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March 17, 2009

Auditors' Report

To the Shareholders of
High Arctic Energy Services Inc.

We have audited the consolidated balance sheets of High Arctic Energy Services Inc. (formerly High Arctic Energy Services Trust) as at December 31, 2008 and 2007 and the consolidated statements of net earnings (loss), comprehensive income (loss) and retained earnings (deficit) and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2008 and 2007 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants
Calgary, Canada

High Arctic Energy Services Inc.

(formerly High Arctic Energy Services Trust)

Consolidated Balance Sheets

As at December 31, 2008 and 2007

($ Million - Audited)

	2008	2007
Assets		
Current assets		
Cash and cash equivalents (Note 5)	22.2	21.0
Accounts receivable (Note 15)	26.5	25.8
Work-in-progress	-	0.2
Due from Optimal Pressure Drilling Services (Note 5)	1.0	9.0
Inventory	2.1	1.9
Prepaid Expenses	1.1	1.2
Assets related to discontinued operations (Note 16)	5.1	6.1
	58.0	65.2
Property and equipment (Note 3)	78.9	95.0
Rigs and equipment under construction (Note 4)	4.5	2.4
Assets held for sale and long term assets related to discontinued operation (Notes 3 and 16)	25.0	65.7
Future taxes (Note 17)	-	0.5
	166.4	228.8
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	20.1	20.6
Income taxes payable	9.4	3.8
Prepaid mobilization revenue	-	1.6
Due to related parties (Note 10)	6.3	5.4
Credit facility and bridge loan (Note 6)	93.4	122.9
Future income tax liabilities (Note 17)	0.2	-
Liabilities related to discontinued operations (Note 16)	1.5	5.8
	130.9	160.1
Convertible Debentures (Note 7)	25.8	23.3
	156.7	183.4
Shareholders' equity (Note 8)	9.7	45.4
	166.4	228.8

Basis of presentation (Note 1)

Commitments and contingencies (Notes 5 and 11)

See accompanying notes

Approved on behalf of the Corporation by:

(signed) "*Michael Binnion*" Director

(signed) "*Christopher Warren*" Director

High Arctic Energy Services Inc.

(formerly High Arctic Energy Services Trust)

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

For the years ended December 31, 2008 and 2007

($ Million except per unit amounts - Audited)

	2008	2007
Revenue (Note 12)	153.7	100.8
Expenses		
Oilfield services	107.2	66.5
General and administration	14.1	10.4
Share based compensation	3.3	0.1
Write-down of long term receivable (Notes 11 and 16)	0.2	14.2
Amortization	15.2	17.9
Foreign exchange (gain) loss	(4.0)	1.9
	136.0	111.0
Operating earnings (loss)	17.7	(10.2)
Interest (Note 4)	20.6	9.7
Financing Costs	1.3	1.7
(Gain) Loss on sale of property, equipment and investments	2.1	(2.9)
Impairment of assets held for sale and Property and Equipment (Note 3)	20.0	9.9
Net earnings (loss) before income taxes and discontinued operations	(26.3)	(28.6)
Income taxes (recovery) (Note 17)	5.3	3.1
Net earnings (loss) from continuing operations	(31.6)	(31.7)
Discontinued Operations, net of tax (Note 16)	(8.0)	(37.9)
Net earnings (loss) and comprehensive income (loss)	(39.6)	(69.6)
Retained earnings (Deficit) – beginning of year	(85.6)	(13.9)
Distributions as a Trust	-	(2.1)
Retained earnings (Deficit)– end of year	(125.2)	(85.6)
Earnings (loss) per share		
- basic and diluted from continuing operations	$ (0.74)	$ (0.83)
- basic and diluted from discontinued operations	$ (0.19)	$ (1.00)
- basic and diluted	$ (0.93)	$ (1.83)

Basis of presentation (Note 1)

See accompanying notes

High Arctic Energy Services Inc.

(formerly High Arctic Energy Services Trust)

Consolidated Statements of Cash Flows

For the years ended December 31, 2008 and 2007

($ Million - Audited)

	2008	2007
Cash provided by (used in):		
Operating activities		
Net earnings (loss) from continued operations	(31.6)	(31.7)
Add non-cash items:		
Amortization	15.2	17.9
Financing accretion and amortization	7.5	0.1
Share-based compensation	3.3	0.1
Write Down of long term receivable (Note 11)	-	14.2
Impairment on assets held for sale	20.0	9.9
Future tax	0.7	(0.5)
Gain (loss) on sale of property and equipment	2.1	(2.9)
	17.2	7.1
Change in non-cash working capital balances (Note 13)	10.4	(20.2)
Cash flows from continuing operating activities	27.6	(13.1)
Investing activities		
Property and equipment and rigs and equipment under construction	(19.8)	(12.2)
Proceeds on sale of property and equipment	13.7	25.8
Advances to Optimal Drilling (Note 5)	(1.0)	-
Change in non-cash working capital balances (Note 13)	-	(8.4)
	(7.1)	5.2
Financing activities		
Advances from (to) related parties	0.9	5.0
Change in credit facility	(32.5)	4.6
Issuance of shares, net of costs	-	37.9
Issuance of convertible debentures, net of costs	-	26.0
Distributions as a Trust	-	(2.1)
Change in non-cash working capital balances (Note 13)	-	(3.3)
	(31.6)	68.1
Net change in cash from continuing operations	(11.1)	60.2
Cash flow from discontinued operations		
Operating activities	(6.5)	(5.8)
Investing activities		
Proceeds on sales of property and equipment	18.8	-
Property and equipment	-	(36.5)
Financing activities	-	-
Net change in cash from discontinued operations	12.3	(42.3)
Net increase (decrease) in cash and cash equivalents	1.2	17.9
Cash and cash equivalents – beginning of year	21.0	3.1
Cash and cash equivalents – end of year	22.2	21.0
Supplemental information		
Cash paid for:		
Interest	14.2	8.7
Income taxes	-	2.0

Basis of presentation (Note 1)

See accompanying notes

1 Basis of Presentation

High Arctic Energy Services Inc. (the "Corporation" or "HAES") is incorporated under the laws of Alberta, Canada and commenced operations on June 29, 2007 as a consequence of a reorganization through a Plan of Arrangement approved by the securityholders of the High Arctic Energy Services Trust (the "Trust"). The reorganization resulted in the Corporation acquiring the business of the Trust through the exchange of each outstanding Trust Unit and Exchangeable Share for common shares of the Corporation on a one-for-one basis, after accounting for the conversion factor applicable to the Exchangeable Shares (Note 8). For accounting purposes, the Corporation is considered a continuation of the Trust.

The Corporation's principal focus is to provide specialized drilling and well completion services to the Canadian and international oil and gas industry. The Corporation's Canadian operations are considered to have some seasonality with peak levels in the first and fourth quarters.

