Services Inc.

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### 9 Assets Held for Sale

The Corporation previously had \$1.7M of property and equipment classified and recorded as assets held for sale (December 31, 2010 - \$1.7 million) which includes assets related to discontinued operations.

The assets held for sale have been transferred back into fixed assets as they no longer meet the criteria for classification as Assets Held For Sale under IFRS. As a result of the transfer, depreciation was recorded from January 1, 2010 until September 30, 2011 and recorded in the third quarter ended September 30, 2011. This resulted in an adjustment to depreciation of \$0.4 million for the three months ended September 30, 2011. The assets will now continue to be depreciated over their remaining useful life.

	<b>Balance as at September 30, 2011</b>
<b>Assets held for sale including assets related to discontinued operations</b>	
Balance January 1, 2010	16.6
Disposals in nine months ended September 30, 2010	(14.9)
Balance as at September 30, 2010	<u>1.7</u>
Disposals from October 1, 2010 through December 31, 2010	-
Balance as at December 31, 2010	<u>1.7</u>
Transfer assets held for sale to fixed assets from January 1, 2011 to September 30, 2011	(1.7)
Balance as at September 30, 2011	<u>-</u>

### 10 Accounts Payable and Accrued Liabilities

	<b>September 30, 2011</b>	<b>December 31, 2010</b>	<b>January 1, 2010</b>
Accounts payable	5.5	4.5	2.9
Accrued liabilities	3.8	5.1	10.7
Accrued payroll	1.6	1.6	1.3
<b>Total</b>	<u><b>10.9</b></u>	<u><b>11.2</b></u>	<u><b>14.9</b></u>

# High Arctic Energy Services Inc.

## Notes to the Consolidated Interim Financial Statements

### For nine months ended September 30, 2011 and 2010

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#### 11 Long-Term Debt and Other Borrowings

On May 6, 2011, the Corporation entered into a new credit facility agreement consisting of a \$20.0 million, two year committed capital loan with a four year amortization, a \$5.0 million two year committed revolving evergreen loan and a \$5.0 million demand revolving operating loan. The \$20.0 million capital loan was advanced to the Corporation on May 6, 2011 and the proceeds applied against the term loan outstanding at that time. The credit facilities are secured by all of the assets of High Arctic and by unlimited guarantees of its foreign subsidiaries.

Until May 6, 2011, the Corporation had a one year term loan with no fixed amortization obligations and an interest rate of prime plus 4.75% provided that prime had a floor amount of 4.75%. On May 6, 2011, the Corporation repaid the outstanding amount on that date of \$23.7 million (December 31, 2010 – \$36.5 million).

The capital loan is subject to quarterly principal payments of \$1.25 million and the first quarterly payment was made on September 30, 2011. The capital loan carries an annual interest rate of the bank's prime interest rate plus 1.75% and has a maturity date of September 30, 2013. The effective interest rate on the capital loan was 5% for the period from May 6, 2011 to September 30, 2011.

The \$5.0 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 1/48th 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 September 30, 2011, the Corporation does not have any amounts drawn against the evergreen loan. The maturity date is September 30, 2013.

The \$5.0 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 September 30, 2011, the Corporation does not have any amounts drawn against the revolving operating loan.

#### Long-term debt consists of the following:

	September 30, 2011	December 31, 2010
Two year capital loan, net of transaction costs <sup>(1)</sup>	18.4	-
Revolving evergreen loan	-	-
	18.4	-
Less: current portion of long-term debt	4.8	-
	13.6	-

(1) The Corporation incurred total transaction costs of \$0.4 million in connection with the new credit facilities which are amortized over the term of the loan as financing expenses.

#### 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 prior to January 1, 2010.

The entire principal amount and all accrued and unpaid interest owing under the Debentures was converted into 24,736,227 common shares of the Corporation as part of a series of transaction completed on April 30, 2010 (see Note 12b). The Corporation had accrued interest of \$3.7 million up to completion of the restructuring transactions on April 30, 2010.

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Share capital of the 24,736,227 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).

