

**High Arctic Energy Services Inc.**  
**Consolidated Balance Sheets**  
**As at September 30, 2009 and December 31, 2008**  
(\$ Million - Unaudited)

	September 30, 2009	December 31, 2008
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	29.3	18.9
Accounts receivable (Note 13)	16.5	23.0
Inventory	3.0	2.1
Prepaid expenses	1.3	0.9
Assets related to Optimal discontinued operations (Note 14)	-	8.0
Assets related to Middle East discontinued operations (Note 14)	1.4	5.1
	51.5	58.0
Property and equipment (Note 3)	55.8	62.4
Assets held for sale including assets related to discontinued operations in the Middle East and Optimal (Notes 3 and 14)	25.2	46.0
	132.5	166.4
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	13.3	18.3
Income taxes payable	10.0	9.4
Due to related parties (Note 8)	6.7	6.3
Credit facility and bridge loan (Note 4)	67.9	93.4
Future income tax liabilities	0.7	0.2
Liabilities related to Optimal discontinued operations (Note 14)	-	1.8
Liabilities related to Middle East discontinued operations (Note 14)	0.5	1.5
Convertible Debentures (Note 5)	27.7	25.8
	126.8	156.7
<b>Shareholders' equity</b> (Note 6)	5.7	9.7
	132.5	166.4
<b>Basis of presentation</b> (Note 1)		
<b>Commitments and contingencies</b> (Notes 9 and 14)		
See accompanying notes		

**Approved on behalf of the Corporation by:**

(signed) "Michael Binnion" Director

(signed) "Christopher Warren" Director

# High Arctic Energy Services Inc.

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

For the three and nine months ended September 30, 2009 and September 30, 2008

(\$ Million except per unit amounts - Unaudited)

	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
<b>Revenue</b> (Note 10)	22.9	36.6	95.9	104.2
<b>Expenses</b>				
Oilfield services	16.6	25.4	67.8	71.2
General and administration	1.9	2.4	6.1	8.9
Share based compensation	-	(0.2)	0.4	-
Amortization	2.3	3.7	7.4	10.1
Foreign exchange (gain) loss	3.1	(2.1)	5.4	(2.3)
	<u>23.9</u>	<u>29.2</u>	<u>87.1</u>	<u>87.9</u>
<b>Operating earnings</b>	(1.0)	7.4	8.8	16.3
Interest	2.6	4.4	8.5	16.7
Financing Costs	-	0.1	0.1	1.2
Gain on sale of property, equipment and investments	(1.1)	(0.1)	(1.1)	(0.4)
Gain on the sale of joint venture interest (Note 14b)	(2.4)	-	(2.4)	-
<b>Net earnings (loss) before income taxes and discontinued operations</b>	(0.1)	3.0	3.7	(1.2)
Income taxes	1.0	1.9	5.3	4.2
<b>Net earnings (loss) from continuing operations</b>	(1.1)	1.1	(1.6)	(5.4)
Middle East Discontinued Operations, net of tax (Note 14a)	(0.2)	(2.9)	(1.0)	(6.2)
Optimal Discontinued Operations, net of tax (Note 14b)	(3.0)	(1.4)	(2.4)	(3.1)
<b>Net earnings (loss) and comprehensive income (loss)</b>	<u>(4.3)</u>	<u>(3.2)</u>	<u>(5.0)</u>	<u>(14.7)</u>
<b>Retained Deficit – beginning of period</b>	(125.9)	(97.1)	(125.2)	(85.6)
<b>Retained Deficit– end of period</b>	<u>(130.2)</u>	<u>(100.3)</u>	<u>(130.2)</u>	<u>(100.3)</u>
<b>Earnings (loss) per share</b>				
- basic and diluted from continuing operations	\$ (0.02)	\$ 0.03	\$ (0.04)	\$ (0.13)
- basic and diluted from discontinued operations	\$ (0.07)	\$ (0.10)	\$ (0.07)	\$ (0.22)

**Basis of presentation** (Note 1)

See accompanying notes

# High Arctic Energy Services Inc.

## Consolidated Statements of Cash Flows

For the three and nine months ended September 30, 2009 and September 30, 2008

(\$ Million - Unaudited)

	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
<b>Cash provided by (used in):</b>				
<b>Operating activities</b>				
Net earnings (loss) from continued operations	(1.1)	1.1	(1.6)	(5.4)
Add non-cash items:				
Amortization	2.3	3.7	7.4	10.1
Financing accretion and amortization	0.7	1.1	2.4	6.3
Share-based compensation	-	(0.3)	0.4	(0.1)
Future tax	-	-	0.5	-
Gain on sale of property and equipment	(1.1)	(0.1)	(1.1)	(0.4)
Gain on the sale of joint venture interest (Note 14b)	(2.4)	-	(2.4)	-
	(1.6)	5.5	5.6	10.5
Change in non-cash working capital balances (Note 11)	8.4	(2.3)	0.9	15.6
Cash flows from continuing operating activities	6.8	3.2	6.5	26.1
<b>Investing activities</b>				
Property and equipment and rigs and equipment under construction	(0.3)	(1.1)	(2.2)	(4.2)
Advances from (to) Optimal Drilling	0.3	(1.3)	1.0	(2.8)
Proceeds on sale of property and equipment	0.1	1.2	1.0	13.1
Proceeds on sale of joint venture interest (Note 14b)	23.5	-	23.5	-
Change in non-cash working capital balances (Note 11)	(0.1)	(0.3)	(0.1)	(0.3)
	23.5	(1.5)	23.2	5.8
<b>Financing activities</b>				
Advances from (to) related parties	0.1	0.2	0.4	(0.1)
Change in credit facility	(23.6)	(15.5)	(26.0)	(28.0)
Issuance of shares, net of costs	-	-	0.6	-
	(23.5)	(15.3)	(25.0)	(28.1)
<b>Net change in cash from continuing operations</b>	<b>6.8</b>	<b>(13.6)</b>	<b>4.7</b>	<b>3.8</b>
<b>Cash flow from discontinued operations</b>				
Operating activities	1.2	(6.2)	4.4	(13.9)
Investing activities				
Proceeds on sales of property and equipment	-	15.6	-	17.3
Property and equipment and rigs and equipment under construction	(0.8)	(2.2)	(2.0)	(10.6)
Financing activities	-	-	-	-
<b>Net change in cash from discontinued operations</b>	<b>0.4</b>	<b>7.2</b>	<b>2.4</b>	<b>(7.2)</b>
Net increase (decrease) in cash and cash equivalents	7.2	(6.4)	7.1	(3.4)
<b>Cash and cash equivalents – beginning of period</b>	<b>22.1</b>	<b>24.0</b>	<b>22.2</b>	<b>21.0</b>
<b>Cash and cash equivalents – end of period</b>	<b>29.3</b>	<b>17.6</b>	<b>29.3</b>	<b>17.6</b>
<b>Cash reported as assets related to discontinued operations</b>	<b>-</b>	<b>(2.8)</b>	<b>-</b>	<b>(2.8)</b>
<b>Cash and cash equivalents</b>	<b>29.3</b>	<b>14.8</b>	<b>29.3</b>	<b>14.8</b>
<b>Supplemental information</b>				
<b>Cash paid for:</b>				
Interest	1.2	3.0	4.0	10.8
Income taxes	0.0	0.0	3.0	0.0
<b>Basis of presentation (Note 1)</b>				
See accompanying notes				

# High Arctic Energy Services Inc.

## Consolidated Notes to the Financial Statements

For the three and nine months ended September 30, 2009 and September 30, 2008

(\$ Million - Unaudited)

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### 1 Basis of Presentation

High Arctic Energy Services Inc. (the "Corporation" or "HAES") is incorporated under the laws of Alberta, Canada, with a principal focus 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 unaudited 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 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 expectation of continued reduced activity levels in the industry, as well as obtaining further extensions of the maturity date for repayment of its outstanding debt. The Corporation's senior credit facility matured on June 12, 2009 and a demand for payment can be made at any time by the lenders. The Corporation has not paid the June 30, 2009 interest payment due on the Convertible Debentures, so the debenture holders can accelerate the maturity date. The Corporation must negotiate an extension to its credit facilities and expects that it may have to restructure the Convertible Debentures and other unsecured debt to achieve an extension. Further asset sales and other conditions may be part of the revised terms of any extension. 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 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

The unaudited interim financial statements of the Corporation and its subsidiaries are presented in accordance with Canadian GAAP. These statements have been prepared using the same accounting policies and methods of computation as described in the financial statements for the year ended December 31, 2008, except as noted below. Accordingly, they should be read in conjunction with the annual audited financial statements and notes thereto for the period ended December 31, 2008.

#### New Accounting Policies

As disclosed in the December 31, 2008 financial statements, the company adopted the following sections from the Canadian Institute of Chartered Accountants ("CICA") handbook:

- 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 adoption of this standard has had no material impact on the Financial Statements.
- Credit risk and fair value of financial assets and liabilities Emerging Issues Committee abstract 173 is effective on January 1, 2009 and requires entities to take both counterparty and their own credit risk into account when measuring the fair value of financial assets and liabilities, including derivatives.

#### Future Accounting Changes

In February 2008 the Accounting Standards Board announced that 2011 is the changeover date for publicly-listed companies to use International Financial Accounting Standards (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

# High Arctic Energy Services Inc.

## Consolidated Notes to the Financial Statements

**For the three and nine months ended September 30, 2009 and September 30, 2008**

(\$ Million - Unaudited)

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impact of IFRS for 2011 and comparative numbers for 2010. Management has prepared a plan to address the adoption process. The impact of adopting IFRS on the company's financial results cannot be reasonably determined at this time.

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.

# High Arctic Energy Services Inc.

Consolidated Notes to the Financial Statements

For the three and nine months ended September 30, 2009 and September 30, 2008

(\$ Million - Unaudited)

## 3 Property and Equipment

	September 30, 2009		
	Cost	Accumulated Amortization	Net
Automotive	3.2	1.4	1.8
Computer hardware	0.5	0.3	0.2
Computer software	0.8	0.7	0.1
Equipment – rental, support and shop	11.2	6.1	5.1
Equipment – drilling support	9.7	4.2	5.5
Equipment – hydraulic workover & UB rigs	36.3	14.9	21.4
Equipment – stand alone, rig assist & nitrogen pumping	47.3	26.6	20.7
Equipment – office	0.5	0.3	0.2
Leasehold improvements	0.9	0.9	-
Rigs and Equipment under construction	0.8	-	0.8
	111.2	55.4	55.8

	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	9.6	2.3	7.3
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
Rigs and Equipment under construction	0.3	-	0.3
	110.3	47.9	62.4

# High Arctic Energy Services Inc.

## Consolidated Notes to the Financial Statements

### For the three and nine months ended September 30, 2009 and September 30, 2008

(\$ Million - Unaudited)

In addition to the value held in property and equipment at September 30, 2009, the Corporation had property and equipment classified and recorded as assets held for sale including assets related to discontinued operations of \$25.2 million (December 31, 2008 - \$46.0 million). The following amounts are included in the balance:

<b><u>Assets held for sale including assets related to discontinued operations</u></b>	<b>September 30, 2009</b>	<b>December 31, 2008</b>
Equipment Held for Sale in Canada	11.6	10.4
Equipment held for sale related to discontinued operations from the Middle East (Note 14)	13.6	14.6
Equipment held for sale related to discontinued operations from Optimal Pressure Drilling (Note 14) Services (Note 14)	-	21.0
	<hr/>	<hr/>
	25.2	46.0

#### 4 Revolving Credit Facility and Bridge Loan

The Corporation has a revolving credit facility with a syndicate of commercial lenders that matured on June 12, 2009. The Corporation has been seeking an extension of the facility as part of its efforts to restructure its loan obligations. The Corporation does not have the capacity to repay the Senior Consolidated Debt (as defined below) should the lenders demand payment (See Note 1). The lenders can demand payment of the entire Senior Consolidated Debt as a result of such debt having matured on June 12, 2009. No further draws may be made on any of the facilities.