Going Concern

These audited consolidated financial statements are stated in Canadian dollars and have been prepared by management in accordance with Canadian Generally Accepted Accounting Principles ("GAAP") on a going concern basis. The consolidated earnings and cash flows for the periods prior to June 29, 2007 are those of the Trust. The going concern basis presumes the realization of assets and discharge of liabilities in the normal course of business for the foreseeable future. The Corporation's ability to continue as a going concern is dependent upon cash flow from operations remaining adequate to meet the cash requirements of the business, notwithstanding an anticipated continuing decline in Canadian oilfield activity, as well as obtaining further extensions of the due date for repayment of its outstanding debt. The Corporation has obtained waivers and amendments to its banking covenants (Note 6) required as a result of not generating sufficient cash flows from operations and not yet completing the asset sales required under the terms of its senior credit facility. The Corporation does not expect to have the ability to repay the $20.0-million Bridge Loan due on March 31, 2009. The Corporation must negotiate additional extensions and amendments to its credit facilities and expects that further asset sales will be required to reduce its debt and maintain compliance with the revised terms. While the Corporation is focusing its best efforts on these matters, there are no assurances that management will be successful in such initiatives. There is therefore a significant risk regarding the Corporation's ability to continue as a going concern. These financial statements do not include any adjustments to the amounts and classification of assets and liabilities that might be necessary should the Corporation be unable to continue in business and therefore be unable to realize its assets and discharge its liabilities in the normal course of business. Such adjustments could be material.

2 Accounting Policies

Measurement Uncertainty

The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. Such estimates include the amortization of property and equipment, recoverability of accounts receivable, valuation of unit-based compensation, accruals for contingencies, valuation of the convertible debenture components, future tax valuation allowance and impairment of property and equipment. Accordingly, actual results could differ from estimated amounts as future confirming events occur and the impact could be material.

Principles of Consolidation

These financial statements represent the accounts of the Corporation and its wholly-owned subsidiary partnership, High Arctic Energy Services LP, and its principal wholly-owned foreign operating subsidiaries - High Arctic Energy Services Cyprus Ltd., High Arctic Energy Services PNG Limited, High Arctic Energy Services Australia PTY Ltd and High Arctic Energy Service LLC – and all other wholly-owned subsidiaries.

($ Million - Audited)

Investments in joint ventures are accounted for using the proportionate consolidation method, whereby the corporation's proportionate share of revenues, expenses, assets and liabilities are included in the accounts. The Corporation holds an investment in a joint venture (Note 5) that it accounts for using the proportionate consolidation method.

Cash and Cash Equivalents

Cash and cash equivalents are comprised of cash and short-term market investments that are highly liquid in nature and have an original maturity date of less than three months.

Inventory

Inventory consists primarily of operating supplies and spare parts not held for sale and is valued at the lower of average cost and net realizable value.

Work-in-Progress

The Corporation follows a policy of deferring start-up costs for new contracts as work-in-progress and amortizing these costs upon commencement of contract revenues. These costs are amortized over the lesser of the number of contract months or one year as the revenue is earned.

Financing Costs

Costs incurred to negotiate new debt or modify existing debt prior to its issuance are deferred and amortized over the term of the related debt provided the receipt of funding is probable. After the facility is operative, such costs are deducted from the related debt and amortized using the effective interest rate method. Any financing costs pertaining to negotiations that are subsequently abandoned are expensed at the time of abandonment.

Property and Equipment

Property and equipment are recorded at cost less accumulated amortization. Equipment is amortized using the declining balance method over their estimated useful lives at the following rates:

Automotive	30%
Computer hardware	30%
Computer software	100%
Equipment – field	10 – 30%
Equipment – drilling rigs	10%
Equipment – hydraulic workover rigs	10 – 30%
Equipment – snubbing, air drilling and nitrogen	10 – 30%
Equipment – office	20%
Leasehold improvements	Lease term or five years

Management assesses the carrying amount of property and equipment for impairment when events indicate that the carrying amount may not be recoverable. In such circumstances, an impairment loss is recognized in income for the amount by which the carrying amount exceeds fair value determined using an estimate of discounted future cash flows of operating equipment attributable to the property and equipment. If the asset has been classed as held for sale, the fair value is determined as the estimated sales value.

Rigs and Equipment Under Construction

Design and construction costs related to equipment under construction, including all costs to prepare the asset for its intended use and interest capitalized during the construction period, are recorded as rigs and equipment under construction and are not subject to amortization until the asset is placed into service.

Investments

Investments in other companies over which the Corporation does not have significant influence are accounted for by the cost method. Investments are written down to their net realizable value should a decline in value occur that is other than temporary.

Income Taxes

The Corporation and its subsidiaries use the liability method of tax allocation in accounting for income taxes. Under this method, future tax assets and liabilities are determined for the income tax consequences attributable to differences between amounts recorded in the financial statements and their respective tax basis, using substantially enacted tax rates. The effect of any change in income tax rates on future tax assets and liabilities is recognized in earnings in the period that the change occurs. To the extent that the Corporation does not consider it to be more likely than not that a future tax asset will be recovered, it provides a valuation allowance against the excess.

Research and Development

Research and development expenditures are expensed as incurred unless recovery of costs associated with the development of new tools and systems can be reasonably assured, given existing and anticipated future industry conditions and assuming all other development cost deferral criteria have been met, in which case the costs are deferred and amortized.

Employee Benefit Plans

The Corporation provides a defined contribution pension plan for employees. Contributions by the Corporation are expensed when contributed. The Corporation has no other post-retirement benefit plans.

Foreign Currency Translation

The Corporation uses the Canadian dollar as its functional currency. Revenues and expenses denominated in foreign currencies are translated at the rate of exchange in effect on the date of the transaction.

The financial statements of the Corporation's foreign subsidiaries are translated using the temporal method. Monetary assets and liabilities of integrated foreign operations are translated using the rate of exchange in effect at the balance sheet date, whereas non-monetary assets and liabilities are translated at historical rates of exchange. Revenues and expenses are measured at average monthly exchange rates, except for amortization, which is determined using the historical exchange rate. Gains and losses resulting from translation are included in the statement of income (loss).

Revenue Recognition

The Corporation's services include fixed or determinable prices based upon daily, hourly or job rates. The sales terms do not include provisions for significant post-service delivery obligations. Revenue is recognized when services are rendered or over equipment rental periods, and when collection is reasonably assured. Mobilization revenue is earned under certain contracts and is generally payable to the Corporation upon successful commencement of operations under the contract. For a contract that includes this element in addition to the normal fee for service element, revenue is allocated to each element of the contract based on the residual method and using the estimated fair value of the elements delivered. The value of the undelivered elements is deferred and recognized when earned. The Corporation defers prepaid mobilization revenues and recognizes them at the time the related services are performed using the percentage of completion method. Revenue for services under the contract are recognized as the service is provided based upon the fair value of the services.

Share-based Compensation Plans

The Corporation has a Share Option Plan which is described in Note 9. The fair value of share purchase options is calculated at the date of the grant using the Black-Scholes option pricing model. The value is recorded as compensation expense over the grant's vesting period, with an offsetting credit to contributed surplus. Upon exercise of the share purchase option, the associated amount is reclassified from contributed surplus to share capital. Consideration received from employees upon exercise of options is credited to shareholders' capital.

Per Share Amounts

Basic per share amounts are calculated using the weighted average number of shares and Exchangeable Shares outstanding during the year. Diluted per share amounts are calculated giving effect to the potential dilution that would occur if stock options, warrants and convertible debentures were exercised or converted into common shares.

