

HIGH ARCTIC ENERGY SERVICES INC.



CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

**FOR THE THREE AND NINE MONTH PERIODS ENDED
SEPTEMBER 30, 2016**

High Arctic Energy Services Inc.

Consolidated Statements of Financial Position

As at September 30, 2016, December 31, 2015 and January 1, 2015

Unaudited - Canadian \$ Millions

	Notes	September 30, 2016	December 31, 2015 (note 3)	January 1, 2015 (note 3)
Assets				
Current assets				
Cash and cash equivalents		24.8	15.5	37.2
Accounts receivable	4	37.8	42.4	20.6
Short term investments	5	10.6	10.6	-
Inventories		9.5	8.0	5.0
Prepaid expenses		1.0	0.9	0.8
		<u>83.7</u>	<u>77.4</u>	<u>63.6</u>
Non-current assets				
Property and equipment	7	211.7	161.7	119.9
Deferred tax asset	8	5.0	5.0	5.0
Loans due from related parties		-	-	0.2
		<u>-</u>	<u>-</u>	<u>0.2</u>
Total assets		<u>300.4</u>	<u>244.1</u>	<u>188.7</u>
Liabilities				
Current liabilities				
Accounts payable and accrued liabilities	9	25.0	23.6	17.4
Income taxes payable		10.0	7.5	3.5
Dividend payable	12	0.9	0.9	0.9
Capital lease obligation	10	1.9	-	-
Current portion of deferred revenue	11	1.8	2.2	0.2
Current portion of long-term debt	13	30.6	-	-
		<u>70.2</u>	<u>34.2</u>	<u>22.0</u>
Non-current liabilities				
Deferred revenue	11	1.2	2.6	0.4
Unfavourable lease liability	6	3.4	-	-
Long-term debt	13	-	4.0	-
Deferred tax liability	8	7.5	2.1	0.7
		<u>7.5</u>	<u>2.1</u>	<u>0.7</u>
Total liabilities		<u>82.3</u>	<u>42.9</u>	<u>23.1</u>
Shareholders' equity	14	<u>218.1</u>	<u>201.2</u>	<u>165.6</u>
Total liabilities and shareholders' equity		<u>300.4</u>	<u>244.1</u>	<u>188.7</u>

Contingencies and commitments 18

See accompanying notes to these consolidated financial statements

Approved on behalf of the Corporation by:

(signed) "Tom Alford" Director

(signed) "Michael Binnion" Director

High Arctic Energy Services Inc.

Consolidated Statements of Changes in Equity

For the nine months ended September 30, 2016 and 2015

Unaudited - Canadian \$ Millions

	Notes	Share capital	Contributed surplus	Accumulated other comprehensive income	Retained earnings (deficit)	Total shareholders' equity
Balance at January 1, 2016 as previously reported		189.7	9.4	34.5	(32.4)	201.2
Cumulative effect of change in accounting policy	3	-	-	(4.8)	4.8	-
Balance at January 1, 2016, Restated		189.7	9.4	29.7	(27.6)	201.2
Net earnings		-	-	-	37.6	37.6
Dividends	12	-	-	-	(7.9)	(7.9)
Other comprehensive income - foreign currency translation loss		-	-	(7.8)	-	(7.8)
Other comprehensive income – gain on short term investments	5	-	-	1.0	-	1.0
Purchase of common shares for cancellation	14	(6.7)	0.2	-	-	(6.5)
Share-based payment transactions		0.6	(0.1)	-	-	0.5
Balance at September 30, 2016		183.6	9.5	22.9	2.1	218.1

	Notes	Share capital	Contributed surplus	Accumulated other comprehensive income (loss)	Retained deficit	Total shareholders' equity
Balance at January 1, 2015		194.3	8.5	11.4	(48.6)	165.6
Net earnings		-	-	-	22.2	22.2
Dividends	12	-	-	-	(8.2)	(8.2)
Other comprehensive income - foreign currency translation gain		-	-	18.5	-	18.5
Other comprehensive income - loss on short term investments	3	-	-	(4.1)	-	(4.1)
Purchase of common shares for cancellation	14	(3.3)	(0.2)	-	-	(3.5)
Share-based payment transactions		0.4	1.0	-	-	1.4
Balance at September 30, 2015, Restated		191.4	9.3	25.8	(34.6)	191.9

See accompanying notes to these consolidated financial statements.

High Arctic Energy Services Inc.