The facility is structured as a \$20-million revolving loan ("Facility A") and a \$100-million equipment-based revolving loan ("Facility B"). Facility A is 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 is 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 lenders dated July 12, 2007 for a \$20-million bridge loan facility (the "Bridge Loan"). 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 its subsidiaries grant security over all of their respective assets.

As at September 30, 2009, the Corporation owed approximately \$2.7 million on Facility A (2008 – \$4.4 million), \$45.2 million on Facility B (2008 - \$74.0 million) and \$20.0 million on the Bridge Loan (2008 – \$20.0 million) (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 \$67.9 million at September 30, 2009 (December 31, 2008 - \$93.9 million). 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%. The Corporation has been subject to an additional 2% per annum interest charge since July 1, 2009 as a result of the event of default caused by its failure to repay the Senior Consolidated Debt on its maturity date.

Although not required at September 30, 2009 as a result of the maturity of the credit facility, maintaining a minimum Consolidated Leverage Ratio ("CLR") is expected to be one of the key financial ratio covenants under any extension of the revolving credit facility and is a key measure used by the Corporation in assessing the progress made to reduce its leverage. The CLR is defined in the revolving credit facility agreement as, in general terms, consolidated total debt, as defined (excluding subordinated debt including the Convertible Debentures), divided by the 12-month trailing adjusted consolidated earnings before interest, depreciation,

# High Arctic Energy Services Inc.

## Consolidated Notes to the Financial Statements

### For the three and nine months ended September 30, 2009 and September 30, 2008

(\$ Million - Unaudited)

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amortization and taxes. The CLR covenant is applied monthly and at September 30, 2009, the Corporation had a CLR of approximately 2.2 to 1.0 compared to what had been a target level of 2.75 to 1.0.

As at September 30, 2009, the Corporation had unpaid fees of \$1.8 million related to amendments to the Senior Consolidated Debt made in 2007 and 2008. An amount of \$2.0 million was paid on May 1, 2009 and the balance was due on June 12, 2009. As at September 30, 2009, the liability for the unpaid cash fees of \$1.8 million has been fully accrued. A total of \$0.6 million of debt fees were expensed as interest in the nine months ended September 30, 2009 and none in the three months ended September 30, 2009 (2008 - \$0.4 million and \$3.9 million for the three and nine months ended respectively).

As part of the loan amendments in 2007 and 2008, the Corporation issued to its lenders 1,500,000 warrants to purchase common shares of the Corporation until June 20, 2010 at an exercise price of \$1.09 per common share. None of the warrants have been exercised.

## 5 Convertible Debentures

In November 2007, the Corporation issued \$27.9-million principal amount of unsecured convertible debentures with a maturity date of 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.

Interest in the amount of \$1.4 million was due and payable on June 30, 2009 and has not been paid to the debenture holders. The subordination terms of the debentures provide that the Corporation shall not pay any interest while there is an event of default under the senior credit facilities. The failure to repay the Senior Consolidated Debt on the maturity date (as described in Note 4) constitutes an event of default for this purpose. The failure of the Corporation to pay the interest constitutes an event of default under the terms of debentures and the debenture holders can accelerate the maturity date, though the remedies available to the holders are restricted by the subordination terms. The Corporation is currently working on a plan to restructure the debentures to meet the demands of the senior lenders with respect to an extension of the credit facility. There is no assurance that the debenture holders will consent to any amendment to the terms of the debentures.

The interest is payable semi-annually on each June 30 and December 31. 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 4, except the consolidated debt used in the numerator includes the convertible debentures. The Consolidated Leverage Ratio remained below 5.0 to 1.0 at September 30, 2009.

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 September 30, 2009, there had not been any conversions of the debentures. The Corporation may elect to issue common shares at market trading value to satisfy the principal amount at maturity or on an acceleration of the maturity.

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 expenses related to the liability component of \$1.6 million and \$0.5 million were recorded in the nine months and three months ended September 30, 2009 (2008 - \$1.6 million and 0.5 million respectively).

# High Arctic Energy Services Inc.

## Consolidated Notes to the Financial Statements

For the three and nine months ended September 30, 2009 and September 30, 2008

(\$ Million - Unaudited)

### 6 Share Capital

#### (a) Details of Shareholders' Equity

##### Authorized

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

<u>Issued</u>	September 30, 2009	December 31, 2008
Common shares (b)	126.9	126.3
Warrants (c)	1.7	1.7
Equity element of convertible debentures (Note 5)	2.8	2.8
Contributed surplus (d)	4.5	4.1
Retained earnings (Deficit)	(130.2)	(125.2)
	<u>5.7</u>	<u>9.7</u>

#### (b) Changes in Issued Shares

	September 30, 2009		December 31, 2008	
	Shares	\$	Shares	\$
Opening Balance	42,442,325	126.3	42,442,325	126.3
Issuance of Shares	3,000,000	0.6	-	-
Common Shares Outstanding	<u>45,442,325</u>	<u>126.9</u>	<u>42,442,325</u>	<u>126.3</u>

#### Issuance of Shares

On January 23, 2009 the corporation issued 3,000,000 common to certain directors and senior officers of the Corporation at an issue price of \$0.20 per share. The offering was completed as a non-brokered private placement, whereby certain officers and directors reinvested bonus amounts paid to them by the Corporation.

#### (c) Warrants

	September 30, 2009	December 31, 2008
Opening Balance	1.7	1.1
June 6, 2008 Renegotiation of Credit Facility (Note 4)	-	0.6
Closing Balance	<u>1.7</u>	<u>1.7</u>

#### (d) Contributed Surplus

	September 30, 2009	December 31, 2008
Opening Balance	4.1	0.8
Share-based compensation (Note 7)	0.4	3.3
Closing Balance	<u>4.5</u>	<u>4.1</u>

# High Arctic Energy Services Inc.

## Consolidated Notes to the Financial Statements

For the three and nine months ended September 30, 2009 and September 30, 2008

(\$ Million - Unaudited)

### (e) Per Share Amounts

The weighted average number of common shares outstanding for the three and nine months ended September 30, 2009 respectively were 45,442,325 and 45,200,567 basic and fully diluted shares (three and nine months ended September 30, 2008 was 42,442,325 fully and basic diluted respectively). All potentially dilutive instruments such as options, warrants and the convertible debentures are anti-dilutive.

## 7 Share-based Compensation Plan

The Corporation has a Stock Option Plan that provides incentive for directors, management and key employees that offers options to purchase shares. A total of 4,544,232 options (being 10% of all outstanding shares) are available for grants under the plan.

At September 30, 2009, a total of 3,448,350 options are outstanding and expire at various dates up to 2014, at amounts that range from \$0.13 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 4.00 years and 385,275 options are currently exercisable.

	Number of Shares	Weighted Average Exercise Price \$/Share
<b>Total Outstanding January 1, 2008</b>	4,151,750	4.69
Granted	415,500	0.77
Exercised	-	-
Cancelled	(2,871,500)	4.59
Forfeited	(508,850)	3.96
<b>Total Outstanding December 31, 2008</b>	1,186,900	3.88
Granted	3,260,100	0.15
Exercised	-	-
Cancelled	(670,000)	1.61
Forfeited	(328,650)	-
<b>Total Outstanding September 30, 2009</b>	3,448,350	1.01

# High Arctic Energy Services Inc.

## Consolidated Notes to the Financial Statements

For the three and nine months ended September 30, 2009 and September 30, 2008

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Exercise Price Range	Options Outstanding			Exercisable Options	
	Number of Options	Remaining Contractual Life (Years)	Weighted Average Exercise Price (\$)	Number of Options	Weighted Average Exercise Price (\$)
\$0.13 to \$1.99	3,052,100	4.27	0.19	51,500	1.75
\$2.00 to \$3.99	136,250	2.48	2.80	95,375	2.80
\$4.00 to \$6.99	53,000	2.20	6.19	37,100	6.19
\$7.00 to \$9.99	75,500	2.01	9.67	69,800	9.70
\$10.00 to \$13.57	131,500	1.20	11.11	131,500	11.11
<b>Total Outstanding September 30, 2009</b>	<b>3,448,350</b>	<b>4.00</b>	<b>1.01</b>	<b>385,275</b>	<b>7.07</b>

The Corporation recognized share-based compensation expense of \$0.4 million for the nine months ended September 30, 2009 (2008 - \$(0.1) million) based on amortizing the expense over the vesting period using the Black-Scholes model. The options valued 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 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. The options in 2009 were valued with a weighted average expected volatility of 79.0%, a risk free interest rate of 1.61%, expected annual dividend yield of 0.0% and an expected life of 5 years.

## 8 Related Party Transactions

In the normal course of business, during the three and nine months ended September 30, 2009, the Corporation incurred general and administration expenses related to premises rent of \$0.2 million and \$0.8 million respectively (2008 - \$0.2 million and \$0.8 million respectively) and equipment and vehicle leases payments of approximately \$0.1 million and \$0.3 million respectively (2008 - \$0.1 million and \$0.5 million respectively) 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, a corporation controlled by the Former CEO loaned the Corporation \$2.0 million at a rate of 11%. This loan is subordinated to the revolving credit facility and Bridge Loan (see Note 4). Interest expense for the nine months ended September 30, 2009 includes \$0.2 million pertaining to this loan (2008 - \$0.2 million) and the interest has not been paid as a result of a subordination agreement.

A further amount of \$4.7 million (2008 - \$4.3 million) has been accrued for amounts that may be owing to the Former CEO, and corporations controlled by him as at September 30, 2009 on account of various transactions. The amounts are unsecured, repayable on demand (but generally subordinated to the revolving credit facility and Bridge Loan) and non-interest bearing. For the nine months ending, the Corporation has accrued \$0.2 million as an estimate of interest at a rate of 6% per annum that may be claimed on overdue amounts. The \$4.7 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. In total, the Corporation has accrued an amount of \$0.7 million as an estimate of the potential interest liability.

# High Arctic Energy Services Inc.

## Consolidated Notes to the Financial Statements

**For the three and nine months ended September 30, 2009 and September 30, 2008**

(\$ Million - Unaudited)

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The Former CEO and corporations controlled by him have demanded payment of the outstanding amounts and have initiated several lawsuits to collect approximately \$6.6 million related to amounts included in the \$4.7 million referred to in the preceding paragraph. The lawsuits appear to be premised on the assumption that those particular amounts are not subordinated to the revolving credit facility and bridge loan agreements with the senior lenders and include claims for amounts that the Corporation has disputed and which have not been accrued.

Optimal Pressure Drilling Services (see Note 14) engaged the services of a director and incurred fees during the nine months ended September 30, 2009 of approximately \$0.1 million that are recorded in Optimal Pressure Drilling Services (2008 – \$0.1 million).

## 9 Commitments and Contingencies

### Accounts Receivable

The Corporation has been 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. On June 29, 2009, the Corporation reached a conditional agreement with Transeuro to settle the litigation between the parties. The Corporation will record any adjustments when the conditions have been satisfied and the settlement is concluded.

The Corporation has commenced litigation against another customer with respect to collection of a receivable for services rendered outside Canada. The receivable, after a provision for possible uncollected amounts, has a carrying value of \$0.6 million, and has been insured with the Export Development Canada. The receivable is also net of \$1 million collected by realizing on a letter of credit. The customer has made a number of allegations and initiated a counter claim concerning performance issues and the cashing of the letter of credit. The Corporation believes that it will ultimately realize an amount in excess of the carrying value.

### Other

A former employee of the Corporation has commenced a wrongful dismissal suit against 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 the Middle East region, and would be liable to EDC 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, 2009, the Corporation was not providing any services under that contract, 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.

# High Arctic Energy Services Inc.

## Consolidated Notes to the Financial Statements

For the three and nine months ended September 30, 2009 and September 30, 2008

(\$ Million - Unaudited)

### Lease Obligations

The Corporation has entered into long-term premises and equipment leases with the Former CEO, (see Note 8) that expire in 2009 and 2010. The premises lease for the head office of the Corporation, entered into with the Former CEO, expires in November of 2009 and the Corporation has entered into a long-term lease with an arms length party for new premises that ends on May 31, 2015.