## 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.

	September 30, 2011	December 31, 2010	January 1, 2010
Retained earnings (deficit)	(117.4)	(127.6)	(142.1)
Common shares (b)	167.5	165.4	126.9
Convertible debentures, equity portion (note 11)	-	-	2.8
Warrants	-	-	1.7
Contributed surplus (c)	6.5	6.3	4.6
Accumulated other comprehensive income(loss)	0.2	(2.3)	-
<b>Total equity (deficiency)</b>	<b>56.8</b>	<b>41.8</b>	<b>(6.1)</b>

### (b) Changes in Issued Shares

	September 30, 2011		December 31, 2010	
	Shares	\$	Shares	\$
Opening balance	43,083,752	163.6	9,088,473	126.9
Issuance of shares	52,885	-	139,228	0.1
Issuance of shares on restructuring transactions	-	-	33,856,051	36.6
Vested restricted shares (note 13)	2,840,000	1.5	-	-
Common shares outstanding	45,976,637	165.1	43,083,752	163.6
Restricted shares outstanding (note 13)	3,620,000	2.4	7,100,000	1.8
Total common and restricted shares outstanding	49,596,637	167.5	50,183,752	165.4

### Share Consolidation

On June 15, 2011, the Corporation completed a consolidation of its common shares on the basis of one (1) new post-consolidation common share for every five (5) pre-consolidation common shares. The 252,183,147 common shares outstanding on that date were consolidated into 50,436,637 shares. In the financial statements, the share consolidation was applied retroactively such that the number of common and restricted shares and stock options issued prior to that time have been restated and the outstanding balances and per share information presented accordingly.

### Issuance of Shares

For the nine months ended September 30, 2011, a total of 52,885 stock options were exercised for shares of the Corporation (see Note 13). For the year ended December 31, 2010, a total of 14,228 stock options were exercised for shares of the Corporation (see Note 13) and 125,000 common shares were issued as a non-brokered private placement as part of an arrangement to settle an outstanding obligation.

# High Arctic Energy Services Inc.

## Notes to the Consolidated Interim Financial Statements

### For nine months ended September 30, 2011 and 2010

(Canadian \$ Million - Unaudited)

#### Restructuring transactions

On April 30, 2010 the Corporation completed a series of transactions whereby the Corporation:

- issued 6,593,677 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 24,736,227 common shares in full settlement of all outstanding principal and accrued interest owed to the holders of the Debentures (see Note 11); and
- issued 2,526,148 common shares to its senior lenders as consideration for a one year term loan to refinance the existing senior credit facilities.

The Corporation issued a total of 33,856,052 common shares as part of the restructuring transactions. The shares were issued at a nominal value of \$1.25 per share. The amount recorded in share capital for the 33,856,052 common shares is the estimated market value of \$33.8 million determined as the trading price of \$1.00 per share at the closing date.

The restructuring transactions resulted in a gain of \$2.7 million being recorded in the three months ended September 30, 2010. Details on the restructuring transactions are summarized as follows:

	Number of Shares	\$ value of Shares	Gain (Loss)
Issuance of common shares on related party debt settlement (Note 14)	6,593,677	6.6	0.6
Issuance of common shares on debenture conversion (Note 11)	24,736,227	24.7	6.9
Issuance of common shares for financing fee (Note 11)	2,526,148	2.5	(2.5)
Transfer of the equity portion of debentures to share capital on debenture conversion (Note 11)	-	2.8	-
Non-cash portion of gain on restructuring transactions	-	-	5.0
Fee on restructuring of credit facility	-	-	(0.4)
Restructuring costs	-	-	(1.9)
	<b>33,856,052</b>	<b>36.6</b>	<b>2.7</b>

#### (c) Contributed Surplus

	Nine Months Ended September 30, 2011	Year ended December 31, 2010
Opening balance	6.3	4.6
Expiry of warrants	-	1.7
Share-based compensation (Note 13)	0.2	-
Closing balance	<b>6.5</b>	<b>6.3</b>

#### (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 restricted shares issued under 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.