Consolidated Statements of Cash Flows

For the three and nine months ended September 30, 2016 and 2015

Unaudited - Canadian \$ Millions

		Three Months Ended September 30 (see Note 3)		Nine Months Ended September 30 (see Note 3)	
		2016	2015	2016	2015
Operating activities					
Net earnings for the period		20.1	10.2	37.6	22.2
Adjustments for:					
Amortization	7	6.0	4.4	17.2	10.8
Share-based compensation	15	0.3	0.4	0.9	1.4
Gain on acquisition	6	(12.7)	-	(12.7)	-
(Gain) loss on sale of property and equipment		-	0.2	(0.1)	0.5
Foreign exchange (gain) loss		(0.3)	(1.9)	0.1	(1.9)
Deferred income tax expense (recovery)	8	(1.8)	1.0	0.9	-
		11.6	14.3	43.9	33.0
Net changes in items of working capital	17	(10.5)	(6.1)	4.1	6.8
Net cash generated from operating activities		1.1	8.2	48.0	39.8
Investing activities					
Additions of property and equipment	7	(0.1)	(2.9)	(7.5)	(39.4)
Business acquisition	6	(42.8)	-	(42.8)	-
Disposal (acquisition) of short term investments	5	0.6	(15.9)	1.1	(16.5)
Disposal of property and equipment	7	-	-	0.1	0.2
Net changes in items of working capital	17	-	(1.4)	-	(3.1)
Net cash used in investing activities		(42.3)	(20.2)	(49.1)	(58.8)
Financing activities					
Long-term debt proceeds	13	40.6	15.0	42.6	15.0
Long-term debt repayments	13	(10.0)	(6.0)	(16.0)	(6.0)
Dividend payments	12	(2.7)	(2.7)	(7.9)	(8.2)
Purchase of common shares for cancellation	14	-	(1.5)	(6.5)	(3.5)
Issuance of common shares, net of costs	14	-	-	0.3	0.1
Capital lease obligation payments	10	(0.1)	-	(0.6)	-
Loan receivable receipts		-	-	-	0.2
Net cash provided by (used in) financing activities		27.8	4.8	11.9	(2.4)
Effect of exchange rate changes		0.5	3.1	(1.5)	5.7
Net change in cash and cash equivalents		(12.9)	(4.1)	9.3	(15.7)
Cash and cash equivalents – beginning of period		37.7	25.6	15.5	37.2
Cash and cash equivalents – end of period		24.8	21.5	24.8	21.5
Cash paid for:					
Interest		0.2	-	0.4	0.2
Income taxes		1.0	0.5	3.9	4.5

See accompanying notes to these consolidated financial statements

High Arctic Energy Services Inc.

Notes to the Consolidated Financial Statements

For the three and nine months ended September 30, 2016 and 2015

(Canadian \$ Million)

1 Nature of Business

High Arctic Energy Services Inc. ("High Arctic" or "the Corporation") is incorporated under the laws of Alberta, Canada and is a publicly traded Corporation listed on the Toronto Stock Exchange under the symbol "HWO". The head office of the Corporation is located at 700 – 2nd Street S.W. Suite 500, Calgary, Alberta, Canada, T2P 2W1. High Arctic's business is to provide contract drilling, well servicing, completion services, equipment rentals and other oilfield services to the oil and natural gas industry in Papua New Guinea and Canada.

2 Basis of Preparation

These condensed interim consolidated financial statements (the "Financial Statements") have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") applicable to the preparation of interim financial statements, including IAS 34 – Interim Financial Reporting ("IAS 34"). These Financial Statements should be read in conjunction with High Arctic's consolidated financial statements for the year ended December 31, 2015 wherein the Corporation's significant accounting policies were presented in Note 3. The significant accounting policies have been consistently applied in the preparation of these Financial Statements except for Note 3 Changes in Accounting Policies - "Impact of Adoption of IFRS 9".

The Financial Statements of High Arctic for the three and nine months ended September 30, 2016 were approved by the Board of Directors on November 10, 2016.

3 Changes in Accounting Policies

Impact of Adoption of IFRS 9

As disclosed in the December 31, 2015 consolidated financial statements, the Corporation has early adopted, as of January 1, 2016, all of the requirements of IFRS 9, *Financial Instruments*, as amended in July 2014 ("IFRS 9"). The Corporation elected to apply the standard retrospectively including the restatement of comparative figures.

IFRS 9 uses a single approach to determine whether a financial asset is classified and measured at amortized cost or fair value, replacing the multiple rules in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments and the contractual cash flow characteristics of the financial assets. Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward in IFRS 9 which has introduced a single expected credit loss impairment model, which is based on changes in credit quality since initial recognition. The adoption of the expected credit loss impairment model did not have a significant impact on the Financial Statements of the Corporation.

The early adoption of IFRS 9 has been applied retrospectively and did not result in a change in the carrying value of any of High Arctic's financial instruments on transition date. The main area of change is the accounting for equity securities previously classified as available for sale. The revised policy of accounting for short term investments resulted in a decrease to retained deficit on December 31, 2015 of \$4.8 million with a corresponding decrease to accumulated other comprehensive income and no impact on the earliest comparative period presented and restated (January 1, 2015). Had the Company continued to apply IAS 39 a loss of \$0.3 million would have been recognized in earnings upon the disposition of an investment in the current period.

High Arctic Energy Services Inc.