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 September 30, 2009 are:

	\$
To September 30, 2010	0.7
To September 30, 2011	0.5
To September 30, 2012	0.3
	<u>1.5</u>

### 10 Segmented Information

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

<u>Revenue</u>	<b>Three Months Ended September 30</b>		<b>Nine Months Ended September 30</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Canada	4.4	12.0	19.5	40.8
International				
Papua New Guinea	18.5	24.6	76.0	63.4
Other	-	-	0.4	-
Total International	<u>18.5</u>	<u>24.6</u>	<u>76.4</u>	<u>63.4</u>
	<u>22.9</u>	<u>36.6</u>	<u>95.9</u>	<u>104.2</u>

### Property and Equipment and Assets Held for Sale from continuing operations

	<b>As at September 30, 2009</b>	<b>As at December 31, 2008</b>
Canada	53.2	56.7
Papua New Guinea	14.2	16.1
	<u>67.4</u>	<u>72.8</u>

# High Arctic Energy Services Inc.

## Consolidated Notes to the Financial Statements

For the three and nine months ended September 30, 2009 and September 30, 2008

(\$ Million - Unaudited)

### 11 Supplementary Information

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

	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
<b>Operations</b>				
Accounts receivable, work-in-progress	12.1	1.3	6.5	16.7
Inventory and prepaid expenses	-	(0.2)	(1.3)	0.4
Accounts payable and accrued liabilities, income taxes payable, amortization of accrued fees and prepaid mobilization revenue	(3.7)	(3.4)	(4.3)	(1.5)
	<u>8.4</u>	<u>(2.3)</u>	<u>0.9</u>	<u>15.6</u>
<b>Investing</b>				
Accounts payable and accrued liabilities	(0.1)	(0.3)	(0.1)	(0.3)
	<u>(0.1)</u>	<u>(0.3)</u>	<u>(0.1)</u>	<u>(0.3)</u>
	<u>8.3</u>	<u>(2.6)</u>	<u>0.8</u>	<u>15.3</u>

### 12 Capital Disclosures

The Corporation's capital structure is comprised of Shareholders' Equity, described in Note 6, Convertible Debentures, described in Note 5, plus the Revolving Credit Facility and Bridge Loan (the "Credit Facility") described in Note 4.

	September 30, 2009	December 31, 2008
Shareholders Equity	5.7	9.7
Convertible Debentures <sup>(1)</sup>	27.9	27.9
Credit Facility <sup>(1)</sup>	67.9	93.9
Cash and cash equivalents	(29.3)	(18.9)
<b>Total Capitalization</b>	<u>72.2</u>	<u>112.6</u>

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

The Corporation's goal is to have a capital structure that will provide the capital to meet the needs of its business and instil confidence with investors, creditors and capital markets. The Corporation has 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 above prevailing industry standards and severely limit the financial flexibility of the Corporation.

# High Arctic Energy Services Inc.

## Consolidated Notes to the Financial Statements

**For the three and nine months ended September 30, 2009 and September 30, 2008**

(\$ Million - Unaudited)

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The Corporation will continue to negotiate to acquire terms for a new credit facility as its current facility expired on June 12, 2009. 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. 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 2.0 to 1.0, or better, compared to the September 30, 2009 level of 2.2 to 1.0.

# High Arctic Energy Services Inc.

## Consolidated Notes to the Financial Statements

For the three and nine months ended September 30, 2009 and September 30, 2008

(\$ Million - Unaudited)

	Twelve Months Ended September 30, 2009	Twelve Months Ended December 31, 2008
<b>Consolidated Total Debt</b>	67.9	93.9
<b>Net earnings (loss) and comprehensive income (loss)</b>	(29.9)	(39.6)
<b>Add (deduct):</b>		
Interest and financing	12.6	21.9
Income tax	6.6	5.3
Amortization	13.5	15.2
Loss (gain) on sale of property and equipment	1.4	2.1
Loss (gain) on sale of joint venture interest	(2.4)	-
Asset impairment	20.0	20.0
Foreign Exchange (gain)/loss, net	3.6	(4.0)
Stock based compensation	3.9	3.3
Write-down of long-term receivable (Note 11)	2.7	2.7
Adjustment for discontinued operations	(0.5)	1.1
Optimal Pressure Drilling Services	(1.1)	0.8
<b>Adjusted EBITDA (Twelve Month)</b>	<b>30.4</b>	<b>28.8</b>
<b>Consolidated Leverage Ratio</b>	<b>2.2</b>	<b>3.3</b>

### 13 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 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 assets and liabilities could be 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.

# High Arctic Energy Services Inc.

## Consolidated Notes to the Financial Statements

For the three and nine months ended September 30, 2009 and September 30, 2008

(\$ Million - Unaudited)

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### **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 three and nine months ended September 30, 2009, 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 \$0.2 million and \$0.7 million respectively.

### **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 three and nine months ended September 30, 2009, a 1% increase in the value of the Canadian dollar relative to the U.S. dollar would have resulted in a \$0.1 million and \$0.4 million decrease in earnings as a result of changes in foreign exchange respectively.

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

### **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 one significant customer. In Papua New Guinea the customer represents approximately 77% of the Corporation's revenue for the three months ended September 30, 2009 and 75% of its accounts receivable at that date. Management has assessed this customer as creditworthy and the Corporation has had no history of collection issues with this customer.

# High Arctic Energy Services Inc.

## Consolidated Notes to the Financial Statements

For the three and nine months ended September 30, 2009 and September 30, 2008

(\$ Million - Unaudited)

The aging of accounts receivables is as follows:

	September 30, 2009
0 to 30 days	4.5
31 to 60 days	0.8
61 to 90 days	3.8
Greater than 90 days	8.1
Allowances for doubtful debts	(0.7)
<b>Total</b>	<b>16.5</b>

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 12).

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	13.3	-	-	-	13.3
Current Tax Payable	10.0	-	-	-	10.0
Liabilities related to Discontinued Operations (Note 16)	0.5	-	-	-	0.5
Convertible Debentures	27.7	-	-	-	27.7
Due to Related Parties	6.7	-	-	-	6.7
Bridge Loan	20.0	-	-	-	20.0
Credit Facility	47.9	-	-	-	47.9
<b>Total</b>	<b>126.1</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>126.1</b>

See Note 1 for further information in relation to liquidity.

## 14 Discontinued Operations

### (a) Middle East Region 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 during 2008 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 were classified as held for sale.

# High Arctic Energy Services Inc.

## Consolidated Notes to the Financial Statements

### For the three and nine months ended September 30, 2009 and September 30, 2008

(\$ Million - Unaudited)

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. The following amounts have been included in the September 30, 2009 and December 31, 2008 Consolidated Balance Sheets.

	September 30, 2009	December 31, 2008
Accounts Receivable	1.4	5.1
Total current assets related to discontinued operations	1.4	5.1
Assets held for sale related to discontinued operations	13.6	14.6
Discontinued assets held for sale (Note 3)	13.6	14.6
	September 30, 2009	December 31, 2008
Current liabilities related to discontinued operations		
Accounts payable and accrued liabilities	0.5	1.5
Total current liabilities related to discontinued operations	0.5	1.5

# High Arctic Energy Services Inc.

## Consolidated Notes to the Financial Statements

For the three and nine months ended September 30, 2009 and September 30, 2008

(\$ Million - Unaudited)

The following amounts have been included in the results for the three and nine months ended September 30, 2009 and 2008 Consolidated Statements of Net Earnings (Loss), Comprehensive Income (Loss) and Retained Earnings (Deficit):

	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
<b>Revenue</b>	0.2	2.9	1.5	13.8
<b>Expenses</b>				
Oilfield services	0.2	3.3	1.3	15.3
General and administration	0.1	0.8	0.7	2.7
Amortization	-	0.3	-	1.1
Foreign exchange (gain) loss	0.1	0.5	0.2	0.4
Impairment on Assets Held for Sale	-	0.2	-	0.2
	0.4	5.1	2.2	19.7
<b>Operating earnings (loss)</b>	(0.2)	(2.2)	(0.7)	(5.9)
(Gain) Loss on sale of property, equipment and investments	-	1.0	0.3	0.1
<b>Net earnings (loss) before income taxes</b>	(0.2)	(3.2)	(1.0)	(6.0)
<b>Income taxes (recovery)</b>	-	(0.3)	-	(0.2)
<b>Discontinued Operations, net of tax</b>	(0.2)	(2.9)	(1.0)	(6.2)

### (b) Optimal Pressure Drilling Services Discontinued Operations

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. Optimal Pressure Drilling Services is operated through separate legal entities (the "JV Entities"), including Optimal Pressure Drilling Services Inc., a Canadian corporation ("Optimal Canada") and Optimal Pressure Drilling Services, S.A. DE C.V., a Mexican corporation ("Optimal Mexico"). Optimal Pressure Drilling Services was owned 51% by the Corporation and 49% by Schlumberger through direct investments in the JV Entities.

On September 25, 2009, the Corporation completed the sale of its entire interest in Optimal Pressure Drilling Services to the Schlumberger Group for aggregate gross proceeds of \$23.5 million. The Corporation reported a gain on sale, net of taxes, of \$2.4 million.

The financial results for the three and nine months ended September 30, 2009 are to the date of sale and comparative figures have been adjusted to remove activities related to Optimal Pressure Drilling Services and to report those amounts as a discontinued operation.

The Corporation invested an aggregate of US\$28.4 million in the JV Entities of which 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.

# High Arctic Energy Services Inc.

## Consolidated Notes to the Financial Statements

### For the three and nine months ended September 30, 2009 and September 30, 2008

(\$ Million - Unaudited)

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 is as presented below. Balance Sheet amounts are shown for December 31, 2008 only due to the sale on September 25, 2009 while Income Statement information reported for the three and nine months ended September 30, 2009 and September 30, 2008 represents the Corporation's 51% proportionate results to the date of sale on September 25, 2009.

#### **Balance Sheet**

**December 31, 2008**

Cash	3.3
Deposits and prepaid expenses	0.2
Accounts receivable	3.5
Total current assets	7.0
Construction in Progress	4.2
Property and equipment	17.9
Total assets	29.1
Accounts payable	1.8
Interest Payable to High Arctic Energy Services	1.6
Due to High Arctic Energy Services	1.0
Notes payable to shareholders	25.3
Total liabilities	29.7
Shareholders' equity & retained earnings (deficit)	(0.6)
Total liabilities and shareholders' equity	29.1

	<b>Three Months Ended September 30</b>		<b>Nine Months Ended September 30</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
<b>Revenue</b>	1.0	2.3	8.4	5.5
<b>Expenses</b>				
Oilfield services	1.8	2.6	7.3	6.2
General and administration	0.1	0.2	0.4	0.4
Amortization	0.9	0.7	2.8	1.8
Foreign exchange (gain) loss	1.1	0.1	-	0.1
Interest	(0.1)	0.1	0.1	0.1
	3.8	3.7	10.6	8.6
<b>Net earnings (loss) before income taxes</b>	(2.8)	(1.4)	(2.2)	(3.1)
<b>Income taxes (recovery)</b>	0.2	-	0.2	-
<b>Net earnings (loss)</b>	(3.0)	(1.4)	(2.4)	(3.1)

As part of the consolidation process, certain intercompany balances are eliminated for consolidated financial statements reporting purposes, including the interest, notes payable and receivable balances on the High

# High Arctic Energy Services Inc.

## Consolidated Notes to the Financial Statements

### For the three and nine months ended September 30, 2009 and September 30, 2008

(\$ Million - Unaudited)

Arctic Loan. The Corporation also had deferred a gain on sale of \$1.4 million on the equipment sold to the JV Entities from 2007 and is included in income on a basis consistent with the future amortization of the related assets by the JV Entities. The remaining deferred gain was recognized as a result of the sale resulting in a gain of \$1.1 million for the nine months ending September 30, 2009 (\$0.3 million nine months ended September 30, 2008).

