

# **HIGH ARCTIC ENERGY SERVICES INC.**



## **CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (UNAUDITED)**

**FOR THE THREE AND NINE MONTHS ENDED  
SEPTEMBER 30, 2013**

# High Arctic Energy Services Inc.

## Consolidated Statements of Financial Position

As at September 30, 2013 and December 31, 2012

Unaudited – Canadian \$ Millions

	Notes	September 30, 2013	December 31, 2012
<b>Assets</b>			
<b>Current assets</b>			
Cash and cash equivalents		28.7	27.4
Accounts receivable		18.6	19.0
Inventories		3.5	3.6
Prepaid expenses		0.9	0.7
Loans due from related parties	11	0.3	-
Income tax receivable		-	1.5
		<u>52.0</u>	<u>52.2</u>
<b>Non-current assets</b>			
Property and equipment	4	70.9	61.3
Deferred income tax asset		5.0	5.0
Loans due from related parties	11	-	0.4
		<u>-</u>	<u>0.4</u>
<b>Total assets</b>		<b><u>127.9</u></b>	<b><u>118.9</u></b>
<b>Liabilities</b>			
<b>Current liabilities</b>			
Accounts payable and accrued liabilities		14.4	14.6
Income taxes payable		1.3	0.5
Dividend payable	7	0.6	0.5
		<u>16.3</u>	<u>15.6</u>
<b>Non-current liabilities</b>			
Long-term debt	6	6.7	13.7
Deferred income tax liability		0.9	1.0
		<u>7.6</u>	<u>14.7</u>
<b>Total liabilities</b>		<b><u>23.9</u></b>	<b><u>30.3</u></b>
<b>Shareholders' equity</b>		<b><u>104.0</u></b>	<b><u>88.6</u></b>
<b>Total liabilities and shareholders' equity</b>		<b><u>127.9</u></b>	<b><u>118.9</u></b>
Contingencies and commitments	12,15		

See accompanying notes to the condensed consolidated interim financial statements.

# High Arctic Energy Services Inc.

## Consolidated Statements of Earnings and Comprehensive Income

For the three and nine months ended September 30, 2013 and 2012

Unaudited - Canadian \$ Millions, except per share amounts

	Notes	Three Months Ended September 30		Nine Months Ended September 30	
		2013	2012	2013	2012
<b>Revenue</b>	17	36.3	35.8	114.0	107.6
<b>Expenses</b>					
Oilfield services	9	24.2	23.6	77.7	70.8
General and administration	9	2.3	2.1	7.3	7.2
Amortization	4	3.0	2.4	8.4	7.0
Share-based compensation	8	0.1	0.5	0.4	1.3
Loss on sale of property and equipment		0.3	-	0.3	-
Excess of insurance proceeds over costs	5	(2.7)	-	(2.7)	-
Foreign exchange gain		(0.3)	(0.2)	(0.1)	(0.1)
		26.9	28.4	91.3	86.2
<b>Operating earnings for the period</b>		<b>9.4</b>	<b>7.4</b>	<b>22.7</b>	<b>21.4</b>
Interest and finance expense		0.2	0.2	0.6	0.8
<b>Net earnings before income taxes</b>		<b>9.2</b>	<b>7.2</b>	<b>22.1</b>	<b>20.6</b>
Current income tax expense		1.7	0.7	4.0	2.7
Deferred income tax (recovery) expense		(0.2)	-	(0.1)	(5.0)
<b>Net earnings for the period</b>		<b>7.7</b>	<b>6.5</b>	<b>18.2</b>	<b>22.9</b>
<b>Earnings per share:</b>					
	7				
Basic		0.16	0.14	0.38	0.49
Diluted		0.16	0.13	0.37	0.47
		<b>Three Months Ended September 30</b>		<b>Nine Months Ended September 30</b>	
		<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
<b>Net earnings for the period</b>		<b>7.7</b>	<b>6.5</b>	<b>18.2</b>	<b>22.9</b>
<b>Other comprehensive income, net of tax: Items that may be reclassified subsequently to net income:</b>					
Foreign currency translation gains (losses) for foreign operations		(1.6)	(1.9)	2.1	(1.7)
<b>Comprehensive income for the period</b>		<b>6.1</b>	<b>4.6</b>	<b>20.3</b>	<b>21.2</b>

See accompanying notes to the condensed consolidated interim financial statements.