Notes to the Consolidated Financial Statements

For the three and nine months ended September 30, 2016 and 2015

(Canadian \$ Million)

The effect on the Consolidated Statement of Financial Position was as follows:

As at December 31, 2015	Accumulated other comprehensive income	Retained deficit	Total shareholders' equity
Balance as previously reported	34.5	(32.4)	201.2
Effect of adoption of IFRS 9	(4.8)	4.8	-
Restated balance	29.7	(27.6)	201.2

As at September 30, 2015	Accumulated other comprehensive income	Retained deficit	Total shareholders' equity
Balance as previously reported	29.9	(38.7)	191.9
Effect of adoption of IFRS 9	(4.1)	4.1	-
Restated balance	25.8	(34.6)	191.9

The effect on the Consolidated Statement of Earnings and Comprehensive Income was as follows:

	Three months ended September 30, 2015	Nine months ended September 30, 2015	Year ended December 31, 2015
Decrease in loss on short term investments, net of taxes	(4.1)	(4.1)	(4.8)
Increase in net earnings for the period	4.1	4.1	4.8
Effect on Comprehensive income for the period	-	-	-

The effect on earnings per share was as follows:

	Three months ended September 30, 2015	Nine months ended September 30, 2015	Year ended December 31, 2015
Balance as previously reported			
- Basic	0.11	0.33	0.49
- Diluted	0.11	0.32	0.48
Effect of adoption of IFRS 9			
- Basic	0.07	0.07	0.09
- Diluted	0.07	0.08	0.09
Restated balance			
- Basic	0.18	0.40	0.58
- Diluted	0.18	0.40	0.57

High Arctic Energy Services Inc.

Notes to the Consolidated Financial Statements

For the three and nine months ended September 30, 2016 and 2015

(Canadian \$ Million)

The effect on the Consolidated Statement of Cash Flows was as follows:

	Three months ended September 30, 2015	Nine months ended September 30, 2015	Year ended December 31, 2015
Increase in net earnings for the period	4.1	4.1	4.8
Decrease in unrealized loss on short term investments	(4.1)	(4.1)	(4.8)
Effect on net cash generated from operating activities	-	-	-

Additional disclosures

Details about the Corporation's short term investments can be found in the notes to the consolidated financial statements as at December 31, 2015. Additional and restated disclosures as at December 31, 2015, as required by IFRS 9 are as follows:

High Arctic periodically invests in the common shares and debt instruments of certain publicly traded oil and natural gas service companies. As at December 31, 2015, the investments are presented at a fair value of \$10.6 million which is \$5.9 million less than the original cost. The difference in fair value of \$5.9 million has been charged to other comprehensive income. Short term investments consist of the following:

	December 31, 2015
Investments in equity securities	10.2
Investments in debt securities	0.4
Total	10.6

Initial measurement of financial instruments

The Corporation classifies and measures financial assets and liabilities on initial recognition as described below:

- Cash and cash equivalents**
Cash and cash equivalents include cash and term deposits and are classified as financial assets at fair value through profit or loss. Cash and cash equivalents are measured at fair value and unrealized gains or losses related to changes in fair value are reported in income.
- Trade and other receivables**
Trade and other receivables are classified as assets at amortized cost and are measured using the effective interest method, less impairment allowance, if any where the financial assets are supported by the Corporation's business model to hold to collect and where the financial assets are considered to consist solely of payments of principal and interest.
- Equity investments**
The Corporation's short term investments are designated as financial assets at fair value through other comprehensive income and are initially recognized at fair value on the settlement date, net of directly attributable transaction costs. Future changes in fair value are recognized in other comprehensive income (OCI), net of tax and are not recycled into income.

There is no longer a requirement to assess impairment going forward on equity investments. Dividends from such investments continue to be recognized in profit or loss as other income when the Corporation's right to receive payments is established.

- Financial liabilities**
Financial liabilities are derecognized when the obligation specified in the contract is discharged, cancelled or expired. For financial liabilities, IFRS 9 retains most of the IAS 39 requirements and since we do not have any financial liabilities designated at fair value through profit or loss, the adoption of IFRS 9 did not impact our accounting policies for financial liabilities.

High Arctic Energy Services Inc.

Notes to the Consolidated Financial Statements

For the three and nine months ended September 30, 2016 and 2015

(Canadian \$ Million)

4 Accounts Receivable

The Corporation applies the simplified approach to providing for expected credit losses as prescribed by IFRS 9, which permits the use of lifetime expected loss provision for all trade receivables. The expected credit losses below also incorporate forward looking information.

Days outstanding:	September 30, 2016	December 31, 2015
Less than 31 days	30.8	23.8
31 to 60 days	3.3	12.6
61 to 90 days	1.7	5.1
Greater than 90 days	2.2	1.6
Loss allowance provision	(0.2)	(0.7)
Total	37.8	42.4

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

Canadian dollar	9.5	4.6
United States dollar (2016 – US\$21.6; 2015 – US\$27.3)	28.3	37.8
Total	37.8	42.4

5 Short Term Investments

High Arctic periodically invests in the common shares and debt instruments of certain publicly traded oil and natural gas service companies. As at September 30, 2016, the investments are presented at a fair value of \$10.6 million (December 31, 2015 - \$10.6 million) which is \$4.5 million (December 31, 2015 - \$5.9 million) less than the original cost. The difference in fair value of \$4.5 million has been included in other comprehensive income. For the nine months ended September 30, 2016, increases in fair value of \$1.0 million (three months ended September 30, 2016 – decreases of \$1.6 million) have been included in other comprehensive income.

During the nine months ended September 30, 2016, the Corporation disposed of investments in equity securities, which had an original cost of \$1.4 million, for proceeds of \$1.1 million. The resulting loss of \$0.3 million has been included in other comprehensive income.