Certain adjustments are required to be made in determining the amounts reported as discontinued operations for the purposes of reporting in the Consolidated Financial Statements of High Arctic Energy Services Inc. The following schedule provides reconciliation between the 51% proportionate results reported above for the three and nine months ended September 30, 2009 and September 30, 2008 and the loss from discontinued operations reported on the Income Statement.

	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
<b>Net earnings (loss)</b>	(3.0)	(1.4)	(2.4)	(3.1)
<b>Adjustments</b>				
Foreign Exchange Adjustment on consolidation	0.2	-	-	(0.3)
Interest eliminated between consolidated entities	(0.4)	0.8	0.4	0.8
Amortization expense related to amortized gain	(0.1)	0.3	-	0.3
<b>Discontinued Operations, net of tax</b>	<b>(3.3)</b>	<b>(0.3)</b>	<b>(2.0)</b>	<b>(2.3)</b>

In addition, the following reconciliations are necessary to obtain the results that are shown on the Consolidated Balance sheet for High Arctic Energy Services:

	December 31, 2008
Cash	3.3
Deposits and prepaid expenses	0.2
Accounts receivable	3.5
Due from Optimal Pressure Drilling Services	1.0
Total current assets related to discontinued operations	8.0
	December 31, 2008
Construction in Progress	4.2
Property and Equipment	17.9
Unamortized Gain on Sale of Assets to Optimal	(1.1)
Discontinued assets held for sale (Note 3)	21.0

**High Arctic Energy Services Inc.**  
**Management Discussion and Analysis**  
**Three and Nine months ended September 30, 2009**

The following is Management's Discussion and Analysis ("MD&A") of the financial condition and results of operations of High Arctic Energy Services Inc. (the "Corporation", "High Arctic" or "HAES") for the three and nine months ended September 30, 2009, as compared to the same periods in 2008. 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, 2009 (the "Financial Statements"). Readers should also read the "*Forward-Looking Statements*" contained at the end of this document.

The discussion and analysis of the financial condition and results of operations presented herein is presented using a continuity of interest accounting basis that recognizes the Corporation is a successor to High Arctic Energy Services Trust (the "Trust").

The Financial Statements and the MD&A are reported in Canadian dollars unless otherwise stated. The financial data presented herein and in the Financial Statements has been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP") on a going concern basis.

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 expectation of continued reduced activity levels in the industry, as well as obtaining further extensions of the maturity date for repayment of its outstanding debt. The Corporation's credit facility matured on June 12, 2009 and a demand for payment can be made at any time by the lenders. The Corporation did not pay the June 30, 2009 interest payment due on the Convertible Debentures, so the debenture holders can potentially accelerate the maturity date. The Corporation must negotiate an extension to its credit facilities and expects that it may have to restructure the Convertible Debentures and other unsecured debt to achieve an extension. Further asset sales and other conditions may also be part of the revised terms of any extension. 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 a significant risk regarding the Corporation's ability to continue as a going concern. The 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.

The MD&A is dated November 12, 2009.

## **Corporate Profile**

High Arctic is an oilfield services company currently operating primarily in Western Canada and Papua New Guinea. Headquartered in Red Deer, High Arctic trades under the symbol HWO on the Toronto Stock Exchange.

The Canadian operation is focused on the provision of snubbing services and the supply of nitrogen to a diverse group of oil and natural gas exploration and production companies operating in Western Canada. The Corporation had 21 snubbing units, 10 nitrogen pumps, 5 nitrogen transports and 3 rack and pinion underbalanced workover units in Canada at September 30, 2009. High Arctic is active in Papua New Guinea where it provides contract drilling and workover services.

## **Capitalization**

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

As at September 30, 2009 and November 12, 2009 there were 45,442,325 issued and outstanding common shares. A total of 4,544,232 stock options (being 10% of all outstanding shares) are available for grant under the Stock Option Plan. As at September 30, 2009, a total of 3,736,350 share options were outstanding and expire at various dates up to 2013, at exercise prices ranging from \$0.15 to \$13.57 per share. As at November 12, 2009, there were a total of 3,736,350 share options outstanding.

There were 1,500,000 warrants outstanding as at September 30, 2009 and as at November 12, 2009, with each warrant giving the holder the right to purchase one common share of the Corporation at a price of \$1.09 per share until June 20, 2010.

**High Arctic Energy Services Inc.**  
**Management Discussion and Analysis**  
**Three and Nine months ended September 30, 2009**

The Corporation's common shares trade on the Toronto Stock Exchange under the symbol HWO. The closing price of the shares on November 11, 2009 was \$0.08 per share. Based upon 45,442,325 issued common shares, the Corporation has an approximate market capitalization of \$3.6 million.

**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 of volatile commodity prices has on industry activity levels. In addition, the Corporation's international financial results are impacted by fluctuations in foreign exchange rates and, in particular, the U.S. dollar to Canadian dollar exchange rate.

	2009			2008				2007
Average for the period	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4
<b>Oil and natural gas prices</b>								
West Texas Intermediate (US \$ /bbl)	\$68.20	\$56.88	\$43.41	\$59.08	\$118.22	\$123.80	\$97.82	\$90.50
AECO (C\$ /Mcf)	\$3.02	\$3.66	\$5.63	\$6.79	\$9.24	\$9.35	\$7.13	\$6.00
<b>Other industry indicators</b>								
Well completions in Western Canada <sup>(1)</sup>	1667	1504	4434	7912	4683	3148	4986	5212
Gas well drilling in Western Canada <sup>(1)</sup>	661	894	2994	4997	2401	1670	3293	3543
Active drilling rigs in Western Canada <sup>(1)</sup>	176	92	320	385	403	170	498	342
Average drilling rig utilization rates <sup>(1)</sup>	21%	11%	37%	44%	46%	19%	56%	38%
US/Canadian dollar exchange rate	0.910	0.858	0.803	0.825	0.961	0.990	0.996	1.019

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

Increases or decreases in the price of oil and natural gas can materially impact oil and gas company spending for 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. Fluctuations in the oil and gas company spending can materially affect the financial results of the Corporation.

High Arctic's Canadian business is primarily dependent on natural gas well drilling and completions. Average prices for oil and natural gas have been lower in the first three quarters of 2009, when compared to the same periods in 2008. Oil prices have strengthened somewhat since the end of 2008; however, natural gas prices have continued to remain weak. The weak natural gas prices will continue to have a negative impact on drilling activity in Western Canada.

The CAODC reported 1,667 wells were completed in Canada during the third quarter of 2009; a decrease of 64% from the 4,683 wells completed in the same period in 2008. Gas well completions in the third quarter of 2009 totalled 661, which was a decrease of 1,740 (72%) gas wells as compared to the same period in 2008. High Arctic's Canadian revenue for the third quarter decreased by 63%, which is in line with the precipitous drop in industry activity.

The Corporation has significant international operations and the lower Canadian dollar as compared to the U.S. dollar had a positive impact on the financial results in first quarter of 2009. The second and third quarters of 2009 have seen the Canadian dollar strengthen against the U.S. dollar resulting in a negative impact on the financial results. For the three and nine months ended September 30, 2009, a 1% increase in the value of the Canadian dollar relative to the U.S. dollar would have resulted in a \$0.1 million and \$0.4 million decrease in earnings as a result of changes in foreign exchange, respectively.

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## **Financial Highlights**

### **Three months ended September 30, 2009 versus 2008**

- During the quarter, the Corporation sold its 51% interest in the Optimal Pressure Drilling Services joint venture for proceeds of \$23.5 million. This resulted in the Corporation recording a gain of \$2.4 million.
- The senior debt level was reduced by \$23.6 million in the quarter ending September 30, 2009 to \$67.9 million as compared to a senior debt level of \$98.4 million at the end of September 30, 2008.
- Revenue from continuing operations decreased by 37% to \$22.9 million in the third quarter of 2009, as compared to revenue of \$36.6 million during the same period of 2008.
- The Corporation recorded a net loss of \$4.3 million (\$0.09 per share) in the third quarter of 2009, as compared to a net loss of \$3.2 million (\$0.07 per share) in the same period of 2008. Continuing operations had a net loss of \$1.1 million (\$0.02 per share) during the third quarter of 2009 as compared to earnings of \$1.1 million (\$0.03 per share) in the third quarter of 2008.
- The Corporation had a net increase of \$7.2 million cash in the third quarter of 2009, resulting in a quarter ending cash balance of \$29.3 million.
- EBITDA was a negative \$0.9 million (\$0.02 per share) for the three months ended September 30, 2009; a decrease of \$9.5 million from EBITDA of \$8.6 million (\$0.20 per share) for the same quarter in 2008. Continuing operations had EBITDA of \$1.3 million in the third quarter of 2009 compared to \$11.1 million in the third quarter of 2008.
- Operating loss was \$4.1 million for the quarter ending September 30, 2009; compared to operating earnings of \$3.9 million for the third quarter of 2008. Continuing operations recorded an operating loss of \$1.0 million; compared to a \$7.4 million of operating earnings in the third quarter of 2008.

### **Nine months ended September 30, 2009 versus 2008**

- Revenue from continuing operations decreased by 8% to \$95.9 million in the nine months ended September 30, 2009, as compared to revenue of \$104.2 million during the same period of 2008.
- The Corporation recorded a net loss of \$5.0 million (\$0.11 per share) in the nine months ended September 30, 2009, which was a \$9.7 million improvement over the 2008 net loss of \$14.7 million (\$0.35 per share). Continuing operations had a net loss of \$1.6 million (\$0.04 per share) during the nine months ended September 30, 2009 as compared to a net loss of \$5.4 million (\$0.13 per share) in the same period of 2008.
- For the nine months ended September 30, 2009, the Corporation had a net increase in cash of \$7.1 million as compared a use of cash of \$3.4 million during the same period of 2008. Cash generated from operating activities (before considering working capital balances) improved for the combined continuing and discontinued operations. A more extensive discussion is included below under "*Cash Flow*".
- EBITDA was \$16.2 million (\$0.36 per share) for the nine months ended September 30, 2009; a decrease of 21% from EBITDA of \$20.4 million (\$0.48 per share) for the same quarter of 2008. Continuing operations had EBITDA of \$16.2 million in the nine months ended September 30, 2009 compared to EBITDA of \$26.4 million during the same period of 2008.
- Operating earnings of \$6.0 million for the nine months ending September 30, 2009 decreased \$1.4 million from operating earnings of \$7.4 million for the same period of 2008. Continuing operations recorded operating earnings of \$8.8 million; a decrease of \$7.5 million from \$16.3 million of operating earnings in the nine months ending September 30, 2008.