Transaction Costs on Debt Issuance

The Corporation requires costs related to obtaining debt financing be deducted from the related debt and amortized over the term of the debt as interest expense using the effective interest rate method.

Financial Instruments

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

A) Held for trading

Held for trading financial instruments are financial assets or financial liabilities that are purchased with the intention of selling or repurchasing in the near term. Any financial instrument can be designated as held for trading as long as its fair value can be reliably measured. A derivative is classified as held for trading unless designated as and considered an effective hedge. Held for trading instruments are recorded at fair value with any subsequent gains or losses from changes in the fair value included in earnings.

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. All of the Corporation's cash equivalents are designated as held-to-maturity investments. The fair values of cash and cash equivalents approximate their carrying value due to their short-term nature.

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 and bridge loan and the interest bearing amount due to related parties are recorded at values that estimate the fair value as the interest payable reflects market rates.

D) Loans and receivables

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

E) Available-for-sale

Available-for-sale assets are those financial assets that are not classified as held for trading, held-to-maturity or loans and receivables. Available-for-sale instruments are recorded at fair value. Any gains or losses arising from the change in fair value are recorded in Other Comprehensive Income and upon the sale of the instrument or other-than-temporary impairment, the cumulative gain or loss is included in earnings.

F) Derivative financial instruments

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 a 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 company 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.

Changes in Accounting Policy

Going Concern – Section 1400 Amendments

Section 1400, General Standards of Financial Statement Presentation, modifies the existing Section 1400 to include requirements aimed at assessing and disclosing an entity's ability to continue as a going concern and disclosing any material uncertainties that may cast significant doubt upon an entity's ability to continue as a going concern. The adoption of this standard has not had a significant impact on the Company's financial statements.

Future Accounting Changes

a) Goodwill and Intangible Assets - Section 3064 - The CICA issued the new Handbook Section 3064, Goodwill and Intangible Assets, which will replace Section 3062, Goodwill and Other Intangible Assets. The new standard establishes revised standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The new standard also provides guidance for the treatment of preproduction and start-up costs and requires that these costs be expensed as incurred. The new standard applies to annual and interim financial statements relating to fiscal years beginning on or after October 1, 2008. Management is currently assessing the impact of this new accounting standard on its consolidated financial statements.

b) International Financial Reporting Standards ("IFRS") - In 2006, the Canadian Accounting Standards Board ("AcSB") published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian GAAP with IFRS over an expected five-year transitional period. In February 2008 the AcSB announced that 2011 is the changeover date for publicly-listed companies to use IFRS, replacing Canada's own GAAP. The date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The transition date of January 1, 2011 will require the restatement for comparative purposes of amounts reported by the Company for the year ended December 31, 2010. The Company has begun assessing the adoption of IFRS for 2011; the financial reporting impact of the transition to IFRS cannot be reasonably estimated at this time.

c) For interim and annual financial statements relating to its fiscal year commencing July 1, 2011, the Company will be required to adopt new CICA Section 1582 “Business Combinations”, Section 1601 “Consolidated Financial Statements” and Section 1602 “Non-Controlling Interests”. Section 1582 replaces existing Section 1581 “Business Combinations”, and Sections 1601 and 1602 together replace Section 1600 “Consolidated Financial Statements.” The adoption of Section 1582 and, collectively, 1601 and 1602, provides the Canadian equivalent to IFRS 3 “Business Combinations” and International Accounting Standard IAS 27 “Consolidated and Separate Financial Statements” respectively. The impact of adopting these new standards has not yet been assessed and cannot reasonably be estimated at this time.

Comparative Figures

Certain comparative figures have been reclassified to conform to the current financial statement presentation. In particular, the comparative figures have been reclassified to reflect discontinued operations presentation for certain international businesses (see Note 16).

($ Million - Audited)

3 Property and Equipment

December 31, 2008	Cost	Accumulated Amortization	Net
Automotive	3.1	1.0	2.1
Computer hardware	0.5	0.3	0.2
Computer software	0.8	0.6	0.2
Equipment – rental, support and shop	11.3	5.3	6.0
Equipment – drilling support	26.4	2.3	24.1
Equipment – hydraulic workover & UB rigs	36.0	13.6	22.4
Equipment – stand alone, rig assist & nitrogen pumping	47.3	23.8	23.5
Equipment – office	0.5	0.2	0.3
Leasehold improvements	0.9	0.8	0.1
	126.8	47.9	78.9

December 31, 2007	Cost	Accumulated Amortization	Net
Automotive	1.5	0.7	0.8
Computer hardware	0.5	0.2	0.3
Computer software	0.8	0.5	0.3
Equipment – rental, support and shop	21.0	4.3	16.6
Equipment – drilling support	7.3	0.7	6.6
Equipment – hydraulic workover & UB rigs	48.5	10.6	37.9
Equipment – stand alone, rig assist & nitrogen pumping	55.3	23.3	32.0
Equipment – office	0.5	0.2	0.3
Leasehold improvements	0.7	0.6	0.1
	136.1	41.1	95.0

The Corporation has provided for an impairment of $20.0 million related to:

(i) a write-down on its three 250K UB rigs which are used in the Canadian operations; and

(ii) a write-down of equipment that is being marketed for sale, including the remaining RAPAD Rig and a further write-down on the heli-portable drilling rig (2007 - $ 9.9 million).

Management assessed the property and equipment balances for evidence of impairments using indicators such as declining market activity, changes in future expected cash flows from operations and, where appropriate, expected costs of disposition.

Evidence of an impairment was assessed using an undiscounted cashflow test and, where the net book value exceeded the undiscounted cashflow analysis, a determination of the assets' fair market value was estimated.

($ Million - Audited)

The estimated fair market value was assessed by management using internal experts for both local and international operations. The measurement of the impairment was assessed as the amount by which the carrying amount of an asset exceeded its fair market value. The entire $20.0 million impairment related to continuing operations was included in the Canadian segment.

In addition to the value held in property and equipment at December 31, 2008, the corporation had property and equipment classified and recorded as assets held for sale from continuing operations of $10.4 million (2007 - $20.1 million) and from discontinued operations in the amount of $ 14.6 million (2007 - $ 43.1 million) as described under Note 16.

4 Rigs and Equipment Under Construction

	Year Ended December 31, 2008	Year Ended December 31, 2007
Equipment – hydraulic workover and drilling rigs		
Opening balance	-	23.9
Construction costs and capitalized interest	0.5	8.0
Units completed and transferred to property and equipment	-	(23.9)
Units completed and transferred to assets held for sale, net of impairment	(0.4)	(8.0)
	0.1	-
Equipment – snubbing, air drilling and nitrogen		
Opening balance	0.8	38.0
Construction costs and capitalized interest	1.1	14.3
Equipment transferred to Optimal Pressure Drilling Services	-	(1.6)
Units completed and transferred to property and equipment	(1.7)	(49.8)
Adjustment for Discontinued Operation (Note 16)	-	(0.1)
	0.2	0.8
Equipment – Optimal Pressure Drilling Services		
Opening balance (commenced January 1, 2008)	1.6	-
Equipment transferred to Optimal Pressure Drilling Services	-	1.6
Net changes in Construction costs and transfers	2.6	-
	4.2	1.6
	4.5	2.4

The Corporation capitalizes interest on the equipment loan (see Note 6) relating to rigs and equipment under construction. During the year ended December 31, 2008 no interest was capitalized to rigs and equipment under construction (2007 - $ 1.7 million).