Short term investments consist of the following:

	September 30, 2016	December 31, 2015
Investments in equity securities	10.2	10.2
Investments in debt securities	0.4	0.4
Total	10.6	10.6

High Arctic Energy Services Inc.

Notes to the Consolidated Financial Statements

For the three and nine months ended September 30, 2016 and 2015

(Canadian \$ Million)

6 Business Acquisition

On August 31, 2016, High Arctic acquired the Production Services Division of Tervita Corporation (the "PS Division") by payment of cash in the amount of \$42.8 million. The acquisition diversifies High Arctic's revenue base within the Canadian well servicing industry. The acquisition has been accounted for as a business combination using the acquisition method of accounting whereby the assets acquired and the liabilities assumed are recorded at estimated fair value on the acquisition date. Any deficiency of the fair value of the identifiable net assets below the consideration paid is recognized as goodwill, and any surplus of the fair value of the identifiable net assets relative to the consideration paid is recorded as a gain on acquisition. Transaction costs associated with the acquisition are expensed when incurred.

The Corporation recognized a gain on the acquisition of the PS Division as the total fair value of the net assets acquired, based on an independent appraisal, exceeds the fair value of the consideration paid.

The following table summarizes the allocation of the purchase price:

Cash and cash equivalents	42.8
Consideration	42.8
Property and equipment	64.0
Unfavourable lease liability – current portion	(0.4)
Unfavourable lease liability – long-term portion	(3.4)
Deferred tax liability (see note 8)	(4.7)
Fair value of net assets acquired	55.5
Gain on acquisition	12.7

The Corporation relied on a third party appraisal for the fair value of the assets acquired, less management's estimate of the liability associated with an unfavorable lease assumed in the transaction and the deferred income taxes associated with the timing differences between the tax and accounting values for the net assets acquired. Changes to any of these assumptions or estimates could impact the amounts assigned to assets acquired, liabilities assumed, and the gain on the acquisition.

Subsequent to the acquisition date, the PS Division's operating results have been included in the Corporation's revenues, expenses and capital spending. From the date of acquisition on August 31, 2016, the PS Division contributed an estimated \$5.0 million of revenue and \$0.5 million of net earnings before tax for the Corporation. If the business combination had been completed on January 1, 2016, the estimated revenue and net earnings before tax for the nine month period ended September 30, 2016 would have been \$39.1 million and \$1.4 million, respectively for the PS Division. The estimated pro forma revenue and net earnings before tax have been adjusted as if the acquisition occurred on January 1, 2016, primarily reflecting the depreciation under the Corporation's accounting policies. This pro forma information is not necessarily indicative of the results that would have been achieved had the business combination been completed on January 1, 2016, or the results that may occur in the future.

During the three and nine month periods ended September 30, 2016, High Arctic incurred \$1.4 million of various costs related to the acquisition of the PS Division which are recognized as an expense in the statement of earnings and comprehensive income. These costs relate mainly to advisory and legal fees.

Amortization of the property and equipment acquired is recognized in the statement of earnings and is at the same rates as is calculated for High Arctic's existing assets with the addition of service rigs which will be amortized on a straight-line basis with a 10% salvage value over 10 to 20 years, depending on the component of the service rigs.

High Arctic Energy Services Inc.

Notes to the Consolidated Financial Statements

For the three and nine months ended September 30, 2016 and 2015

(Canadian \$ Million)

7 Property and Equipment

The following tables provide a continuity of the property and equipment costs, net of impairment and accumulated amortization, and provide details of the effects of foreign currency translation for the year ended December 31, 2015 and the nine months ended September 30, 2016.

Cost:	Vehicles	Oilfield equipment	Computer hardware and office equipment	Land & Building	Work-in-progress	Total
Balance January 1, 2015	13.2	152.3	3.2	5.2	53.1	227.0
Additions	-	3.4	-	0.1	36.5	40.0
Disposals	(0.8)	(2.9)	(0.8)	-	-	(4.5)
Transfers	0.3	88.5	0.3	-	(89.1)	-
Effect of foreign exchange	-	26.9	-	-	-	26.9
Balance December 31, 2015	12.7	268.2	2.7	5.3	0.5	289.4
Acquisition (see note 6)	1.0	55.0	-	8.0	-	64.0
Additions	-	-	-	-	8.1	8.1
Capital lease obligation (see note 10)	-	-	-	-	2.5	2.5
Disposals	(0.4)	(2.9)	-	-	-	(3.3)
Transfers	0.2	9.8	0.2	-	(10.2)	-
Effect of foreign exchange	-	(9.6)	-	-	(0.1)	(9.7)
Balance September 30, 2016	13.5	320.5	2.9	13.3	0.8	351.0

Accumulated amortization and impairments:	Vehicles	Oilfield Equipment	Computer hardware and office equipment	Land & Building	Work-in-progress	Total
Balance, January 1, 2015	9.3	95.2	2.5	0.1	-	107.1
Amortization for the year	0.7	15.5	0.4	0.1	-	16.7
Disposals	(0.7)	(2.4)	(0.7)	-	-	(3.8)
Effect of foreign exchange	-	7.7	-	-	-	7.7
Balance, December 31, 2015	9.3	116.0	2.2	0.2	-	127.7
Amortization for the period	0.4	16.6	0.1	0.1	-	17.2
Disposals	(0.4)	(2.3)	-	-	-	(2.7)
Effect of foreign exchange	-	(2.9)	-	-	-	(2.9)
Balance September 30, 2016	9.3	127.4	2.3	0.3	-	139.3

Carrying amounts of property and equipment:

At December 31, 2015	3.4	152.2	0.5	5.1	0.5	161.7
At September 30, 2016	4.2	193.1	0.6	13.0	0.8	211.7

High Arctic Energy Services Inc.