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**Selected Information**

The following is a summary of selected financial information of the Corporation:

	Three Months Ended September 30			Nine Months Ended September 30		
	2009	2008	Change	2009	2008	Change
\$ millions (except per share amounts)						
<b>Revenue</b> - continuing operations	22.9	36.6	(13.7)	95.9	104.2	(8.3)
- discontinued operations	1.2	5.2	(4.0)	9.9	19.3	(9.4)
- total	24.1	41.8	(17.7)	105.8	123.5	(17.7)
<b>Net earnings (loss) before discontinued operations</b>	(1.1)	1.1	(2.2)	(1.6)	(5.4)	3.8
Per share (basic and diluted)	\$(0.02)	\$0.03	\$(0.05)	\$(0.04)	\$(0.13)	\$0.09
<b>Net earnings (loss) from discontinued operations</b>	(3.2)	(4.3)	1.1	(3.4)	(9.3)	5.9
Per share (basic and diluted)	\$(0.07)	\$(0.10)	\$0.03	\$(0.07)	\$(0.22)	\$0.15
<b>Net loss</b>	(4.3)	(3.2)	(1.1)	(5.0)	(14.7)	9.7
Per share (basic and diluted)	\$(0.09)	\$(0.07)	\$(0.02)	\$(0.11)	\$(0.35)	\$0.24
<b>Cash flow</b> - continuing operations	6.0	(13.6)	19.6	3.9	3.8	0.1
- discontinued operations	1.2	7.2	(6.0)	3.2	(7.2)	10.4
- total	7.2	(6.4)	13.6	7.1	(3.4)	10.5
<b>EBITDA</b> - continuing operations	1.3	11.1	(9.8)	16.2	26.4	(10.2)
- discontinued operations	(2.2)	(2.5)	0.3	-	(6.0)	6.0
- total	(0.9)	8.6	(9.5)	16.2	20.4	(4.2)
Per share (basic and diluted)	\$(0.02)	\$0.20	\$(0.22)	\$0.36	\$0.48	\$(0.12)
<b>Operating earnings (loss)</b>						
- continuing operations	(1.0)	7.4	(8.4)	8.8	16.3	(7.5)
- discontinued operations	(3.1)	(3.5)	0.4	(2.8)	(8.9)	6.1
- consolidated	(4.1)	3.9	(8.0)	6.0	7.4	(1.4)

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**Net Income to EBITDA**

*EBITDA is a non-GAAP measure calculated by looking at net earnings before the deduction of interest expense, taxes, depreciation and amortization. The following table provides a quantitative reconciliation of net earnings to EBITDA split to show the effect of the Continuing Operations and Discontinued Operations for three months ended September 30, 2009 and 2008.*

Three months ended September 30								
\$ millions	2009				2008			
	Discontinued Operations			Consolidated	Discontinued Operations			Consolidated
Continuing Operations	Middle East	Optimal Pressure Drilling Services	Continuing Operations		Middle East	Optimal Pressure Drilling Services		
<b>Net earnings (loss)</b>	<b>(1.1)</b>	<b>(0.2)</b>	<b>(3.0)</b>	<b>(4.3)</b>	<b>1.1</b>	<b>(2.9)</b>	<b>(1.4)</b>	<b>(3.2)</b>
<b>Add (deduct)</b>								
Interest and financing fees	2.6	-	(0.1)	2.5	4.5	-	0.1	4.6
Taxes	1.0	-	0.2	1.2	1.9	(0.3)	-	1.6
Amortization	2.3	-	0.9	3.2	3.7	0.3	0.7	4.7
(Gain) Loss on sale of property and equipment	(1.1)	-	-	(1.1)	(0.1)	1.0	-	0.9
(Gain) Loss on sale of investment	(2.4)	-	-	(2.4)	-	-	-	-
<b>EBITDA</b>	<b>1.3</b>	<b>(0.2)</b>	<b>(2.0)</b>	<b>(0.9)</b>	<b>11.1</b>	<b>(1.9)</b>	<b>(0.6)</b>	<b>8.6</b>

*The following table provides a quantitative reconciliation of net earnings to EBITDA split to show the effect of the Continuing Operations and Discontinued Operations for nine months ended September 30, 2009 and 2008.*

Nine months ended September 30								
\$ millions	2009				2008			
	Discontinued Operations			Consolidated	Discontinued Operations			Consolidated
Continuing Operations	Middle East	Optimal Pressure Drilling Services	Continuing Operations		Middle East	Optimal Pressure Drilling Services		
<b>Net earnings (loss)</b>	<b>(1.6)</b>	<b>(1.0)</b>	<b>(2.4)</b>	<b>(5.0)</b>	<b>(5.4)</b>	<b>(6.2)</b>	<b>(3.1)</b>	<b>(14.7)</b>
<b>Add (deduct)</b>								
Interest and financing fees	8.6	-	0.1	8.7	17.9	-	0.1	18.0
Taxes	5.3	-	0.2	5.5	4.2	0.2	-	4.4
Amortization	7.4	-	2.8	10.2	10.1	1.1	1.8	13.0
(Gain) Loss on sale of property and equipment	(1.1)	0.3	-	(0.8)	(0.4)	0.1	-	(0.3)
(Gain) Loss on sale of investment	(2.4)	-	-	(2.4)	-	-	-	-
<b>EBITDA</b>	<b>16.2</b>	<b>(0.7)</b>	<b>0.7</b>	<b>16.2</b>	<b>26.4</b>	<b>(4.8)</b>	<b>(1.2)</b>	<b>20.4</b>

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**Discontinued Operations**

The Corporation reported the operations in the Middle East region, including Tunisia and India, as discontinued at December 31, 2008. These areas had ongoing losses and negative cash flow leading to cash funding requirements that could not be sustained. Management determined that the situation was unlikely to improve. In keeping with the Corporation's strategy of focusing on its core businesses and to exit unprofitable areas, the decision was made to discontinue operations in these areas to the extent possible.

The Corporation has transferred some of the assets from that region to other core areas and has sold other assets and used the proceeds of those sales to reduce its debt. At December 31, 2008 the remaining property and equipment in those operating areas had been classified as assets held for sale.

On September 25, 2009 the Corporation concluded the sale of its 51% share of Optimal Pressure Drilling Services joint venture to its joint venture partner. Revenue and earnings from Optimal Pressure Drilling Services have been included in discontinued operations. High Arctic's share of the net loss for the third quarter of 2009 was \$3.0 million as compared to a loss of \$1.4 million in the third quarter of 2008. High Arctic's share of the net loss for the nine months ending September 30, 2009 was \$2.4 million as compared to a loss of \$3.1 million during the same period of 2008.

**Operating Results for the Three and Nine Months Ended September 30, 2009 and 2008**

(Note: amounts below combine amounts from continuing and discontinued operations)

\$ millions	Three Months Ended September 30			Nine Months Ended September 30		
	2009	2008	Change	2009	2008	Change
<b>Revenue</b>						
Canada	4.4	12.0	(7.6)	19.5	40.8	(21.3)
International	18.5	24.6	(6.1)	76.4	63.4	13.0
Discontinued operations	1.2	5.2	(4.0)	9.9	19.3	(9.4)
<b>Total Revenue</b>	<b>24.1</b>	<b>41.8</b>	<b>(17.7)</b>	<b>105.8</b>	<b>123.5</b>	<b>(17.7)</b>
<b>Oilfield services expense</b>						
Continuing operations	16.6	25.4	8.8	67.8	71.2	3.4
Discontinued operations	2.0	5.9	3.9	8.6	21.5	12.9
<b>Total oilfield service expense</b>	<b>18.6</b>	<b>31.3</b>	<b>12.7</b>	<b>76.4</b>	<b>92.7</b>	<b>16.3</b>
% of Revenue	77%	75%	(2%)	72%	75%	3%
<b>Oilfield services operating margin</b>						
Continuing operations	6.3	11.2	(4.9)	28.1	33.0	(4.9)
Discontinued operations	(0.8)	(0.7)	(0.1)	1.3	(2.2)	3.5
<b>Total oilfield services operating margin</b>	<b>5.5</b>	<b>10.5</b>	<b>(5.0)</b>	<b>29.4</b>	<b>30.8</b>	<b>(1.4)</b>
% of Revenue	23%	25%	(2%)	28%	25%	3%
Equipment utilization in Canada	24%	44%	(20%)	31%	47%	(16%)
CAODC drilling utilization	21%	46%	(25%)	23%	40%	(17%)

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**Operations in Canada**

In Canada, natural gas prices and, to a lesser extent, oil prices are the primary drivers of the Corporation's activity levels, as the netbacks expected to be received by its customers heavily influence their drilling and completion plans.

- The overall wells completed in Western Canada during the third quarter of 2009 decreased by 64% from the third quarter of 2008. Natural gas well completions decreased by 72% from 2,401 in the third quarter of 2008 to 661 in the third quarter of 2009. The Corporation's activity in the Canadian market correlates to a greater degree to the amount of natural gas well drilling. As a result of declining commodity prices, which began late in the 3<sup>rd</sup> quarter of 2008, drilling activity in the Western Canadian Sedimentary Basin began to slow down in late 2008 and that activity slowdown has continued during the first three quarters of 2009. A total of 7,605 wells were completed in Western Canada during the first nine months of 2009 which is a decrease of 5,212 (41%) as compared to 12,817 well completions during the same period of 2008. The resulting decrease in activity levels has increased competitiveness within the oilfield services industry and put downward pressure on the day rates the Corporation is able to charge its customers.
- In October 2008, CAODC forecast that 14,325 wells would be drilled during 2009 in the Western Canadian Sedimentary Basin. The CAODC now expects 8,787 wells to be completed in 2009 as compared to 20,729 well completions reported for 2008.
- Canadian revenue declined by \$7.6 million (63%) to \$4.4 million in the quarter ended September 30, 2009, from \$12.0 million in the same quarter of 2008. The decline was attributable to the significant decrease in drilling activity in Western Canada, reduced day rates and one of the Corporation's major customers significantly reducing their activity in Western Canada.
- The Corporation's overall Canadian equipment utilization rate was 24% for the third quarter of 2009, compared to 44% for the third quarter of 2008. These compare to the CAODC rig utilization averages of 21% and 46% for the third quarter 2009 and 2008, respectively, indicating the Corporation's utilization comparatives are in line with industry averages. Equipment utilization is determined by dividing the number of days a unit operates by the number of days in the relevant period.
- The Corporation's largest business line in Canada is snubbing services. Utilization rates for the snubbing units for the quarter ended September 30, 2009 was 19% as compared to the quarter ended September 30, 2008 utilization of 52%.
- Nitrogen equipment utilization was 34% in the third quarter of 2009; a decrease from the 37% utilization in the third quarter of 2008.
- The Corporation has three 250K UB hydraulic workover units. These units had no utilization in the third quarter of 2009. The decline in activity is the result of increasing competition from substitute technologies and new competitors entering the marketplace. Management made the decision during the first quarter of 2009 to not actively market these units on a well to well basis until market conditions improve.

**International Operations**

- The Corporation's activity in Papua New Guinea accounted for \$18.5 million in revenue for the quarter ended September 30, 2009 as compared to \$24.6 million for the quarter ended September 30, 2008.
- Services in Papua New Guinea are provided under longer term contracts rather than the well to well contracts common in Canada. In the third quarter of 2009, the Corporation had one drilling rig operating as compared to one drilling rig and one hydraulic workover unit operating during the third quarter of 2008. The decrease in revenue for the third quarter of 2009 as compared to the third quarter of 2008 is mainly the result of the hydraulic workover unit (Rig 102) being stacked late in the second quarter of 2009.
- Rig 103 in Papua New Guinea commenced drilling its first well in December 2007 under a three year contract that expires on December 31, 2010. Rig 103 was stacked in July 2009 and is under a much reduced day rate while stacked. It is undetermined at this point when or if the rig will be called back to active operations.

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- Rig 101 commenced drilling operation in Papua New Guinea in October 2007 and its contract was completed in the third quarter of 2008. It was replaced with Rig 104, which commenced operations on its first well in December 2008. Rig 104 is expected to remain drilling throughout 2009.
- Rigs 101, 103 and 104 are each owned by our customer in Papua New Guinea and leased to High Arctic under an operating lease. The revenue includes amounts related to the recovery of lease related costs. The lease cost is included under oilfield services expense. High Arctic owns Rig 102 and owns drilling support equipment.

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

- Oilfield services expense as a percentage of revenue, on a consolidated basis, was 77% in the quarter ended September 30, 2009, compared to 75% in 2008. For the nine month period ending September 30, 2009 oilfield services expense as a percentage of revenue was 72% as compared to 75% for the same period of 2008.
- 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. Oilfield services expense was \$18.6 million in the quarter ended September 30, 2009; a decline of 41% as compared to the same quarter of 2008 where oilfield services expense was \$31.3 million. This is the result of continuing efforts by management to reduce both fixed and variable costs as the Corporation is faced with lower activity levels and lower day rates in both the Canadian and international markets.
- Oilfield services expense associated with the continuing operations was 72% of continuing revenue in the quarter ended September 30, 2009 and 69% in the same period of 2008. For the nine month period ending September 30, 2009 oilfield services expense as a percentage of revenue was 71% as compared to 68% for the same period of 2008.
- Cost reductions in Canada implemented in the first quarter of 2009 have helped reduce oilfield services expense.