# High Arctic Energy Services Inc.

## Consolidated Statements of Changes in Equity

For the three and nine months ended September 30, 2013 and 2012

Unaudited - Canadian \$ Millions, except per share amounts

		Accumulated other				
	Notes	Share capital	Contributed surplus	comprehensive income (loss)	Retained deficit	Total equity
<b>Balance, December 31, 2011</b>		<b>167.9</b>	<b>6.6</b>	<b>(1.3)</b>	<b>(109.6)</b>	<b>63.6</b>
Net earnings for the period		-	-	-	22.9	22.9
Dividends	7	-	-	-	(2.5)	(2.5)
Other comprehensive loss		-	-	(1.7)	-	(1.7)
Normal course issuer bid	7	(0.6)	0.3	-	-	(0.3)
Share-based payment transactions	8	1.0	0.4	-	-	1.4
<b>Balance, September 30, 2012</b>		<b>168.3</b>	<b>7.3</b>	<b>(3.0)</b>	<b>(89.2)</b>	<b>83.4</b>
Net earnings for the period		-	-	-	5.9	5.9
Dividends	7	-	-	-	(1.5)	(1.5)
Other comprehensive income (loss)		-	-	0.6	-	0.6
Normal course issuer bid	7	(0.4)	0.2	-	-	(0.2)
Share-based payment transactions	8	0.6	(0.2)	-	-	0.4
<b>Balance, December 31, 2012</b>		<b>168.5</b>	<b>7.3</b>	<b>(2.4)</b>	<b>(84.8)</b>	<b>88.6</b>
Net earnings for the period		-	-	-	18.2	18.2
Dividends	7	-	-	-	(5.3)	(5.3)
Other comprehensive income		-	-	2.1	-	2.1
Normal course issuer bid	7	(0.2)	0.1	-	-	(0.1)
Share-based payment transactions	8	0.4	0.1	-	-	0.5
<b>Balance, September 30, 2013</b>		<b>168.7</b>	<b>7.5</b>	<b>(0.3)</b>	<b>(71.9)</b>	<b>104.0</b>

See accompanying notes to the condensed consolidated interim financial statements.

# High Arctic Energy Services Inc.

## Consolidated Statements of Cash Flows

For the three and nine months ended September 30, 2013 and 2012

Unaudited - Canadian \$ Millions, except per share amounts

	Notes	Three Months Ended September 30		Nine Months Ended September 30	
		2013	2012	2013	2012
<b>Operating activities</b>					
Net earnings for the period		7.7	6.5	18.2	22.9
Adjustments for:					
Amortization	4	3.0	2.4	8.4	7.0
Share-based compensation	8	0.1	0.5	0.4	1.3
Loss on sale of property and equipment		0.3	-	0.3	-
Excess of insurance proceeds over costs	5	(2.7)	-	(2.7)	-
Deferred income tax (recovery) expense		(0.2)	-	(0.1)	(5.0)
		8.2	9.4	24.5	26.2
Net changes in items of working capital	10	0.6	(2.1)	2.4	1.8
<b>Net cash generated from operating activities</b>		<b>8.8</b>	<b>7.3</b>	<b>26.9</b>	<b>28.0</b>
<b>Investing activities</b>					
Purchase of property and equipment	4	(6.9)	(10.1)	(17.7)	(17.0)
Insurance proceeds	5	2.8	-	3.2	-
Disposal of property and equipment		-	-	0.4	-
<b>Net cash used in investing activities</b>		<b>(4.1)</b>	<b>(10.1)</b>	<b>(14.1)</b>	<b>(17.0)</b>
<b>Financing activities</b>					
Dividend payments	7	(1.9)	(1.5)	(5.2)	(2.0)
Issuance of common shares	7	-	-	0.1	0.2
Purchase of common shares for cancellation	7	-	(0.2)	(0.2)	(0.3)
Loan receivable		0.1	0.2	0.1	0.4
Repayment of long-term debt	6	(4.0)	-	(7.0)	(2.5)
<b>Net cash used in financing activities</b>		<b>(5.8)</b>	<b>(1.5)</b>	<b>(12.2)</b>	<b>(4.2)</b>
<b>Net change in cash</b>		<b>(1.1)</b>	<b>(4.3)</b>	<b>0.6</b>	<b>6.8</b>
<b>Effect of exchange rate changes</b>		<b>(0.6)</b>	<b>(0.6)</b>	<b>0.7</b>	<b>(0.6)</b>
<b>Net change in cash and cash equivalents</b>		<b>(1.7)</b>	<b>(4.9)</b>	<b>1.3</b>	<b>6.2</b>
<b>Cash and cash equivalents – Beginning of period</b>		<b>30.4</b>	<b>27.6</b>	<b>27.4</b>	<b>16.5</b>
<b>Cash and cash equivalents – End of period</b>		<b>28.7</b>	<b>22.7</b>	<b>28.7</b>	<b>22.7</b>
<b>Cash paid for:</b>					
Interest		<b>0.2</b>	<b>0.2</b>	<b>0.4</b>	<b>0.5</b>
Income taxes		<b>0.7</b>	<b>-</b>	<b>1.7</b>	<b>3.4</b>

See accompanying notes to the condensed consolidated interim financial statements.