# High Arctic Energy Services Inc.

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(Canadian \$ Million - Unaudited)

	Three months ended September 30, 2011		Nine months ended September 30, 2011		Three months ended September 30, 2010		Nine months ended September 30, 2010	
	Number of Shares	Earnings per Share	Number of Shares	Earnings per Share	Number of Shares	Earnings per Share	Number of Shares	Earnings per Share
Weighted average number of common shares used in basic earnings per share	45,976,629	\$0.07	44,703,948	\$0.23	42,945,212	\$0.07	28,062,970	\$0.35
<b>Adjustments for:</b>								
Convertible debentures	-		-		-		-	
Stock options	124,409		126,225		144,995		161,458	
Restricted shares	3,620,000		3,567,253		-		-	
Weighted average number of common shares used in diluted earnings per share	49,721,038	\$0.06	48,397,426	\$0.21	43,090,207	\$0.07	28,224,428	\$0.35

# High Arctic Energy Services Inc.

## Notes to the Consolidated Interim Financial Statements

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### 13 Share-based Compensation

#### 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 4,959,663 options (being 10% of all outstanding shares) are available for grants.

At September 30, 2011, a total of 1,311,710 options are outstanding and expire at various dates up to 2016, at amounts that range from \$0.65 to \$49.99 per share. These options are exercisable over a term of 5 years and are generally 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 3.77 years and 279,445 options are currently vested and eligible to be exercised.

	Number of Options	Weighted Average Exercise Price \$/Share
<b>Total Outstanding January 1, 2010</b>	642,110	3.95
Granted	617,500	1.00
Exercised	(14,228)	0.75
Expired	(11,900)	52.65
Forfeited	(88,002)	5.75
<b>Total Outstanding December 31, 2010</b>	<b>1,145,480</b>	<b>1.75</b>
Granted	403,500	1.41
Exercised	(52,885)	.75
Expired	(5,800)	53.74
Forfeited	(178,585)	2.61
<b>Total Outstanding September 30, 2011</b>	<b>1,311,710</b>	<b>1.35</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 (\$)
\$0.65 to \$9.99	1,294,940	3.77	1.11	262,675	1.00
\$10.00 to \$19.99	11,070	-	13.77	11,070	13.77
\$20.00 to \$34.99	4,700	-	29.92	4,700	29.92
\$35.00 to \$49.99	1,000	-	46.35	1,000	46.35
<b>Total Outstanding September 30, 2011</b>	<b>1,311,710</b>	<b>3.77</b>	<b>1.35</b>	<b>279,445</b>	<b>2.15</b>

Share-based compensation is a non-cash item and is measured in accordance with a prescribed formula. Share-based compensation expense recognized by the Corporation for the Stock Option Plan for each of the three and nine months ended September 30, 2011 was \$0.1 million and \$0.2 million (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%;

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### For nine months ended September 30, 2011 and 2010

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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 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 "Plan"). The maximum number of common shares initially available for issuance by the Corporation under the Plan was 7,578,444 common shares. These shares are issued in trust for the benefit of designated beneficiaries and vest to each designated beneficiary over a 3 year period. 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 common shares. The shares are not freely tradable prior to vesting and any shares that do meet the vesting conditions are returned by the trustee to the Corporation for cancellation. The number of restricted shares granted is 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 and an equivalent share based compensation amount is recorded. 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 common 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.

On September 1, 2010, the Corporation issued 7,100,000 shares under the Plan to a trustee for the benefit of designated directors and executive management. 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 and a share capital amount of \$0.825 per share will be recorded as the related share-based compensation expense is recognized.

On March 14, 2011 a further 200,000 shares were granted under the Plan to a trustee for the benefit of designated senior managers. 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 and a share capital amount of \$1.05 per share will be recorded as the related share-based compensation expense is recognized.

#### Restricted Common Shares Issued under the Share Incentive Plan:

	<b>Nine months ended September 30, 2011</b>	<b>Year ended December 31, 2010</b>
Opening balance	7,100,000	-
Grant of common shares	200,000	7,100,000
Vested common shares	(2,840,000)	-
Forfeitures	(840,000)	-
Closing balance	<u>3,620,000</u>	<u>7,100,000</u>

For the three and nine months ended September 30, 2011 the corporation incurred share based compensation expense of \$0.3 million and \$2.1 million, respectively (\$1.8 million was recorded for the year ended December 31, 2010) and an amount of up to \$1.4 million (before recognizing a reduction for any future forfeitures of common shares) remains to be amortized in future periods in respect of the common shares issued to date under the Plan.