**Selected Expense Information**

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

**General and Administrative**

	Three Months Ended September 30			Nine Months Ended September 30		
	2009	2008	Change	2009	2008	Change
\$ millions						
<b>General and administrative</b>						
From continuing operations	1.9	2.4	0.5	6.1	8.9	2.8
From discontinued operations	0.2	1.0	0.8	1.1	3.1	2.0
<b>Total</b>	<b>2.1</b>	<b>3.4</b>	<b>1.3</b>	<b>7.2</b>	<b>12.0</b>	<b>4.8</b>
<b>% of Revenue</b>	8.7%	8.1%	(0.6%)	6.8%	9.7%	2.9%

Management began to take actions in the first quarter of 2009 in continuing to reduce general and administrative expenses to reflect decreased activity levels. General and administrative expenses have decreased by 40% (\$4.8 million) in 2009 on a year to date basis as compared to the same period in 2008, largely due to personnel and salary reductions. Discontinued operations has accounted for \$2.0 million of the overall year to date cost reductions.

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**Share-based Compensation**

\$ millions	Three Months Ended September 30			Nine Months Ended September 30		
	2009	2008	Change	2009	2008	Change
<b>Share-based compensation</b>	-	(0.2)	(0.2)	0.4	-	(0.4)
<b>% of Revenue</b>	-	(0.5%)	(0.5%)	0.4%	-	(0.4)%

The Corporation recognized share-based compensation expense of \$0.4 million for the nine months ended September 30, 2009. (2008 - \$0.0 million) based on amortizing the expense over the vesting period using the Black-Scholes model. The options valued 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 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. The options in 2009 were valued with a weighted average expected volatility of 78.0%, a risk free interest rate of 1.83%, expected annual dividend yield of 0.0% and an expected life of 5 years.

**Amortization**

\$ millions	Three Months Ended September 30			Nine Months Ended September 30		
	2009	2008	Change	2009	2008	Change
<b>Amortization</b>						
From continuing operations	2.3	3.7	1.4	7.4	10.1	2.7
From discontinued operations	0.9	1.0	0.1	2.8	2.9	0.1
<b>Total</b>	<b>3.2</b>	<b>4.7</b>	<b>1.5</b>	<b>10.2</b>	<b>13.0</b>	<b>2.8</b>
<b>% of Revenue</b>	13.3%	11.2%	(2.1%)	9.6%	10.5%	0.9%

The decrease in amortization reflects the reclassification in 2007 and 2008 of certain property and equipment to Assets Held for Sale that are not depreciated. In 2008, the Corporation provided for an impairment of \$21.7 million related to a write down on i) its three 250K UB rigs, ii) the write down of equipment that is being marketed for sale, including the one remaining RAPAD Rig, and iii) a further write down on a heli-portable drilling rig. As at September 30, 2009 the recorded amounts of the assets held for sale was \$25.2 million as management's estimate of the realizable value. The three 250K UB rigs, on which an impairment of \$11.8 million was recorded as part of the 2008 amount, are not part of the assets held for sale.

**Foreign Exchange (Gain) Loss**

\$ millions	Three Months Ended September 30			Nine Months Ended September 30		
	2009	2008	Change	2009	2008	Change
<b>Foreign exchange (gain) loss</b>						
From continuing operations	3.1	(2.1)	(5.2)	5.4	(2.3)	(7.7)
From discontinued operations	1.2	0.6	(0.6)	0.2	0.5	0.3
<b>Total</b>	<b>4.3</b>	<b>(1.5)</b>	<b>(5.8)</b>	<b>5.6</b>	<b>(1.8)</b>	<b>(7.4)</b>
<b>% of Revenue</b>	17.8%	(3.6%)	(21.4%)	5.3%	(1.5%)	(6.8%)

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The Corporation has exposure to U.S. dollar revenues and expenses, primarily through its international operations, and to local currencies including the Kina in Papua New Guinea and the Dirham in Dubai (which is tied to the U.S. dollar). The U.S. Dollar has weakened against the Canadian for the year going from 1.2194 per Canadian dollar at January 1, 2009 to 1.0861 at September 30, 2009.

**Interest Expense**

	Three Months Ended September 30			Nine Months Ended September 30		
	2009	2008	Change	2009	2008	Change
\$ millions						
<b>Interest expense</b>						
From continuing operations	2.6	4.4	1.8	8.5	16.7	8.2
From discontinued operations	(0.1)	0.1	0.2	0.1	0.1	-
<b>Total</b>	2.5	4.5	2.0	8.6	16.8	8.2
<b>% of Revenue</b>	10.4%	10.8%	0.4%	8.1%	13.6%	5.5%

The principal amount of the senior debt (credit facility and bridge loan) was \$67.9 million at September 30, 2009, compared to \$93.9 million at December 31, 2008. The interest rate applicable to all loans under the senior debt is based on prime. The interest expense has decreased with the decrease in the prime rate and the decrease in the average outstanding principal amount.

At December 1, 2008 the interest rate on the Convertible Debentures decreased from 12% to 10% as a result of the Corporation reducing its overall Consolidated Leverage Ratio to below 5.00 to 1.00.

The amortization of financing fees relates primarily to the bridge loan origination fee in July 2007 and to the credit facility and bridge loan extensions on October 22, 2007 and June 6, 2008. As at March 31, 2009 all these fees had been fully amortized.

The convertible debenture accretion expense is a non-cash charge based on assigning a value to the share conversion feature at the time the debentures were issued and expensing that notional value over time.

The following table provides details of interest expense for continuing operations for the nine months ended September 30:

	Nine months ended September 30		
	2009	2008	Change
\$ millions			
<b>Interest expense on Senior Debt</b>	3.6	8.2	4.6
<b>Interest expense on Convertible Debentures</b>	2.1	2.8	0.7
<b>Interest expense on other debt</b>	0.5	0.2	(0.3)
<b>Amortization of financing fees</b>	0.8	4.0	3.2
<b>Convertible debenture accretion expense</b>	1.6	1.6	-
<b>Total</b>	8.6	16.8	8.2

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***Financing Costs***

	Three Months Ended September 30			Nine Months Ended September 30		
	2009	2008	Change	2009	2008	Change
\$ millions						
<b>Financing Cost</b>	-	0.1	0.1	0.1	1.2	1.1
<b>% of Revenue</b>	0.0%	0.2%	0.2%	0.1%	1.0%	0.9%

Financing costs of \$0.1 million during the first nine months of 2009 are primarily related to legal costs and other expenses associated with the Corporation's existing credit facility. Financing costs for 2008 relate to the pursuit of alternative sources of equity and debt financing arrangements that were not consummated as the proposed terms were not acceptable.

***(Gain) / Loss on Sale of Property and Equipment***

	Three Months Ended September 30			Nine Months Ended September 30		
	2009	2008	Change	2009	2008	Change
\$ millions						
<b>(Gain) / loss on sale of property and equipment</b>	(1.1)	0.9	2.0	(0.8)	(0.3)	0.5
<b>% of Revenue</b>	(4.6)%	2.2%	6.8%	(0.8%)	(0.2%)	0.6%

The Corporation continues to sell excess and underutilized assets. Equipment is sold at current market rates and the gains or losses are the result of receiving proceeds in excess or below the net book value of asset sold.

***(Gain) / Loss on Sale of Investments***

	Three Months Ended September 30			Nine Months Ended September 30		
	2009	2008	Change	2009	2008	Change
\$ millions						
<b>(Gain) / loss on sale of property, equipment and investments</b>	(2.4)	-	2.4	(2.4)	-	2.4
<b>% of Revenue</b>	(9.9%)	-	9.9%	(2.3%)	-	2.3%

On September 25, 2009 the Corporation completed the sale of its interest in Optimal Pressure Drilling Services joint venture for proceeds of \$23.5 million net of taxes in Mexico of \$0.2 million. As a result of this sale the Corporation reported a gain of \$2.4 million.

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***Income Taxes (Recovery)***

\$ millions	Three Months Ended September 30			Nine Months Ended September 30		
	2009	2008	Change	2009	2008	Change
<b>Income taxes (recovery)</b>	1.2	1.6	0.4	5.5	4.4	(1.1)
<b>% of Revenue</b>	5.0%	3.8%	(1.2%)	5.2%	3.6%	(1.4%)

The income tax expense primarily relates to current taxes payable in Papua New Guinea. The Corporation is not currently taxable in Canada as the result of ongoing losses. The Corporation uses the liability method of tax allocation in accounting for income taxes. Under this method, future tax assets and liabilities are determined for the income tax consequences attributable to difference between amounts recorded in the financial statements and their respective tax bases, using a substantially enacted tax rate. The effect of any change in income tax rates on future tax assets and liabilities is recognized in earnings in the period that the change occurs. The Corporation has not recognized any future net benefit associated with unrecognized tax pools due to the uncertainty of the Corporation's ability to use those tax pools. The Corporation does not expect to be taxable in Canada during 2009 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.

\$million except per share amounts	Sep 30, 2009	Jun 30, 2009	Mar 31, 2009	Dec 31, 2008	Sep 30, 2008	Jun 30, 2008	Mar 31, 2008	Dec 31, 2007
<b>Revenue</b> - continuing operations	22.9	31.2	41.8	40.7	36.6	28.2	39.4	34.4
- discontinued operations	1.2	3.9	4.8	4.3	5.2	7.3	6.8	4.9
- total	<b>24.1</b>	<b>35.1</b>	<b>46.6</b>	<b>45.0</b>	<b>41.8</b>	<b>35.5</b>	<b>46.2</b>	<b>39.3</b>
<b>Net earning (loss) – before discontinued operations</b>	(1.1)	(3.1)	2.6	(21.4)	1.1	(6.6)	0.1	(22.9)
Per share (basic and diluted)	\$(0.02)	\$(0.07)	\$0.06	\$(0.50)	\$0.03	\$(0.16)	\$0.00	\$(0.54)
<b>Net earning (loss) – discontinued operations</b>	(3.2)	0.5	(0.7)	(3.5)	(4.3)	(2.7)	(2.3)	(32.3)
Per share (basic and diluted)	\$(0.07)	\$0.01	\$(0.02)	\$(0.08)	\$(0.10)	\$(0.06)	\$(0.05)	\$(0.76)
<b>Net earning (loss)</b>	(4.3)	(2.6)	1.9	(24.9)	(3.2)	(9.3)	(2.2)	(55.2)
Per share (basic and diluted)	\$(0.09)	\$(0.06)	\$0.04	\$(0.58)	\$(0.07)	\$(0.22)	\$(0.05)	\$(1.30)

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**Liquidity and Capital Resources**

*Selected Capitalization Data (on a Consolidated Basis, including Discontinued Operations)*

	September 30	December 31	Change
	2009	2008	
\$ millions except financial ratios			
Current assets	51.5	58.0	(6.5)
Current liabilities excluding credit facility and convertible debentures <sup>(1)</sup>	31.2	37.5	(6.3)
Operating working capital <sup>(2)</sup>	20.3	20.5	(0.2)
Operating working capital ratio <sup>(3)</sup>	1.65	1.55	0.10
Senior credit facility	67.9	93.9	(26.0)
Convertible debentures	27.9	27.9	-
Shareholders' equity	5.7	9.7	(4.0)
Total debt-to-capitalization ratio <sup>(4)</sup>	0.94	0.93	0.01
Cash and cash equivalents	29.3	18.9	10.4

Notes:

- (1) Calculated as current liabilities less the current portion of the credit facility, bridge loan and convertible debentures.
- (2) Calculated as current assets less current liabilities excluding the current portion of the credit facility, bridge loan and convertible debentures.
- (3) Calculated as current assets divided by current liabilities excluding the current portion of the credit facility, bridge loan and convertible debentures.
- (4) Calculated as long-term debt (senior credit facility and subordinated convertible debentures) divided by the sum of long-term debt and shareholders' equity.