5 Investment in Optimal Pressure Drilling Services

On December 31, 2007 the Corporation formed a joint venture ("Optimal Pressure Drilling Services") with the Schlumberger group ("Schlumberger") for the purpose of providing underbalanced drilling ("UBD") services and managed pressure drilling ("MPD") services to the worldwide upstream oil and gas industry. The principal customer of Optimal Pressure Drilling Services is currently Schlumberger. Optimal Pressure Drilling Services is operated through separate legal entities (the “JV Entities”), including Optimal Pressure Drilling Services Inc., a Canadian corporation (“Optimal Canada”), Optimal Pressure Drilling Services, S.A. DE C.V., a Mexican corporation (“Optimal Mexico”) and Optimal Pressure Drilling Services International Ltd., a Barbados corporation.

Optimal Pressure Drilling Services is owned 51% by the Corporation and 49% by Schlumberger through direct investments in the JV Entities. As part of the initial formation of Optimal Pressure Drilling Services, the Corporation sold its existing UBD and MPD equipment and the technology associated with its existing UBD and MPD businesses, including intellectual property rights, to those entities for proceeds of approximately US$18.2 million. The start-up and ongoing capital needs are proportionately funded by the Corporation and Schlumberger.

As per the terms of the joint venture agreement, the parties entered into a put & call agreement that will allow the Corporation to sell its interest to Schlumberger or Schlumberger to purchase the interest of the Corporation based on a certain premium to the fair market value of the JV Entities at the time of exercise, as determined under the put & call agreement. The put & call agreement contains the procedures for determining the fair market value at the time of exercise. Following an exercise of the put or the call, the Corporation would be prevented from conducting UBD and MPD activities and competing directly or indirectly with Schlumberger and the JV Entities for a period of three (3) years. However, this non-compete provision will not apply to UBD and MPD activities conducted by the Corporation within Canada, the United States of America, Western Europe and Papua New Guinea.

The joint venture agreement sets out the initial cash contribution commitment to the JV Entities that is required to meet their anticipated capital requirements for the first year. The cash contributions are being used by Optimal Pressure Drilling Services to fund the purchase of equipment required for the business and for working capital. The Corporation’s portion of the initial cash commitment is US$33.2 million of which US$18.9 million was paid on closing at December 31, 2007, and a further US$9.5 million was paid during 2008. The balance of US$4.8 million is to be advanced as required by Optimal Pressure Drilling Services. Of the US$28.4 million, advanced by the Corporation to December 31, 2008, an amount of US$0.8 million was paid to Optimal Canada in the form of share capital and US$27.6 million was paid to Optimal Mexico in the form of an interest bearing shareholder loan of US$20.7 million and share capital of US$6.9 million. The shareholder loan is unsecured, bears interest at a rate of 8% per annum payable quarterly, the principal is repayable at any time at the option of Optimal Mexico and the Corporation is entitled to full repayment upon ceasing to be a shareholder. Schlumberger contributed proportionate amounts based on its 49% interest.

($ Million - Audited)

Optimal Pressure Drilling Services commenced operations January 1, 2008. Summarized financial information (in CDN$) for the Corporation's 51% proportionate interest in the JV Entities at December 31, 2008 and December 31, 2007 is as follows:

Balance Sheet	**2008**	**2007**
Cash	3.3	14.3
Deposits and prepaid expenses	0.2	0.0
Accounts receivable	3.5	0.1
Total current assets	7.0	14.4
Construction in Progress	4.2	1.6
Property and equipment	17.9	11.8
Total assets	29.1	27.8
Accounts payable	3.4	0.0
Due to High Arctic Energy Services	1.0	9.0
Notes payable to shareholders	25.3	13.4
Total liabilities	29.7	22.4
Shareholders' equity & retained earnings (deficit)	(0.6)	5.4
Total liabilities and shareholders' equity	29.1	27.8

Income Statement	**2008**
Revenue	8.7
Oilfield services	9.1
General & administration	0.4
Amortization	2.4
Foreign exchange (Gain) Loss	4.1
Interest on High Arctic Loan	1.6
Income taxes	-
Net earnings (loss)	(8.9)

As part of the consolidation process, certain intercompany balances are eliminated for consolidated financial statements reporting purposes, including the interest on the High Arctic Loan. The Corporation deferred a gain on sale of $1.4 million on the equipment sold to the JV Entities in 2007. A gain of 0.2 is included in income for the year ended December 31, 2008 on a basis consistent with the future amortization of the related assets by the JV Entities.

Included in the cash and cash equivalents balance for the Corporation is an amount of $ 3.3 million (the Corporation's proportionate share) held by Optimal Pressure Drilling Services to fund its cash requirements.

6 Revolving Credit Facility and Bridge Loan

The Corporation has a revolving credit facility with a syndicate of commercial lenders. The facility is comprised of a $20-million revolving loan (“Facility A”) and a $100-million equipment-based revolving loan (“Facility B”). Facility A may be drawn to a maximum of the lesser of $20-million and the total of 75% of eligible Canadian accounts receivable aged less than 90 days and 90% of eligible foreign receivables insured by the Export Development Canada (the “Facility A Borrowing Base”). Facility B may be drawn to a maximum of the lesser of $100-million and 75% of the appraised orderly liquidation value of eligible equipment (the “Facility B Borrowing Base”). The Corporation also entered into a bridge facility credit agreement with one of the syndicate lenders dated July 12, 2007 for a $20-million bridge loan facility (the "Bridge Loan") which is drawn down in full. The obligations under the revolving credit facility and the Bridge Loan are secured by, among other things, the pledge of accounts receivable and the eligible equipment pursuant to debentures under which the Corporation and certain subsidiaries grant security over all of their respective assets. The lenders have also taken security over any proceeds arising under the put & call agreement described in Note 5.

As at December 31, 2008, the Corporation owed approximately $4.2 million on Facility A (2007 – $6.8 million), $69.7 million on Facility B (2007 - $99.6 million) and $20.0 million on the Bridge Loan (the aggregate amounts owing on Facility A, Facility B and the Bridge Loan are herein referred to as the “Senior Consolidated Debt”). Accordingly, the Senior Consolidated Debt was approximately $93.9 million (December 31, 2007 - $126.4 million) excluding debt issue costs that were offset against that amount as reported on the balance sheet. The interest rate applicable to all prime loans under the revolving credit facility is prime plus 2% for amounts drawn up to 2.75x consolidated earnings before interest, depreciation, amortization and taxes and prime plus 4% for the excess drawn over the 2.75x amount. The interest rate applicable to the Bridge Loan is prime plus 6.25%. Prior to October 22, 2007, the interest rate applicable to all prime loans under the revolving credit facility was prime plus 1% and prime plus 6.25% under the Bridge Loan.