Notes to the Consolidated Financial Statements

For the three and nine months ended September 30, 2016 and 2015

(Canadian \$ Million)

8 Deferred Income Taxes

The following table provides a reconciliation of the Corporation's deferred tax asset for the nine months ended September 30, 2016:

	Deferred tax asset
Balance, January 1, 2016	5.0
Recognition of previously unrecognized deferred tax asset related to loss carryforwards in Canada	4.7
Deferred tax liability related to temporary differences recognized as part of the acquisition (see note 6)	(4.7)
Balance, September 30, 2016	5.0

The following table provides a reconciliation of the Corporation's deferred tax liability for the nine months ended September 30, 2016:

	Deferred tax liability
Balance, January 1, 2016	2.1
Recognition of additional deferred tax liabilities related to the Company's PNG business	5.4
Balance, September 30, 2016	7.5

9 Accounts Payable and Accrued Liabilities

	September 30, 2016	December 31, 2015
Accounts payable	10.7	13.5
Accrued liabilities	11.8	7.0
Accrued payroll	2.1	3.1
Unfavourable lease liability (see note 6)	0.4	-
Total	25.0	23.6

10 Capital Lease Obligation

During the first nine months of 2016, the Corporation received certain equipment under a finance lease. The fair value of the equipment of \$2.5 million has been included with property and equipment with a corresponding lease obligation liability that is reduced by the principal portion of the monthly payments related to the principal of the lease. As at September 30, 2016, future minimum lease payments totaled \$2.0 million (including the expected exercise of this option) and are all due within one year. These future lease payments include an amount of \$0.1 million representing interest, and as at September 30, 2016 the remaining obligation related to the lease was \$1.9 million.

High Arctic Energy Services Inc.

Notes to the Consolidated Financial Statements

For the three and nine months ended September 30, 2016 and 2015

(Canadian \$ Million)

11 Deferred Revenue

Pursuant to contracts related to the provision of drilling rigs, the Corporation has received payments that will be recognized as revenue in future periods over the life of the related drilling contracts. As at September 30, 2016, \$1.8 million (December 31, 2015 - \$2.2 million) will be recognized as revenue in the next twelve months and has been disclosed as a current liability with the remaining \$1.2 million (December 31, 2015 - \$2.6 million) disclosed as a non-current liability.

12 Dividend Payable

Dividends are recorded as a liability on the date of declaration by the Corporation's Board of Directors. During the nine months ended September 30, 2016, the Corporation declared dividends of \$7.9 million (2015 - \$8.2 million), of which \$0.9 million was payable as of September 30, 2016 (December 31, 2015 - \$0.9 million). Since September 30, 2016, a monthly dividend of \$0.0165 per share has been declared for a total of \$0.9 million.

13 Long-Term Debt

As at September 30, 2016, the main components of the Corporation's available credit facilities are a \$40.0 million revolving loan and a \$5.0 million revolving operating loan. The maturity date of amounts outstanding under both main components of the credit facilities is August 31, 2017 and no principal payments are required prior to that date. Security for outstanding long-term debt includes all of the assets of the Canadian parent and guarantees given by its material foreign subsidiaries. As of September 30, 2016 the Corporation had drawn \$30.6 million on its debt facility.

The available amount under the \$40.0 million revolving loan facility is limited to 65% of the net book value of the Canadian fixed assets plus 65% of the net book value of fixed assets in High Arctic Energy Services (Singapore) Pte. Ltd. limited to export guarantees provided by Export Development Canada ("EDC"), less priority claims. The amount available to draw under the \$5.0 million revolving operating loan is limited to 75% of acceptable accounts receivable (85% for investment grade receivables), plus 90% of insured receivables, less priority payables as defined in the loan agreement. As at September 30, 2016, the guarantee had been executed with EDC and the total remaining credit available to draw under the facility was \$14.4 million (December 31, 2015 - \$21.5 million).

The credit facility agreement permits borrowing in Canadian or US dollars and contains an interest rate grid whereby the interest rate applicable to borrowings will vary according to the currency of the borrowings and a prescribed leverage ratio. An annual standby fee of 0.35% is charged on any undrawn portion of the facilities. The effective interest rate on the long-term debt was 3.5% on the balance outstanding in 2016 (2015 - 4.0%).

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

High Arctic Energy Services Inc.