The Corporation continues to focus on reducing its debt leverage and maintaining sufficient liquidity for its operating needs. The Corporation's objective is to have a capital structure that will provide the capital to meet the requirements of its business and instil confidence in investors, creditors and the capital markets. To accomplish this, the Corporation 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.

The Corporation had a cash balance of \$29.3 million as at September 30, 2009 and needs to maintain sufficient cash to meet its cash needs for the foreseeable future. Ongoing business needs and the near term cash needs include approximately \$11 million required to pay income taxes primarily relating to Papua New Guinea, most of which is expected to be payable over the next 60 days.

The Corporation generated positive cash flow from operations after working capital adjustments during the third quarter of 2009 as described below. Industry conditions are expected to remain weak well into 2010, which creates a significant risk of negative operating cash flows. The Corporation's accounts payable and accounts receivable are substantially all current which, together with the cash balance, provides some cushion. No major capital expenditures are planned for the remainder of 2009 or the first quarter of 2010, as the Corporation plans to continue to keep tight control on spending and limit capital spending largely to maintenance capital.

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***Revolving Credit Facility and Bridge Loan***

The Corporation has a revolving credit facility with a syndicate of commercial lenders that matured on June 12, 2009. The Corporation has been seeking an extension of the facility as part of its efforts to restructure its loan obligations. The Corporation does not have the capacity to repay the Senior Consolidated Debt (as defined below) should the lenders demand payment (*see Note 1 of the Financial Statements*). The lenders can demand payment of the entire Senior Consolidated Debt as a result of such debt having matured on June 12, 2009. No further draws may be made on any of the facilities.

The facility is comprised of a \$20-million revolving loan ("Facility A") and a \$100-million equipment-based revolving loan ("Facility B"). Facility A is 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 is 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"). 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.

As at September 30, 2009, the Corporation owed approximately \$2.7 million on Facility A (2008 – \$4.4 million), \$45.2 million on Facility B (2008 - \$74.0 million) and \$20.0 million on the Bridge Loan (2008 – \$20.0 million) (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 \$67.9 million at September 30, 2009 (December 31, 2008 - \$93.9 million). 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%. The Corporation has been subject to an additional 2% per annum interest charge since July 1, 2009 as a result of the event of default caused by its failure to repay the Senior Consolidated Debt on its maturity date.

***Convertible Debentures***

In November 2007, the Corporation issued \$27.9-million principal amount of unsecured convertible debentures with a maturity date of 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.

Interest in the amount of \$1.4 million was due and payable June 30, 2009 and has not been paid to the debenture holders. The subordination terms of the debentures provide that the Corporation shall not pay any interest while there is an event of default under the senior credit facilities. The failure to repay the Senior Consolidated Debt on the maturity date (*see Revolving Credit Facility and Bridge Loan*) constitutes an event of default for this purpose. As a result of agreements with the debenture holders, the Corporation agreed to pay the June 30, 2009 interest by August 10, 2009. As the Corporation did not make that interest payment, an event of default occurred and the debenture holders are entitled to accelerate the maturity date, though the remedies are restricted by the subordination terms. The Corporation is currently working on a plan to restructure the debentures to meet the demands of the senior lenders with respect to an extension of the credit facility.

**Cash Flow**

**Cash – Operating Activities – Continuing Operations**

For the quarter ended September 30, 2009, cash used in operating activities was \$1.6 million before reflecting working capital adjustments, compared to cash provided by operating activities of \$5.5 million in the quarter ended September 30, 2008. After consideration of working capital adjustments, cash provided by operating activities in the quarter ended September 30, 2009 was \$6.8 million, compared to cash provided by operating activities of \$3.2 million in the quarter ended September 30, 2008.

In the third quarter of 2009, the outstanding accounts receivable balance decreased by \$17.8 million. Accounts payable and taxes payable decreased by \$6.2 million. The changes in the working capital balances resulted in the

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net increase in non-cash working capital of \$8.4 million in the quarter ended September 30, 2009 as compared to a net decrease in working capital of \$2.3 million in the same quarter of 2008.

**Investing Activities – Continuing Operations**

For the quarter ended September 30, 2009, net expenditures to acquire rigs, equipment and other operational assets were \$0.3 million, compared to acquisitions of \$1.1 million for the quarter ended September 30, 2008 (both amounts after the change in accounts payable related to constructing rigs and equipment).

During the quarter ended September 30, 2009 the Corporation received proceeds from the sale of assets of \$0.1 million, compared to \$1.2 million for the quarter ended September 30, 2008. In addition the Corporation sold its interest in Optimal Pressure Drilling Services joint venture, receiving proceeds of \$23.5 million in the third quarter of 2009. Those proceeds were applied to the senior debt.

**Financing Activities – Continuing Operations**

During the quarter ended September 30, 2009, the Corporation repaid its credit facility by \$23.6 million. In the quarter ending September 30, 2008, the Corporation repaid its credit facility by \$15.5 million.

**Cash Flows from Discontinued Operations**

For the quarter ended September 30, 2009, cash provided by operating activities was \$1.2 million, compared to cash used by operating activities of \$6.2 million in the quarter ended September 30, 2008.

**Customer Concentration**

The Corporation's accounts receivable 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 one significant customer. Services are provided to this customer in Papua New Guinea. That customer represents approximately 77% of the Corporation's revenue for the three months ended September 30, 2009 and 75% of its accounts receivable at that date. Management has assessed this customer as creditworthy and the Corporation has had no history of collection issues with this customer.

**Commitments and Contingencies**

**Accounts Receivable**

The Corporation has been 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. On June 29, 2009, the Corporation reached a conditional agreement with Transeuro to settle the litigation between the parties. The Corporation expects the conditions will be met during the fourth quarter of 2009 and will record any adjustments when the settlement is completed.

The Corporation has also commenced litigation against another customer with respect to collection of a receivable for services rendered outside Canada. The receivable, after a provision for possible uncollected amounts, has a carrying value of \$0.6 million, and has been insured with the Export Development Canada. The receivable is also net of \$1 million collected by realizing on a letter of credit. The customer has made a number of allegations and initiated a counter claim concerning performance issues and the cashing of the letter of credit.

**Other**

The former President and CEO of the Corporation and corporations controlled by him have initiated several lawsuits to collect approximately \$6.6 million related to loans and unpaid amounts. The lawsuits appear to be premised on the assumption that those particular amounts are not subordinated to the revolving credit facility and bridge loan

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agreements with the senior lenders. The Corporation believes that it has made an adequate provision in its financial statements for any amounts that may be owed.

A former employee of the Corporation has commenced a wrongful dismissal suit against 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 a contract in the Middle East region. 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 June 30, 2009, the Corporation was not providing any services under the contract, 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.

### 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, 2009:

\$ millions	Payments Due by Period				
	Total	Less than 1 Year	1 – 3 Years	4 – 5 Years	After 5 Years
Long-term debt obligations <sup>(1)</sup>	67.9	67.9	-	-	-
Convertible debentures <sup>(2)</sup>	27.9	27.9	-	-	-
Operating lease obligations	1.6	0.3	0.5	0.6	0.2
Related party operating lease obligations <sup>(3)</sup>	0.6	0.4	0.2	-	-
<b>Total obligations</b>	<b>98.0</b>	<b>96.5</b>	<b>0.7</b>	<b>0.6</b>	<b>0.2</b>

(1) On June 12, 2009 the revolving credit facility the Corporation had with a syndicate of commercial lenders expired. It is actively being renegotiated. However, the full amount of the loan is shown as due as of September 30, 2009. Refer to Note 4 of the Financial Statements for the period ended September 30, 2009.

(2) The subordination terms of the debentures provide that the Corporation shall not pay any interest while there is an event of default under the senior credit facilities. Pursuant to the debentures, an event of default allows the debenture holder to accelerate the maturity date. The Corporation is currently working with the debenture holders on a plan to restructure the debentures to meet the demands of the senior lenders to provide an extension of the credit facility. Refer to Note 5 of the Financial Statements for the period ended September 30, 2009.

(3) Related party operating lease obligations are for vehicle and property leases due to a related party, the former President and CEO of the Corporation (see "Related Party Transactions").

### Risk Management and Uncertainties

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

- volatilities in global supply and demand and market prices for oil and natural gas and the effect of these volatilities on the demand for oilfield services generally;
- uncertainties in weather affecting the duration of the service periods and the activities that can be completed, including the seasonality that affects industry activity in Canada;

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

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

The Corporation is also subject to specific risks.

### **Financing Risk**

The Corporation is exposed to risk associated with access to equity capital and debt financing required for business needs and to repay existing debt financing. The Corporation's current debt levels are above industry standards and the senior credit facilities have matured and demand for payment can be made at any time. The present financial condition of the Corporation, coupled with uncertain levels of near term industry activity, exposes the Corporation to the risk that necessary capital cannot be acquired on a timely basis, on reasonable terms to the Corporation, or at all.

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.

The level of the Corporation's indebtedness from time-to-time could impair its ability to obtain additional financing in the future on a timely basis to take advantage of business opportunities that may arise.

### **Customer Concentration**

Notwithstanding its large customer base, the Corporation has one significant customer. Services are provided to this customer in Papua New Guinea. That customer represents approximately 77% of the Corporation's revenue for the three months ended September 30, 2009 and 75% of its accounts receivable at that date. Management has assessed this customer as creditworthy and the Corporation has had no history of collection issues with the customer.

### **Interest Rate Risk**

The Corporation is exposed to interest rate risk on its Senior Consolidated Debt and does not currently hold any financial instruments that mitigate this risk. The Corporation's Senior Consolidated Debt is linked to the prime rate. A 1% increase or decrease in the prime rate for the year would have resulted in \$0.2 million change in interest expense for the quarter based on the outstanding balances as at September 30, 2009.

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**Income Tax Risk**

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

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

**Operational Risk and Insurance**

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

**Reliance on Key Personnel**

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

**Credit Risk**

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

**Risk of Foreign Operations**

The Corporation operates in international locations including Papua New Guinea and Mexico, 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 local qualified staff.

**Foreign Exchange Rate Risk**

High Arctic's consolidated Financial Statements are presented in Canadian dollars. The Corporation is exposed to foreign currency fluctuations, as most of its international revenues and expenses are denominated in U.S. dollars. Foreign entities with a domestic functional currency expose the Corporation to currency risk on the translation of these entities' financial assets and liabilities to Canadian dollars for consolidation.

**Dependence on Suppliers**

High Arctic sources supplies and materials from a variety of suppliers in Canada and internationally. Failure of suppliers to deliver supplies and materials in a timely and efficient manner would be detrimental to the Corporation's ability to maintain levels of service to its customers. High Arctic attempts to mitigate this risk by maintaining strong relations with key suppliers. However, if the current suppliers are unable to provide the supplies and materials, or

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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 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 affect on the Corporation's ability to generate revenue and earnings.

**Other**

The Corporation has specific risks that result from its unique situation. The former President and Chief Executive Officer of the Corporation, directly or indirectly, has the ability to control the votes to approximately 39% of the issued and outstanding shares and, as such, is in a position to significantly influence the outcome of actions requiring shareholder approval. Those shares, however, are subject to a Pooling Agreement dated June 6, 2008 under which votes for directors are cast based on the decision of a majority of the former Chief Executive Officer, the Chairman of the Board and the Chief Restructuring Officer until January 31, 2010.

Additional risk factors relating to the Corporation are also outlined in the Annual Information Form for the year ended December 31, 2008.

**Critical Accounting Estimates**

The Corporation's significant accounting policies are described in Note 2 to the Consolidated Financial Statements for the year ended December 31, 2008. The preparation of consolidated financial statements requires that certain estimates and judgments be made in regard to the reported amounts of revenue and expense as well as the carrying value of assets and liabilities. These estimates are based upon historical experience and the judgment of management.