The Corporation has obtained waivers and amendments of certain financial covenant requirements to avoid a covenant default that would have resulted in the Senior Consolidated Debt being repayable immediately and triggered a cross default under the Convertible Debentures (see Note 7) and expects that further waivers and extensions will be required. The Corporation obtained a waiver of the requirement to have a current ratio of 1:25 to 1:00 as at December 31, 2008. Effective on June 6, 2008, the revolving credit facility and the Bridge Loan were amended (the “Amendments”) to extend the maturity date and to establish new covenants that are consistent with the Corporation’s business plan. The revolving term period of Facility A and Facility B was extended to March 31, 2009, after which the outstanding principal will become payable over a 36-month period. The maturity date of the Bridge Loan is now March 31, 2009. The Corporation does not expect to have the capacity to repay the Bridge Loan on March 31, 2009 and will be required to negotiate an extension of time.

As part of the Amendments of June 6, 2008, High Arctic agreed to generate net proceeds to apply against the loans of at least $50 million through the sale of equipment to be completed by January 31, 2009. The sales were to be completed at defined intervals so that 25% was completed by July 31, 2008, 50% completed by September 30, 2008, 75% completed by November 30, 2008 and the remaining sales were to be completed by January 31, 2009. As at March 24, 2009, the Corporation had completed asset sales of $30.8 million and the due date for the remaining asset sales of $19.2 million has been extended to March 31, 2009 by virtue of extension agreements dated December 26, 2008 and March 18, 2009. The Corporation will require additional extensions of time to complete the asset sales, which it expects to receive from its lenders.

The CLR is defined in the revolving credit facility agreement as, in general terms, consolidated total debt, as defined, divided by the 12-month trailing adjusted consolidated earnings before interest, depreciation, amortization and taxes. The CLR test is applied monthly and at December 31, 2008, the Corporation had a CLR of approximately 3.26 to 1.0 which was within the required level of 3.45 to 1.0. The maximum allowed CLR will decrease over time until it reaches 2.75 to 1.0 to be achieved by March 31, 2009. The Corporation is not permitted any further draws under its revolving credit facilities until its Consolidated Leverage Ratio (“CLR”) is below a level to be agreed with its lenders. The Corporation may not achieve the CLR levels currently established for 2009 as a result of not meeting the asset sales requirements.

Commencing with the first quarter of 2009, the Corporation must use 50% of excess cash flow (which is generally defined as consolidated earnings before interest, depreciation, amortization and taxes, less debt service requirements, allowable capital expenditures and cash income taxes, all as determined by the lenders acting reasonably) to repay Facility A and Facility B amounts until the CLR has been reduced to 2.75 to 1.0 and thereafter to repay the Bridge Loan.

Assuming the proceeds from the mandatory asset sales and the $4.0 million payment made in December 2008 are the only principal payments made by March 31, 2009, in addition to the maturity of the Bridge Loan of $20.0 million, the remaining principal outstanding on the revolving credit facility of $52.0 million will become repayable in 36 equal monthly payments as follows: to December 31, 2009 - $13.0 million; to December 31, 2010 - $17.3 million; to December 31, 2011 - $17.3 million and to December 31, 2012 - $4.4 million.

To facilitate the Amendments, the Corporation agreed to pay its lenders an amendment fee of approximately $1.1 million. In addition, in consideration for amendments to the Bridge Loan, the Corporation:

(i) issued to the lender 1,000,000 warrants to purchase common shares of the Corporation until June 20, 2010 at an exercise price of $1.09 per common share; and

(ii) amended the expiry date to June 20, 2010 (as opposed to April 29, 2009) and the exercise price to $1.09 (as opposed to $1.60) per common share in respect of the 500,000 warrants to purchase common shares of the Corporation that were previously issued to the lender on October 29, 2007.

The Corporation also incurred $1.1 million in fees related to amendments made in October 2007 to the revolving credit facility and $2.7 million in fees related the Bridge Loan amendments made at that time. The $1.1 million was repaid in June 2008 from proceeds of the asset sales. The $2.7 million together with the additional fee of $1.1 million referred to above was deferred until March 31, 2009 provided that, if the revolving credit facility is extended at that time, the fees will be 40% payable on March 31, 2009 and the balance payable in nine equal monthly payments to December 31, 2009.

As at December 31, 2008, the liability for the unpaid cash fees of $3.8 million has been accrued. Unamortized fees of $0.5 million were deducted from the related debt and are being amortized using the effective interest rate method over the period to March 31, 2009. A total of $4.2 million of the fees were expensed as interest in the year ended December 31, 2008. The Corporation valued the warrants at $0.6 million using the following assumptions in the Black-Scholes model: average risk-free interest rate of 4.2%; average expected life of 1.5 years; expected volatility of 75% and a weighted average estimate of dividend yield of nil.

7 Convertible Debentures

During November 2007, the Corporation issued $27.9-million principal amount of 12 percent unsecured convertible debentures due December 31, 2012. Costs related to the issuance of the debenture were $1.9 million, of which $1.7 million was deducted against the related debt and is being amortized over the 60 month term of the debt using the effective interest rate method.

The interest is payable semi-annually on each June 30 and December 31. An amount of $2.1 million was paid on June 30, 2008, which represented the initial period which was larger than 6 months, and $ 1.6 million was paid on December 31, 2008 on account of interest accrued to that date. The interest rate was initially 12% but reduced to 10% effective December 1, 2008 as a result of the fact that the Consolidated Leverage Ratio had dropped below 5.0 to 1.0. The Consolidated Leverage Ratio is similar to the CLR for the revolving credit facilities described in Note 6, except the consolidated debt used in the numerator includes the convertible debentures. The Consolidated Leverage Ratio remained below 5.0 to 1.0 at December 31, 2008.

The debentures are convertible into common shares of the Corporation at the option of the holder at any time prior to maturity, at a conversion price equal to $1.62 per share, subject to customary anti-dilution adjustments, and conversion is subject to the terms and conditions set out in the certificates representing the debentures. At December 31, 2008, there had not been any conversions of the debentures. The Corporation may elect to issue common shares to satisfy the principal amount at maturity.

($ Million - Audited)

Subject to certain limits, the Corporation may redeem all or any portion of the convertible debentures at any time after the third anniversary date from issue. The redemption price is $1,050 per $1,000 of principal amount if the redemption occurs on or before November 14, 2011 and $1,025 per $1,000 of principal amount if the redemption is after November 14, 2011 and prior to maturity.

As the convertible debentures are considered a compound financial instrument, the liability and equity components are presented separately. The debentures have been accounted for using the residual method, resulting in an equity element stemming from the call option in the amount of $2.8 million, net of related issue costs of $0.2 million, being credited to shareholders' equity. The liability was valued using an estimated borrowing rate of 16%. Accretion expense related to the liability component of $2.2 million was recorded in the year ended December 31, 2008 ($0.1 was recorded in the year ended December 31, 2007).