# High Arctic Energy Services Inc.

## Notes to the Consolidated Interim Financial Statements

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### 14 Related Party Transactions

- (a) During May, 2011 High Arctic made loans to certain directors and officers of the Corporation in the total aggregate amount of \$1.1 million. 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 under the Corporation's executive and director share incentive 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 common 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. As at September 30, 2011, the total amount outstanding related to these loans was \$0.8 million.
- (b) An individual who, prior to April 30, 2010, controlled almost 40% of the outstanding shares and who was a director and officer of the Corporation until December 16, 2008 (the "Shareholder") made various loans and advances to the Corporation. Interest expense for the nine months ended September 30, 2010 includes \$0.2 million accrued to March 31, 2010. As part of the restructuring transactions completed on April 30, 2010 (see Note 12), the Corporation issued 6,593,677 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.

### 15 Expenses

#### Oilfield Services expenses by nature

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Personnel costs and personnel related costs	11.4	10.3	31.8	27.9
Drilling rig rental cost	4.7	4.7	16.3	12.9
Material and supplies cost	1.6	3.2	7.6	10.4
Equipment operating and maintenance costs	1.0	0.5	4.7	3.4
Other	0.9	0.5	1.8	1.3
<b>Total</b>	<b>19.6</b>	<b>19.2</b>	<b>62.2</b>	<b>55.9</b>

#### General and administrative expenses by nature

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Personnel costs and personnel related costs	1.0	1.1	3.4	3.5
Professional, legal and consulting fees	0.2	0.3	0.8	0.8
Facility costs	0.6	0.3	1.4	1.3
Other	-	-	0.1	0.3
<b>Total</b>	<b>1.8</b>	<b>1.7</b>	<b>5.7</b>	<b>5.9</b>

# High Arctic Energy Services Inc.

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### 16 Gain on Sale of Investments

In the first quarter of 2011, the Corporation recorded a gain of \$2.0 million arising on the sale of 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.

#### Inventory

The Corporation has been supplied with an inventory of spare parts with a value of US \$5.2 million by a customer in Papua New Guinea. The inventory is owned by the customer and has not been recorded on the books of High Arctic. At the end of the contract, the Corporation must return an equivalent inventory to the customer. The Corporation believes it currently has sufficient inventory on hand to meet that obligation and accordingly no provision has been made for any potential shortfall.

#### Other

The Corporation has posted a performance bond of approximately US\$3.8 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 September 30, 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 long term debt, credit facility and convertible debentures described in Note 11 less cash and cash equivalents.

	September 30, 2011	December 31, 2010	January 1, 2010
Shareholders' equity (deficiency)	56.8	41.8	(6.1)
Convertible debentures	-	-	27.9
Credit facility	-	36.5	65.4
Total long-term debt	18.4	-	-
Cash and cash equivalents	(9.3)	(24.3)	(27.6)
<b>Total Capitalization</b>	<b>65.9</b>	<b>54.0</b>	<b>59.6</b>

# High Arctic Energy Services Inc.

## Notes to the Consolidated Interim Financial Statements

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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.

Financing decisions for the foreseeable future will be governed largely by managing the available cash and liquidity available under the Corporation's credit facilities based on the timing and extent of expected operating and capital cash outlays. Future equity financings are a possibility to raise capital for new business opportunities.

The Company's loan facilities are subject to four financial covenants, which are reported to the lender on a quarterly basis. These financial covenants are used by management to monitor capital and to assess the funds available to commit for capital expenditures, with the main focus on the Maximum Funded Debt to EBITDA and the Minimum Fixed Charge Coverage Ratios, which are measures that have no prescribed meaning under IFRS.

Funded Debt to EBITDA is defined as the ratio of consolidated Funded Debt to the aggregate EBITDA for the trailing four quarters. Funded Debt is defined generally as indebtedness and liabilities which constitute debt in accordance with IFRS but excluding accounts payable, other short-term non-interest bearing liabilities and future income taxes. EBITDA is a defined term in the lending agreement and generally means net income plus interest expense, cash taxes payable, depreciation, amortization, future income taxes, share-based compensation and other non-cash expenses and excludes and gains or losses from the sale of assets. This ratio must be maintained below 2.00:1. For the rolling four quarters ended September 30, 2011, this ratio was 0.60:1.