The principal critical accounting estimate of the Corporation relates to amortization of property and equipment, including asset and impairment write-downs, if any. All amortization is carried out on the basis of the estimated useful lives of the related assets. Equipment under construction is not amortized until put into use. Included in property and equipment is equipment acquired under capital leases. All equipment is amortized based on the declining balance method, with rates ranging from 10% to 30%.

Assessing the reasonableness of the estimated useful lives of properties requires judgment and is based on currently available information, including periodic amortization studies conducted by the Corporation. Additionally, the Corporation canvasses its competitors to ensure it utilizes methodologies and rates consistent with the remainder of the sector in which the Corporation operates. Changes in circumstances, such as technological advances, changes to the Corporation's business strategy, changes in the Corporation's capital strategy, or changes in regulations may result in the actual useful lives differing from the Corporation's estimates.

A change in the remaining useful life of a group of assets, or their expected residual value, will affect the amortization rate used to amortize the group of assets, and thus affect amortization expense as reported in the Corporation's results of operations. These changes are reported prospectively when they occur.

The Corporation regularly assesses equipment carrying values and estimates whether future cash flows will exceed the carrying values at any point in time. Should this not be the case, the Corporation records an impairment for the estimated deficiency.

Another important estimate made by the Corporation, in particular due to its international exposure, is the allowance for collection of doubtful accounts. In addition to its day-to-day monitoring of its accounts receivable position, the Corporation has instituted detailed credit reviews prior to commencement of contractual arrangements and the use of export insurance provided by Export Development Canada where practical.

Lastly, the Corporation operates in Canada and several international jurisdictions with varying taxation policies and procedures for determining taxable income. In particular, the Corporation must estimate its earnings and capital expenditures in Canada in order to assess whether it will be liable for income tax. It must also estimate whether a future tax valuation allowance is required when recording a future tax asset. The Corporation must also estimate its

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tax liability in the foreign jurisdictions in which it operates, based on its understanding of the foreign tax laws and the application of those laws.

### **Related Party Transactions**

In the normal course of business, during the three and nine months ended September 30, 2009, the Corporation incurred general and administration expenses related to premises rent of \$0.2 million and \$0.8 million respectively (2008 - \$0.2 million and \$0.8 million respectively ) and equipment and vehicle leases payments of approximately \$0.1 million and \$0.3 million respectively (2008 - \$0.1 million and \$0.5 million respectively) 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, a company controlled by the Former CEO loaned the Corporation \$2.0 million at a rate of 11%. This loan is subordinated to the revolving credit facility and Bridge Loan (see Note 4 in the *Financial Statements*). Interest expense for the nine months ended September 30, 2009 includes \$0.2 million pertaining to this loan (2008 - \$0.2 million).

A further amount of \$4.7 million (2008 - \$4.3 million) has been accrued for amounts that may be owing to the Former CEO, and companies controlled by him, as at September 30, 2009, on account of various transactions. The amounts are unsecured, repayable on demand (but generally subordinated to the revolving credit facility and Bridge Loan) and non-interest bearing. For the nine months ending, the Corporation has accrued \$0.2 million as an estimate of interest at a rate of 6% per annum, that may be claimed on overdue amounts. The \$4.7 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. In total, the corporation has accrued an amount of \$0.7 million as an estimate of the potential interest liability.

A corporation controlled by the Former CEO and the CEO himself commenced several legal actions to collect approximately \$6.5 million in related to amounts included in the \$4.7 million described above. See Note 9 in the *Financial Statements* for additional information.

Optimal Pressure Drilling Services (*see Note 14 in the Financial Statements*) engaged the services of a director and incurred fees during the nine months ended September 30, 2009 of approximately \$0.1 million that are recorded in Optimal Pressure Drilling Services (2008 - \$0.1 million).

### **New Accounting Standards**

As disclosed in the December 31, 2008 financial statements, the company adopted the following sections from the Canadian Institute of Chartered Accountants ("CICA") handbook:

- 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 adoption of this standard has had no material impact on the Financial Statements.
- Credit risk and fair value of financial assets and liabilities Emerging Issues Committee abstract 173 is effective on January 1, 2009 and requires entities to take both counterparty and their own credit risk into account when measuring the fair value of financial assets and liabilities, including derivatives.

### **Future Accounting Changes**

In February 2008 the Accounting Standards Board announced that 2011 is the changeover date for publicly-listed companies to use International Financial Accounting Standards (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

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Corporation for the year ended December 31, 2010. The Corporation has begun assessing the impact of IFRS for 2011, and comparative numbers for 2010, and has prepared a plan to address the adoption process. The impact of adopting IFRS on the company's financial results cannot be reasonably determined at this time.

For interim and annual financial statements relating to its fiscal year commencing July 1, 2011, the Corporation 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 IAS 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.

### **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.

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

The Corporation's management is responsible for establishing and maintaining adequate internal controls over financial reporting. All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be designed effectively can provide only reasonable assurance with respect to financial statement preparation and presentation. The Corporation has adopted the Committee of Sponsoring Organizations of the Treadway Commission (COSO) framework to evaluate the design of internal controls over financial reporting. Throughout 2008, internal control audits were performed in Canada and Papua New Guinea to test the design and operating effectiveness of the internal control systems. As a result of the internal control audits, the Corporation's management believes there are adequate controls over financial reporting. The Corporation appointed a permanent Chief Financial Officer in 2008 and hired other accounting professionals necessary to appropriately maintain and improve internal control systems. As a result of the ongoing financial pressures experienced by the Corporation 2007 and 2008, the ability to attract additional independent board members has been hampered, though an additional independent board member was added on May 7, 2009. The Corporation did not make any change in its internal control over financial reporting during the quarter ended September 30, 2009 that has materially affected, or is reasonably likely to affect, the Corporation's internal control over financial reporting.

Also, projections of any evaluation of effectiveness to future periods are subject to the risks that controls become inadequate because of changes in conditions or personnel, or that the degree of compliance with the policies or procedures may deteriorate.

With the assistance of external consultants, throughout 2008, the Corporation reviewed the design and effectiveness of its ICFR. The Corporation identified the activities in Canada and Papua New Guinea as critical elements to the certification of the controls. The activities in the Middle East were being wound down throughout 2008 and as a result were scoped out of the testing and reported as discontinued operations in the financial statements. Further, the Corporation sold its 51% share of Optimal Pressure Drilling Services joint venture. The Corporation's 51% share of revenue and earnings (losses) from the joint venture have been reported as discontinued operations as of March 31, 2009 and has been scoped out of the ICFR testing and reporting. For the quarter ended September 30, 2009 the discontinued operations in the Middle East and Optimal Pressure Drilling Services accounted for \$1.2 million in revenue, and a \$0.3 million operating loss.

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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 2008, the Corporation then performed subsequent testing to ensure that processes and controls were operating effectively.

Based upon their evaluation of the ICFR, the interim CEO and CFO have concluded that the Corporation's ICFR have certain weaknesses relating to income tax management.

As a result of the Corporation's financial position over the past two years, its ability to attract additional independent board members was hampered. On May 7, 2009, the Corporation added an additional independent member to the board. Management and current board members continue to work to improve the Corporation's financial position, which should improve the ability to attract additional independent board members and enhance overall corporate governance.

At December 31, 2007, the Corporation identified that improvements in its financial risk management, forecasting and financing ability were necessary. The Corporation was able to improve these ICFR weaknesses through the addition of experienced personnel, additional training, improvements in processes and procedures, and the completion of actionable tasks. The Corporation also appointed a permanent CFO in March 2008, which addressed another of the ICFR weaknesses identified at December 31, 2007.

While the Corporation is continually improving its ICFR, no material changes were made during the quarter ended September 30, 2009 that would materially affect or are reasonably likely to materially affect the Corporation's ICFR.

### **International Financial Reporting Standards Update**

The Canadian Accounting Standards Board has confirmed that use of International Financial Reporting Standards (IFRS) will be required for years beginning on or after January 1, 2011 for profit-oriented publicly accountable entities. Therefore, the Corporation must be in a position to report its results and comparatives in accordance with IFRS beginning January 1, 2011.

The Corporation has established a project plan to convert from current Canadian GAAP to IFRS. The project plan consists of three phases: diagnose the impact of conversion, develop the implementation plan, and implementation.

#### **Phase I: Diagnose the Impact of Conversion**

The goal of this phase was to identify the impacts and changes required in accounting systems, processes, procedures, accounting policies and internal controls with the conversion from Canadian GAAP to IFRS. With the assistance of external consultants, the Corporation has completed the diagnosis phase, which included estimating the financial and systems impact and defining requirements for financial information. A preliminary roadmap has been developed to assist in the conversion to IFRS. In addition, personnel from the Corporation have been sent on outside training to gain a better understanding of the impacts on the conversion.

#### **Phase II: Develop the Implementation Plan**

This phase consists of designing and developing a detailed plan for implementing the changes required with conversion to IFRS. It addresses changes in systems, processes, procedures, policies and internal controls that have to be implemented. The detailed implementation plan requires a comprehensive analysis of the impact of the IFRS differences identified in the initial diagnostic phase. An Implementation Plan Team has been created and has been developing the implementation plan. The Corporation expects to complete the detailed implementation plan by November 30, 2009.

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**Phase III: Implementation**

During the implementation phase, the Corporation will execute the required changes to business processes, procedures, financial systems, accounting policies, and internal controls over financial reporting. At this time, the impact on financial statements is not reasonably determinable.

**Outlook**

The Corporation expects to see continued difficult conditions in the Canadian oilfield services sector until natural gas prices improve significantly. The depressed commodity prices have caused our customers to significantly limit their exploration and development budgets for 2009, as they carefully manage cash flows and credit facilities. Despite improved access to capital for producers in recent months and the extension of royalty incentives announced by the Alberta Government in late June, 2009, the Corporation believes that activity levels for the remainder of 2009 and well into 2010 will remain relatively weak.

Current industry estimates are for less than 8,500 wells to be drilled for all of 2009. This represents an approximate 60% decline in overall industry activity compared to 2008. Recently, the Canadian Association of Oilwell Drilling Contractors (CAODC) released its 2010 forecast and they have predicted only a modest 6% increase over 2009 drilling activity for Western Canada. The Corporation expects that the fourth quarter of 2009 and the first quarter of 2010 will see the continued trend of substantial year over year declines in activity.

In Papua New Guinea, our customer is facing its own cost pressures and is seeking the assistance of the Corporation to help improve its efficiencies. One of the two drilling rigs was "stacked" in July 2009 and is not expected to resume drilling operations until sometime during the first half of 2010. The second drilling rig, Rig 104 which began drilling in December 2008 is expected to continue drilling. Rig 102, the Corporation's hydraulic workover rig, was also shut down and "stacked" in July and its prospects for further work are very uncertain at this time. Several oil and gas companies have recently invested in Papua New Guinea which is very positive, but most likely will not lead to new work before 2010.

The Corporation continues to wind down its activity in certain international areas as it focuses on more promising opportunities elsewhere. The Corporation will continue to market for sale surplus assets as part of the reduced activity and as part of a plan to reduce debt and rationalize business operations.

For the Corporation to be successful in addressing the risks and opportunities outlined in this document, it must deal with its high debt levels. See *Liquidity and Capital Resources*. The Corporation has been financially strained since early 2007 as a result of its international expansion and its capital expenditure program. The Corporation hopes to restructure its balance sheet, possibly converting some debt into equity. The process has become more challenging because of uncertain market conditions.

**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 sell assets, raise capital and restructure its long-term debt obligations (including the Corporation's ability to obtain necessary waivers and extensions relating to the Credit Facilities);
- commodity prices and the impact that they have on industry activity;
- estimated capital expenditure programs for fiscal 2009 and subsequent periods;

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- 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.
- 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 below and elsewhere in this MD&A, along with the risk factors set out in the Annual Information Form for the year ended December 31, 2008

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.

### **Non-GAAP Terms**

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

### **Additional Information**

Additional information on the Corporation, including the Information Circular dated April 6, 2009 and the Annual Information Form for the year ended December 31, 2008, can be found on SEDAR at [www.sedar.com](http://www.sedar.com).