8 Share Capital

(a) Details of Shareholders' Equity

Authorized

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

Issued	**2008**	**2007**
Common shares (b)	126.3	126.3
Warrants (c)	1.7	1.1
Equity element of convertible debentures (Note 7)	2.8	2.8
Contributed surplus (d)	4.1	0.8
Retained earnings (Deficit)	(125.2)	(85.6)
	9.7	45.4

(b) Changes in Issued Shares	**2008**		**2007**	
	Shares	**$**	**Shares**	**$**
Opening Balance (1)	42,442,325	126.3	26,127,213	89.2
Issuance of Trust Units	-	-	5,225,442	13.6
Value attributed to warrants on private placement	-	-	-	(0.8)
Issuance of Trust Units	-	-	10,921,746	28.4
Unit issuance costs	-	-	-	(4.1)
Changes in conversion ratio – Series B Exchangeable Shares	-	-	167,924	-
Common Shares Outstanding	42,442,325	126.3	42,442,325	126.3

(1) The opening balance for 2007 refers to the Trust Units and Series A and Series B Exchangeable Shares outstanding at that time that were converted to Common Shares on June 29, 2007 under the Plan of Arrangement as described below.

($ Million - Audited)

Issuance of Trust Units

On March 28, 2007 the Trust issued 5,225,442 Trust Units and 1,306,361 Trust Unit purchase warrants (with an exercise price of $2.98 per Trust Unit and that expired on September 28, 2008) for aggregate consideration of $13.6 million. On that date, the Trust also issued 2,500,000 Trust Units in exchange for 2,500,000 Exchangeable Shares. The Trust valued the warrants at $0.8 million using the following assumptions in the Black-Scholes model: average risk-free interest rate of 4.2%; average expected life of 1.5 years; expected volatility of 40% and a weighted average estimate of distribution yield of nil.

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

Plan of Arrangement

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

(c) Warrants	2008	2007
Opening Balance	1.1	-
Issuance of Trust Units (b)	-	0.8
October 22, 2007 Bridge Loan (Note 6)	-	0.3
June 6, 2008 Renegotiation of Facility (Note 6)	0.6	-
Closing Balance	1.7	1.1

(d) Contributed Surplus	2008	2007
Opening Balance	0.8	0.7
Share-based compensation (Note 9)	3.3	0.1
Closing Balance	4.1	0.8

(e) Per Share Amounts

The weighted average number of common shares outstanding for the year ended December 31, 2008 was 42,442,325 basic and fully diluted shares (2007 – 38,123,527 fully and basic diluted respectively). All potentially dilutive instruments such as options, warrants and the convertible debentures are anti-dilutive.

($ Million - Audited)

9 Share-based Compensation Plan

The Corporation has a Share Option Plan that provides incentive for directors, management and key employees that provides options to purchase shares. A total of 4,244,232 options (being 10% of all outstanding shares) are available for grants under the plan.

At December 31, 2008, a total of 1,186,900 options are outstanding and expire at various dates up to 2013, at amounts that range from $0.65 to $13.57 per share. These options have a term of 5 years and allow the holder to exercise their options over a three-year vesting period with 40% exercisable on the first anniversary date, 30% on the second anniversary date and 30% on the third anniversary date. The options have an average remaining contractual life of 3.49 years and 443,960 options are currently exercisable.

	Number of Shares	Weighted Average Exercise Price $/Share
Total Outstanding January 1, 2007	1,619,000	12.62
Granted	3,148,900	2.61
Exercised	-	-
Forfeited	(616,150)	8.77
Total Outstanding December 31, 2007	4,151,750	4.69
Granted	415,500	0.77
Exercised	-	-
Cancelled	(2,871,500)	4.59
Forfeited	(508,850)	3.96
Total Outstanding December 31, 2008	1,186,900	3.88

	Options Outstanding			Exercisable Options	
Exercise Price Range	Number of Options	Remaining Contractual Life (Years)	Weighted Average Exercise Price ($)	Number of Options	Weighted Average Exercise Price ($)
$0.65 to $1.99	645,000	4.14	1.12	100,000	1.70
$2.00 to $3.99	204,900	3.23	2.80	81,960	2.80
$4.00 to $6.99	56,500	2.95	6.14	34,450	6.21
$7.00 to $9.99	118,500	2.75	9.70	82,950	9.70
$10.00 to $13.57	162,000	1.94	11.19	144,600	11.03
Total Outstanding December 31, 2008	1,186,900	3.49	3.88	443,960	6.79

The Corporation recognized share-based compensation expense of $3.3 million for the year ended December 31, 2008 based on amortizing the expense over the vesting (2007 - $0.1 million) using the Black-Scholes model. The options valued prior to 2008 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 valued using an average risk-free interest rate of

3.4%; average expected life of 5 years; expected volatility of 67.6% and an expected annual dividend yield of nil.

During 2008 a total of 2,871,500 options were cancelled voluntarily by the holders, all of which were "out-of-the-money". A total share based compensation expense of $3.1 million was recognized in relation to these cancelled options.

On August 12, 2008, the Corporation adopted a stock appreciation rights plan ("SAR plan") intended to supplement the Share Option Plan. Under the terms of the SAR plan, the Corporation may grant stock appreciation rights ("SARs") to its directors, officers and employees that entitle them to receive a cash payment based on the appreciation in value of the corporation's common shares from the initial price set at the time of award. A maximum of 5,375,000 SARs may be issued under the SAR plan. As at December 31, 2008, the entire 5,375,000 were awarded and outstanding each with an initial price $0.75. Since that initial price exceeded the value of the common shares at December 31, 2008, no expense has been recorded to date. During January 2009, the Corporation cancelled all of the outstanding SARs.

10 Related Party Transactions

In the normal course of business, during the year ended December 31, 2008, the Corporation incurred general and administration expenses related to premises rent of $1.0 million (2007 - $1.1 million) and equipment and vehicle leases payments of $0.6 million (2007 - $0.9 million) charged by companies controlled by the person who was the President and Chief Executive Officer of the Corporation until December 16, 2008 (the "Former CEO") and remains the largest shareholder of the Corporation.

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

As part of the terms of the October 22, 2007 amendments to the Corporation's credit facility, in October 2007, the Former CEO loaned the Corporation $2.0 million at a rate of 11%. This loan is secured by a promissory note repayable on a subordinated basis to the revolving credit facility and Bridge Loan (see Note 6). Interest expense for 2008 includes $0.2 million pertaining to this loan.

A further amount of $4.3 million (2007 - $ 3.4 million) is owed to the Former CEO, and companies controlled by him, as at December 31, 2008 on account of various transactions. The amounts are unsecured, repayable on demand (subject to certain subordination limits under the revolving credit facility and Bridge Loan) and non-interest bearing. For the year ending, the Corporation has accrued $0.1 million as an estimate of interest at a rate of 6% per annum, that may be paid on overdue amounts. The $4.3 million also includes an amount of $1.0 million recorded during the year ended December 31, 2008 as an estimate of a liability related to the purchase of fixed assets.

Optimal Pressure Drilling Services (see Note 5) engaged the services of a director and incurred fees during 2008 of approximately $0.2 million (2007 - $ 34,000) that are recorded in Optimal Pressure Drilling Services.

11 Commitments and Contingencies

Accounts Receivable

The Corporation is involved in litigation with Transeuro Energy Corp ("Transeuro") over amounts owing for goods and services rendered by the Corporation in Canada, Dubai, Armenia, Ukraine and Papua New Guinea.