Notes to the Consolidated Financial Statements

For the three and nine months ended September 30, 2016 and 2015

(Canadian \$ Million)

14 Share Capital and Other Components of Equity

(a) Share Capital

Authorized – an unlimited number of common shares and an unlimited number of preferred shares

Issued:	Nine months ended September 30, 2016		Year ended December 31, 2015	
	Shares	\$	Shares	\$
Balance, beginning of period	54,330,169	189.5	55,645,652	194.1
Issuance of shares upon exercise of options (note 15)	149,400	0.6	208,800	0.7
Normal course issuer bid	(1,911,400)	(6.7)	(1,569,983)	(5.5)
Vested restricted shares (note 15)	45,600	0.1	45,700	0.2
Common shares outstanding	52,613,769	183.5	54,330,169	189.5
Restricted shares outstanding (note 15)	13,200	0.1	58,800	0.2
Total common and restricted shares outstanding	52,626,969	183.6	54,388,969	189.7

Issuance of Shares

For the nine months ended September 30, 2016, a total of 149,400 (year ended December 31, 2015 - 208,800) stock options were exercised for shares of the Corporation (see note 15).

Normal Course Issuer Bid

In January, 2015, the Corporation received approval from the Toronto Stock Exchange to acquire for cancellation up to 5 percent of the Corporation's issued and outstanding common shares under a Normal Course Issuer Bid ("the Bid"). The Bid commenced on January 12, 2015 and was valid for one year. As of December 31, 2015, 1,569,983 common shares had been purchased and cancelled pursuant to the Bid at a total cost of \$5.7 million. An additional 65,600 common shares were purchased in January, 2016 prior to the conclusion of the one year period.

In January, 2016, the Corporation received approval from the Toronto Stock Exchange to renew the Bid for a one year period. As of September 30, 2016, 1,845,800 common shares had been purchased and cancelled at a total cost of \$6.5 million pursuant to the renewal.

(b) Per Share Amounts

The following table summarizes the weighted average number of common shares used in calculating basic and diluted earnings per share. All potentially dilutive instruments such as options and the restricted shares issued under the Executive and Director Share Incentive Plan are considered.

	Nine months ended September 30, 2016		Nine months ended September 30, 2015	
	Number of Shares	Earnings per Share	Number of Shares	Earnings per Share
Weighted average number of common shares used in basic earnings per share	53,048,037	\$0.71	55,168,808	\$0.40
Dilution effect of options	357,578	-	567,821	-
Weighted average number of common shares used in diluted earnings per share	53,405,615	\$0.70	55,736,629	\$0.40

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	Three months ended September 30, 2016		Three months ended September 30, 2015	
	Number of Shares	Earnings per Share	Number of Shares	Earnings per Share
Weighted average number of common shares used in basic earnings per share	53,143,966	\$0.38	54,965,237	\$0.18
Dilution effect of options	275,373	-	504,203	-
Weighted average number of common shares used in diluted earnings per share	53,419,339	\$0.37	55,469,440	\$0.18

For the nine months ended September 30, 2016, 2,490,022 stock options (2015 – 2,642,579) were excluded from the calculation of diluted earnings per share as the effect would have been anti-dilutive.

15 Share-based Compensation

Stock Option Plan

The Corporation has a Stock Option Plan under which options to purchase common shares may be granted to directors, management and certain employees. A total of 5,262,696 options (being 10% of all outstanding shares) are available for grants. At September 30, 2016, a total of 2,847,600 options are outstanding and expire at various dates up to 2021, at amounts that range from \$1.28 to \$5.32 per share. These options are exercisable over a term of 5 years and are generally subject to a three year vesting period with 40% exercisable by the holder after the first anniversary date, 70% after the second anniversary date and 100% after the third anniversary date. The options have an average remaining contractual life of 2.8 years and 1,987,600 options are currently vested and eligible to be exercised.

	Number of Options	Weighted Average Exercise Price \$/Share
Total Outstanding January 1, 2015	3,247,100	3.65
Granted	614,000	3.67
Exercised	(208,800)	2.08
Forfeited	(112,400)	4.75
Expired	(7,700)	3.90
Total Outstanding December 31, 2015	3,532,200	3.71
Granted	185,000	3.46
Exercised	(399,400)	2.11
Forfeited	(470,200)	4.39
Total Outstanding September 30, 2016	2,847,600	3.81

The options exercised in 2016 had a weighted average market price of \$3.72 per share on the date of exercise.

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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 (\$)
\$1.28 to \$2.11	255,000	0.3	1.34	255,000	1.34
\$2.12 to \$2.83	334,000	2.1	2.80	256,000	2.79
\$3.24 to \$3.87	1,431,000	3.4	3.64	829,000	3.58
\$4.92 to \$5.32	827,600	2.8	5.26	653,900	5.26
Total Outstanding					
September 30, 2016	2,847,600	2.8	3.81	1,993,900	3.74

Share-based compensation is a non-cash item and is measured in accordance with a prescribed formula. Share-based compensation expense recognized by the Corporation for the Stock Option Plan for the nine months ended September 30, 2016 was \$0.4 million (2015 - \$1.1 million). The fair values of stock options granted have been estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

Period of Grant	Nine months ended September 30, 2016	Nine months ended September 30, 2015
Average fair value per option granted	0.62	0.71
Average expected life (years)	3.0	3.0
Expected volatility (%)	37	41
Expected forfeiture rate (%)	0	0
Average risk-free interest rate (%)	0.50	0.46
Expected distribution yield (%)	5.7	5.2

Share Incentive Plan

During the nine months ended September 30, 2016, there were no changes in the shares issued under the EDSIP. For the nine months ended September 30, 2016, the Corporation incurred share based compensation expense of \$0.1 million (2015- \$0.2 million) related to the EDSIP and an amount of up to \$0.1 million (before recognizing a reduction for any future forfeitures of common shares) remains to be amortized in future periods in respect of the common shares issued to date under the Plan.