Fixed Charge Coverage Ratio is defined as EBITDA less cash taxes, dividends and unfunded capital expenditures divided by the total of principal payments on long-term debt and capital leases plus interest, all calculated on a consolidated basis for the trailing four quarters. This ratio must be maintained above 1.25:1. For the rolling four quarters ended September 30, 2011, this ratio was 10.7:1.

The Corporation remains in compliance with all financial covenants under its credit facility agreement.

## 19 Financial Instruments and Risk Management

### Fair Value of Financial Assets and Liabilities

Accounts receivable and cash and cash equivalents 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 capital loan is a floating rate credit facility and fluctuates in response to changes in the prime interest rates. For the three and nine months ended September 30, 2011 an increase or decrease in interest expense for each one percent change in

# High Arctic Energy Services Inc.

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interest rates on the loan facility would have amounted to \$0.05 million and \$0.2 million respectively (2010 - \$0.1 million and \$0.3 million respectively).

#### **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 nine months ended September 30, 2011, a 1% nominal change in the value of the Canadian dollar relative to the U.S. dollar would have resulted in a \$0.2 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 credit reviews prior to commencement of contractual arrangements.

#### **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 57% and 48% of the Corporation's revenue for the three and nine months ended September 30, 2011 and 53% of its accounts receivable at that date. The second significant customer is a major Canadian exploration and production company which represents approximately 10% and 12% of the Corporation's revenue for the three and nine months ended September 30, 2011 and 3% 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.

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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	10.9	-	-	-	10.9
Long-term debt <sup>(1)</sup>	5.0	10.0	3.7	-	18.7
<b>Total</b>	<b>15.9</b>	<b>10.0</b>	<b>3.7</b>	<b>-</b>	<b>29.6</b>

(1) excludes debt transaction costs of \$0.3 million

## 20 Operating Lease Arrangements

### **Lease Obligations**

The Corporation has entered into long-term premise 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 premise 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 September 30, 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	0.5	0.7	0.2	-	1.4
<b>Total lease commitments</b>	<b>0.5</b>	<b>0.7</b>	<b>0.2</b>	<b>-</b>	<b>1.4</b>

# High Arctic Energy Services Inc.

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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:

	Three Months Ended September 30		Nine months ended September 30	
	2011	2010	2011	2010
Revenue				
Canada	11.2	9.2	31.2	27.0
Papua New Guinea and other	18.1	19.8	58.9	59.0
<b>Total</b>	<b>29.3</b>	<b>29.0</b>	<b>90.1</b>	<b>86.0</b>
Oilfield services expense	19.6	19.2	62.2	55.9
<b>Oilfield services margin</b>	<b>9.7</b>	<b>9.8</b>	<b>27.9</b>	<b>30.1</b>
General and administration	1.8	1.7	5.7	5.9
Share-based compensation	0.4	0.7	2.3	0.7
Amortization	2.5	2.0	6.5	5.9
Gain on sale of investments	-	-	(2.0)	-
Loss on sale of fixed assets	-	0.1	-	0.1
Foreign exchange loss (gain)	0.8	(0.2)	0.9	0.3
<b>Operating earnings from continuing operations</b>	<b>4.2</b>	<b>5.5</b>	<b>14.5</b>	<b>17.2</b>
	Three Months Ended September 30		Nine months ended September 30	
	2011	2010	2011	2010
Assets				
Canada	41.2	48.5	41.2	48.5
Papua New Guinea and other	45.7	42.3	45.7	42.3
<b>Total</b>	<b>86.9</b>	<b>90.8</b>	<b>86.9</b>	<b>90.8</b>
Liabilities				
Canada	21.4	45.3	21.4	45.3
Papua New Guinea and other	8.7	8.0	8.7	8.0
<b>Total</b>	<b>30.1</b>	<b>53.3</b>	<b>30.1</b>	<b>53.3</b>

### 22 Discontinued Operations

A decision was made during 2008 to discontinue operations in the Middle East Region, including Tunisia and India, due to ongoing losses. During 2010, the Corporation divested of the remaining assets and used the net proceeds 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.