Due primarily to the collection risk related to the financial condition of Transeuro, the Corporation has fully expensed the remaining receivable as a write-down on long term receivables at December 31, 2008. A write-down of $20.7 million in 2007 and a further write-down of $2.7 million in 2008 has been recorded. The write-down on the receivable was applied to both the Canadian business, which is ongoing, and the Middle East that has been reported as a discontinued operation (Note 16). These financial statements do not include any further receivables due from Transeuro.

($ Million - Audited)

Other

A former employee of the Corporation has commenced a wrongful dismissal suit against the Corporation. A formal offer from the plaintiff to settle for $0.5 million was rejected by the Corporation. The Corporation has made a provision in its financial statements for an amount that it believes is adequate to cover any exposure.

The Corporation has posted a performance bond that has been guaranteed by Export Development Canada (or "EDC") of approximately US$3.5 million, in respect of its contract in Kuwait, and would be liable to EDC for this amount if EDC was required to honour the bond as a result of a default by the Corporation in the performance of its obligations under the contract. 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 December 31, 2008, the Corporation was not providing any services in Kuwait, as the two rigs providing services to date have both been released from service by the customer but can be called back to service at any time during the term of the contract ending in August 2012.

Lease Obligations

The Corporation has entered into long-term premises and equipment leases with the Former CEO, as described in Note 10, that expire in 2010. The premises leases contain an option to renew for a further five years.

In addition, the Corporation has entered into lease obligations in Papua New Guinea for equipment and premises with arms length parties. Future minimum lease payments as at December 31, 2008 are:

	$
To December 31, 2009	1.3
To December 31, 2010	0.3
To December 31, 2011	0.1
	1.7

12 Segmented Information

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

Revenue	2008	2007
Canada	53.8	64.6
International		
Papua New Guinea	91.7	32.1
Mexico	8.1	4.1
Other	0.1	-
Total International	99.9	36.2
	153.7	100.8

($ Million - Audited)

Property and Equipment, Rigs and Equipment Under Construction and Assets Held for Sale from continuing operations	**2008**	**2007**
Canada	56.0	98.3
Mexico	21.7	10.9
Papua New Guinea	16.1	8.3
	93.8	117.5

13 Supplementary Information

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

	2008	**2007**
Operations		
Accounts receivable, work-in-progress	8.8	(25.6)
Inventory and prepaid expenses	(0.5)	(0.1)
Accounts payable and accrued liabilities, income taxes payable, amortization of accrued fees and prepaid mobilization revenue	2.1	5.5
	10.4	(20.2)
Investing		
Accounts payable and accrued liabilities	-	(8.4)
Financing		
Distributions as a Trust	-	(3.3)
	10.4	(31.9)

14 Capital Disclosures

The Corporation's capital structure is comprised of Shareholders' Equity, described in Note 8, Convertible Debentures, described in Note 7, plus the Revolving Credit Facility and Bridge Loan (the "Credit Facility") described in Note 6.

	December 31, 2008	**December 31, 2007**
Shareholders Equity	9.7	45.4
Convertible Debentures(1)	27.9	27.9
Credit Facility(1)	93.9	126.4
Cash and cash equivalents	(22.2)	(21.0)
Total Capitalization	109.3	178.7

($ Million - Audited)

(1) The Convertible Debentures and the Credit Facility are shown at their principal amounts owing. The amounts reported on the balance sheet differ because issue costs and equity elements have been netted against the principal amount.

The Corporation's strategy is to have a capital structure that will provide the capital to meet the needs of its business and instil confidence with investors, creditors and capital markets. The Corporation has determined that it must reduce its debt levels and increase the shareholder's equity to reduce its leverage ratios and provide adequate financial flexibility to meet the financial obligations, both current and long term. During 2006 and 2007, the Corporation increased its debt levels to fund the acquisition of new equipment and the expansion of its international business. Its current debt levels are well above prevailing industry standards and severely limit the financial flexibility of the Corporation.

The Corporation must continue to reduce its debt levels to meet the financial covenant tests imposed under the Credit Facility. Sales of non-performing and underutilized assets are being actively pursued to generate funds to pay down the Credit Facility. Future equity financings are a possibility to further reduce the risk associated with the current highly leveraged capital structure. Financing decisions for the foreseeable future will be governed largely by the requirement to reduce debt and manage the covenants imposed under the Credit Facility, as more fully discussed in Note 6. Longer term, once the debt levels are reduced to acceptable levels, financing decisions will be based on the timing and extent of expected operating and capital cash outlays.

The Corporation monitors its debt levels and ability to service the debt using non-GAAP financial metrics with the primary one being the Consolidated Leverage Ratio or CLR. The CLR is defined in the revolving credit facility agreement as, in general terms, consolidated total debt, excluding the Convertible Debentures, as defined, divided by the 12-month trailing adjusted consolidated earnings before interest, depreciation, amortization and taxes (EBITDA). The Corporation's objective is to reduce the CLR to a level of 2.00 to 1.0, or better, compared to the December 31, 2008 level of 3.26 to 1.0.

	Twelve Months Ended December 31, 2008	Twelve Months Ended December 31, 2007
Consolidated Total Debt	**93.9**	**126.4**
Net earnings (loss) and comprehensive income (loss)	(39.6)	(69.6)
Add (deduct):		
Interest and financing	21.9	11.4
Income tax	5.3	5.3
Amortization	15.2	22.6
Gain on sale of property and equipment	2.1	(0.9)
Gain on sale of investments	-	(2.0)
Asset impairment	20.0	31.4
Foreign Exchange (gain)/loss, net	(4.0)	2.6
Stock based compensation	3.3	0.1
Write-down of long-term receivable (Note 11)	2.7	20.6
Adjustment for discontinued operations	1.1	-
Optimal Pressure Drilling Services	0.8	-
Adjusted EBITDA (Twelve Month)	**28.8**	**21.5**
Consolidated Leverage Ratio	**3.26**	**5.88**

The Corporation's maximum allowable CLR at December 31, 2008 was 3.45 to 1.0. The maximum CLR will need to decrease over time to meet the requirements under its loan agreements. See Note 6.

15 Financial Instruments and Risk Management

Fair Value of Financial Assets and Liabilities

The Company's cash and cash equivalents are designated as held-for-trading and are measured at carrying value, which approximates fair value due to the short-term nature of these instruments. Accounts receivable and due from Optimal Pressure Drilling Services 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, due to related party, the credit facility and Bridge Loan and convertible debentures are designated as other liabilities and are recorded at cost. The fair values of the Company's liabilities are lower than carrying value due to the going concern issues discussed in Note 1.

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 revolving credit facility and Bridge Loan are floating rate credit facilities and will fluctuate in response to changes in market interest rates. For the year ended December 31, 2008, an increase or decrease in interest expense for each one percent change in interest rates on revolving credit facility and Bridge Loan would have amounted to $0.9 million.

Foreign Currency Risk

Foreign exchange 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 year ended December 31, 2008, a 1% increase in the value of the Canadian dollar relative to the U.S. dollar would have resulted in a $0.5 million decrease in earnings 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 affects certain segments of the Corporation's business. The Corporation mitigates this exposure with its diversification into international operations not dependent on the Canadian oil and gas industry.