Restricted Shares Units

During the three months ended September 30, 2016, 100,000 Restricted Share Units ("RSUs") were granted and 26,400 RSUs were forfeited and cancelled. For the nine months ended September 30, 2016, the Corporation incurred \$0.4 million of share based compensation expense (2015 -\$0.1 million) related to the 153,600 RSUs outstanding and an amount of up to \$0.1 million (before recognizing a reduction for any future forfeitures) remains to be amortized in future periods in respect of the RSUs.

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16 Expenses

	Three months ended September 30		Nine months ended September 30	
	2016	2015	2016	2015
Oilfield services expenses by nature:				
Personnel costs and personnel related costs	11.5	14.4	33.9	40.2
Drilling rig and other rental costs	8.1	11.6	25.3	33.6
Material and supplies cost	4.3	8.1	15.5	18.2
Equipment operating and maintenance costs	3.9	1.9	6.9	5.4
Other	0.3	0.4	1.1	0.8
Total	28.1	36.4	82.7	98.2
General and administrative expenses by nature:				
Personnel costs and personnel related costs	2.9	2.3	7.5	7.1
Facility costs	0.3	0.3	0.9	1.1
Professional, legal and consulting fees	0.2	0.2	0.8	0.7
Leases	0.3	0.3	0.9	0.8
Other	0.1	0.3	0.4	0.8
Total	3.8	3.4	10.5	10.5

17 Supplemental Cash Flow Information

Changes in non-cash working capital is comprised of:

	Three months ended September 30		Nine months ended September 30	
	2016	2015	2016	2015
Accounts receivable	(18.2)	(10.7)	3.1	(6.1)
Inventory and prepaid expenses	(0.4)	(1.9)	(1.8)	(2.4)
Accounts payable and accrued liabilities	7.7	4.1	1.4	8.0
Deferred revenues	(0.5)	(0.4)	(1.6)	1.7
Income taxes payable	0.9	1.4	3.0	2.5
Total changes in non-cash working capital	(10.5)	(7.5)	4.1	3.7
Related to:				
Operating activities	(10.5)	(6.1)	4.1	6.8
Investing activities	-	(1.4)	-	(3.1)
	(10.5)	(7.5)	4.1	3.7

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18 Contingencies and Commitments

Inventory

The Corporation has been supplied an inventory of spare parts with a value of US \$5.5 million by a customer in Papua New Guinea. The inventory is owned by the customer and has not been recorded on the books of High Arctic. At the end of the contract, the Corporation must return an equivalent amount of inventory to the customer. The Corporation believes it currently has sufficient inventory on hand to meet that obligation and accordingly no material provision has been made for any potential shortfall.

Other

The Corporation is party to legal actions arising in the normal course of business. The Corporation believes that an ultimate liability arising from these matters is not probable to have a material effect on the Financial Statements and no amounts have been recorded for any potential liability.

Operating Lease Commitments

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

The minimum lease payments for the next five years as at September 30, 2016 are:

	1 Year	2-3 Years	4-5 Years	Beyond 5 Years	Total
Facility lease commitments	2.0	2.3	1.7	9.7	15.7
Total lease commitments	2.0	2.3	1.7	9.7	15.7

19 Capital Disclosures

The Corporation's capital structure is comprised of shareholders' equity, bank indebtedness and long-term debt less cash and cash equivalents.

	September 30, 2016	December 31, 2015
Shareholders' equity	218.1	201.2
Current portion of long-term debt	30.6	-
Long-term debt	-	4.0
Cash and cash equivalents	(24.8)	(15.5)
Total Capitalization	223.9	189.7

The Corporation's goal is to have a capital structure that will provide the capital to meet the needs of its business and instil confidence with investors, creditors and capital markets.

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

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20 Financial Instruments and Risk Management

Fair Value of Financial Assets and Liabilities

Cash and cash equivalents include cash and term deposits and are classified as financial assets at fair value through profit or loss. Cash and cash equivalents are measured at fair value and unrealized gains or losses related to changes in fair value are reported in income. Accounts receivable, prepaid expenses and other receivables are classified as assets at amortized cost using the effective interest method, less impairment allowance, if any. Any gains or losses on the realization of loans and receivables are included in earnings. The fair value of accounts and other receivables and the demand portion of any amounts due from related parties approximate their carrying values due to the short-term nature of these instruments.

The Corporation's short term investments are designated as financial assets at fair value through other comprehensive income and are initially recognized at fair value on the settlement date, net of directly attributable transaction costs. Future changes in fair value are recognized in other comprehensive income (OCI), net of tax and are not recycled into income. Financial assets at fair value comprise listed Canadian public company investments. These assets are carried at fair value on the Consolidated Statements of Financial Position. Fair value is determined by quoted prices in active markets for identical assets (Level 1).