Credit Risk

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

($ Million - Audited)

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 over 400 customers comprised of small independent, intermediate and large multinational oil and gas producers. Notwithstanding its large customer base, the Corporation has two significant customers. The first significant customer is a major Canadian exploration and production company which represents approximately 12.2% of the Corporation's revenue for the year ended December 31, 2008 and 2.8% 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. Services are provided to the second significant customer in Papua New Guinea. That customer represents approximately 59.7% of the Corporation's revenue for the year ended December 31, 2008 and 57.4% of its accounts receivable at that date. Management has assessed the two customers as creditworthy and the Corporation has had no history of collection issues with either customer.

The aging of accounts receivables as at December 31, 2008 is as follows:

	$
0 to 30 days	19.6
31 to 60 days	6.7
61 to 90 days	1.2
Greater than 90 days	0.1
Allowances for doubtful debts	(1.1)
Total	**26.5**

The allowance for doubtful debts provision is based on an individual account by account analysis and the customer's prior credit history.

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 budgets are updated when required as conditions change (see Note 14).

($ Million - Audited)

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

	1 Year	2-3 Years	4-5 Years	Beyond 5 Years	Total
Accounts Payable	20.1	-	-	-	20.1
Current Tax Payable	9.4	-	-	-	9.4
Liabilities related to Discontinued Operations (Note 16)	1.5				1.5
Convertible Debentures	-	-	27.9	-	27.9
Due to Related Parties	-	6.3	-	-	6.3
Bridge Loan	20.0	-	-	-	20.0
Credit Facility	31.9	37.3	4.7	-	73.9
Total	**82.9**	**43.6**	**32.6**	**-**	**159.1**

See Note 1 for further information in relation to liquidity.

16 Discontinued Operations

The activities in the Middle East region, including Tunisia and India, were identified as operations where losses and negative cash flow were leading to cash funding requirements that could not be sustained. Management determined that the situation was unlikely to improve and the decision was made to discontinue operations in that region to the extent possible. The Corporation has divested of assets through sales and has used the proceeds on sales to reduce its debt. At December 31, 2008 the remaining assets have been classified as held for sale.

The Middle East region operations are in the same general industry as the other regions of the Corporation and therefore this region was not a separate segment, as it had similar characteristics of the other geographical regions. The cash flows of this component were tracked separately by management and were managed as a separate geographical oilfield service component within the overall corporate structure. Accordingly, it has been accounted for as a discontinued operation.

Comparative figures have been adjusted to remove activities in the Middle East, Tunisia and India operations and to report those amounts as a discontinued operation.

($ Million - Audited)

The following amounts have been included in the December 31, 2008 and 2007 Consolidated Balance Sheets.

	2008	2007
Current assets related to discontinued operations		
Accounts Receivable	5.1	5.2
Inventory	-	0.1
Prepaid Expenses	-	0.5
Work In Progress	-	0.3
Total current assets related to discontinued operations	5.1	6.1
Long term assets related to discontinued operations		
Long Term Receivable (Note 11)	-	2.5
Total long term assets related to discontinued operations	-	2.5
Assets held for sale		
Assets held for sale related to discontinued operations	14.6	43.1
Discontinued assets held for sale (Note 3)	14.6	43.1

	2008	2007
Current liabilities related to discontinued operations		
Accounts payable and accrued liabilities	1.5	5.8
Total current liabilities related to discontinued operations	1.5	5.8

($ Million - Audited)

The following amounts have been included in the December 31, 2008 and 2007 Consolidated Statements of Net Earnings (Loss), Comprehensive Income (Loss) and Retained Earnings (Deficit):

	2008	2007
Revenue	14.8	29.3
Expenses		
Oilfield services	16.4	30.5
General and administration	2.8	1.1
Write-down of long term receivable (Note 11)	2.5	6.5
Amortization	1.0	4.7
Foreign exchange (gain) loss	(0.9)	0.7
	21.8	43.5
Operating earnings (loss)	(7.0)	(14.2)
(Gain) Loss on sale of property, equipment and investments	(0.4)	-
Impairment on Assets	1.7	21.5
Net earnings (loss) before income taxes	(8.3)	(35.7)
Income taxes (recovery)	(0.3)	2.2
Discontinued Operations, net of tax	(8.0)	(37.9)

($ Million - Audited)

17 Income Taxes

The tax provision for income tax in the consolidated statement of net earnings and retained earnings varies from the amount that would be computed by applying the expected income tax rate of 30% (2007 – 32%) to the income (loss) before taxes. The principal reasons for differences between “expected” income tax and the amount actually recorded are as follows:

	2008	2007
Earning from continuing operations before income taxes	(26.3)	(28.6)
Earnings from discontinued operations before income taxes	(8.3)	(35.7)
	(34.6)	(64.3)
Computed Income tax expense at expected rate	(10.4)	(20.6)
Increase (decrease) resulting from:		
Permanent non-deductible items	1.6	(0.2)
Non deductible losses – International tax exempt countries	2.4	9.1
Revenue based Taxes in foreign jurisdictions	(0.3)	0.7
Allowance for disputed tax		1.9
Tax Rate Differences	(0.1)	(0.5)
Mexico losses and temporary differences not recognized for tax	1.4	-
Canadian Losses and temporary differences not recognized for tax	10.4	14.9
Income tax expense (recovery)	**5.0**	**5.3**
Represented by:		
Current Income tax on continuing operations	**4.7**	**3.6**
Future Income tax on continuing operations	**0.6**	**(0.5)**
Current Income tax on discontinued operations	**(0.3)**	**2.2**
Future Income tax on discontinued operations	**-**	**-**

Differences between the accounting and tax basis of assets and liabilities at the tax rates expected to apply upon the reversal of the differences are shown below. At December 31, 2008 the Corporation’s future tax liability is in respect of its subsidiary operations in Papua New Guinea. The Corporation has recorded a valuation allowance against all Canadian and Mexican temporary differences

	2008	2007
Property and equipment and assets held for sale - Canada	15.0	8.4
Property and equipment – Papua New Guinea	(0.1)	0.5
Other assets and reserves – Papua New Guinea	(0.1)	-
Financing Costs	2.9	2.5
Losses carried forward	5.9	6.8
Future Tax valuation allowance	(23.8)	(17.7)
Future tax asset (liability)	(0.2)	0.5

At December 31, 2008, the Canadian losses carried forward for income tax purposes of $23.7 million expire in 2027 and 2028. The Corporation has the ability to file amended tax returns to adjust certain discretionary deductions to mitigate the risk of expiring loss carry forwards.

18 Subsequent Events

On January 23, 2009 High Arctic Energy Services closed a non-brokered placement of 3,000,000 common shares to certain directors and senior officers of the Corporation. The offering was completed at a price of $0.20 per common share for aggregate proceeds of $600,000. The offering was completed as a non-brokered private placement whereby certain directors and officers of the Corporation re-invested bonus amounts paid to them by High Arctic in exchange for the common shares.

On January 14, 2009 the corporation announced that it had cancelled substantially all of the outstanding SARs and has since cancelled all of the outstanding SARs under the stock appreciation rights plan. In connection with the cancellation of the SARs the Corporation issued stock options to acquire an aggregate of 3,040,100 common shares at an exercise price of $0.15 per common share.