Accounts payable and accrued liabilities and the long-term debt are designated as other liabilities and are recorded at amortized cost.

Financial and Other Risks

The Corporation is exposed to financial risks arising from its financial assets and liabilities. The financial risks include market risk relating to interest rate risk, foreign currency risk, commodity price risk, risks of foreign operations, income tax 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.

Other Price Risk

Other price risk is the risk that the fair value or future cash flows of financial instruments will fluctuate as a result of changes in market prices (other than those arising from interest rate risk or foreign currency risk) whether those changes are caused by factors specific to the individual financial instrument, its issuer or factors affecting all similar financial instruments in the market or a market segment. Exposure to other price risk is primarily in short term investments where changes in quoted prices on investments in equity securities impact the underlying value of investments.

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 long-term debt is a floating rate credit facility and fluctuates in response to changes in the prime interest rates. For the nine months ended September 30, 2016 a one percent change in interest rates on the loan facility would not have been material.

Foreign Currency Risk

Foreign currency risk is the risk that a variation in the exchange rate between Canadian and foreign currencies will affect the Corporation's results. The majority of the Corporation's international revenue and expenses are transacted in U.S. dollars and the Corporation does not actively engage in foreign currency hedging. For the nine months ended September 30, 2016, a \$0.01 change in the value of the Canadian dollar relative to the U.S. dollar would not have been material.

Credit Risk and Customers

Credit risk is the risk of a financial loss occurring as a result of a default by a counter party on its obligation to the Corporation. The Corporation's financial instruments that are exposed to credit risk consist primarily of accounts receivable and cash balances held in banks. The Corporation mitigates credit risk by regularly monitoring its accounts receivable position and depositing cash in properly capitalized banks. The Corporation also institutes credit reviews prior to commencement of contractual arrangements.

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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 a wide range of customers comprised of small independent, intermediate and large multinational oil and natural gas producers. Notwithstanding its large customer base, the Corporation provided services to four large multinational/regional customers (2015 – three) which individually accounted for greater than 10% of its consolidated revenues during the nine months ended September 30, 2016. Sales to these four customers were approximately \$48.5 million, \$19.6 million, \$22.4 million and \$31.9 million respectively for the nine months ended September 30, 2016 (2015 - \$49.8 million, \$72.5 million, nil and \$1.4 million). As at September 30, 2016, these four customers represented 15%, 18%, 8% and 23%, respectively, of outstanding accounts receivable (December 31, 2015 – three customers represented a total of 80%). Management has assessed the four customers as creditworthy and the Corporation has had no history of collection issues with these customers.

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, the authorization of contractual agreements and the capacity available under the loan facility. The Corporation seeks to manage its financing based on the results of these processes. The following are the contractual maturities of financial liabilities in their future fair value amounts:

September 30, 2016	Beyond 5				Total
	1 Year	2-3 Years	4-5 Years	Years	
Accounts payable	25.0	-	-	-	25.0
Lease obligation payable	1.9	-	-	-	1.9
Dividends payable	0.9	-	-	-	0.9
Long-term debt	31.6	-	-	-	31.6
Total	59.4	-	-	-	59.4

December 31, 2015	Beyond 5				Total
	1 Year	2-3 Years	4-5 Years	Years	
Accounts payable	23.6	-	-	-	23.6
Dividends payable	0.9	-	-	-	0.9
Long-term debt ⁽¹⁾	0.2	4.1	-	-	4.3
Total	24.7	4.1	-	-	28.8

⁽¹⁾ Long-term debt includes future expected interest payments.

21 Related Party Transactions

The Corporation's related parties include its wholly-owned subsidiaries and the directors and officers of the Corporation. Balances and transactions between the Corporation and its subsidiaries are eliminated on consolidation and, therefore, are not disclosed. The Corporation enters into transactions with related parties from time to time, which are in the normal course of business and measured at the exchange amount, which is considered similar to those negotiable with third parties. During the nine months ended September 30, 2016, \$41,000 was paid to a company, owned in part by three directors of the Corporation, for services provided to the Corporation.

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22 Operating Segment

The Corporation determines its operating segment based on internal information reviewed by the Board of Directors to allocate resources and assess performance. The Corporation operates in two geographic areas within one operating segment which provides oilfield services to customers in Canada and Papua New Guinea. The amounts related to each geographic area are as follows:

	Three months ended		Nine months ended	
	September 30		September 30	
	2016	2015	2016	2015
Revenue				
Papua New Guinea	37.3	50.2	124.1	127.7
Canada	10.2	8.3	21.6	24.2
Total	47.5	58.5	145.7	151.9

Revenues are attributed to geographical areas based on the location in which the services are rendered.

	September 30, 2016	December 31, 2015
Current assets		
Papua New Guinea	61.3	54.9
Canada	22.4	22.5
	83.7	77.4
Non-current assets		
Papua New Guinea	113.0	127.7
Canada	103.7	39.0
	216.7	166.7
Total assets	300.4	244.1
Liabilities		
Papua New Guinea	38.2	34.9
Canada	44.1	8.0
Total liabilities	82.3	42.9