# High Arctic Energy Services Inc.

## Notes to the Condensed Consolidated Interim Financial Statements

For the three and nine months ended September 30, 2013 and 2012

Unaudited - Canadian \$ Millions

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### 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 8112 Edgar Industrial Drive, Red Deer, Alberta, Canada, T4P 3R2. High Arctic's principal focus is to provide contract drilling, completion services and other oilfield services to the oil and gas industry in Canada and Papua New Guinea.

As of September 30, 2013, 20,401,534 common shares of the Corporation were owned by FBC Holdings S.A.R.L. representing 41% of the outstanding common shares and restricted shares.

### 2 Basis of Preparation

These condensed consolidated interim 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"). The condensed consolidated interim financial statements have been prepared following the same accounting policies and methods of computation as the consolidated financial statements for the year ended December 31, 2012; except for the new standards, interpretations and amendments mandatorily effective for the first time from January 1, 2013, as described in Note 3 and income taxes, which in interim periods are accrued based on an estimate of the annualized effective tax rate applied to year to date taxable earnings and the changes in accounting policies as described below. The disclosures provided below do not include all of the information required for full annual financial statements and should be read in conjunction with the Corporation's annual consolidated financial statements and the notes thereto for the year ended December 31, 2012, which have been prepared in accordance with IFRS as issued by the IASB.

Certain comparative amounts for the three and nine months ended September 30, 2012 have been restated to conform to the current year's presentation.

These interim consolidated financial statements were approved by the Corporation's Board of Directors on November 12, 2013, after review by the Corporation's Audit Committee.

### 3 Changes in Accounting Policies

#### New standards and amendments effective for the first time

The Corporation has adopted the following new and revised standards, along with any consequential amendments, effective January 1, 2013. The following new standards and amendments were made in accordance with the applicable transitional provisions, but have not had a material impact on the Corporation:

- IFRS 7: *Financial Instruments: Disclosures*
- IFRS 10: *Consolidated Financial Statements*
- IFRS 11: *Joint Arrangements*
- IFRS 12: *Disclosure of Interests in Other Entities*
- IFRS 13: *Fair Value Measurement*
- IAS 27: *Separate Financial Statements*
- IAS 28: *Investments in Associates and Joint Ventures*
- IAS 19: *Employee Benefits*

Effective January 1, 2013, the Corporation adopted the amendments to IAS 1, *Presentation of Financial Statements*. These amendments require the Corporation to group items within other comprehensive income by those that will be subsequently reclassified to net earnings and those that will not. Accordingly, the Corporation has updated the presentation of other comprehensive income in the Consolidated Statements of Earnings and Comprehensive Income. These changes did not result in any adjustments to other comprehensive income or comprehensive income.

The Company assessed its consolidation conclusions on January 1, 2013 and determined that the adoption of IFRS 10 did not result in any change in the consolidation status of any of its subsidiaries and investees.

# High Arctic Energy Services Inc.

## Notes to the Condensed Consolidated Interim Financial Statements

For the three and nine months ended September 30, 2013 and 2012

Unaudited - Canadian \$ Millions

In May 2013, the IASB released an amendment to IAS 36, Impairment of Assets. This amendment requires entities to disclose the recoverable amount of an impaired cash generating unit. The amendment is effective January 1, 2014. Early adoption is permitted.

There were no new or amended standards issued during the nine months September 30, 2013 that are applicable for the Corporation for future periods, except for the amendment to IAS 36, Impairment of Assets. A description of standards and interpretations, other than those indicated above, that will be adopted by the Corporation in future periods can be found in the notes to the annual Consolidated Financial Statements for the year ended December 31, 2012.

### 4 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, 2012 and the nine months ended September 30, 2013.

<b>Cost:</b>	<b>Light vehicles</b>	<b>Heavy trucks</b>	<b>Oilfield equipment</b>	<b>Computer hardware and office equipment</b>	<b>Land</b>	<b>Work-in-progress</b>	<b>Total</b>
<b>Balance January 1, 2012</b>	<b>2.6</b>	<b>19.5</b>	<b>102.8</b>	<b>2.7</b>	<b>-</b>	<b>1.0</b>	<b>128.6</b>
Additions	0.4	0.4	-	0.3	1.2	17.6	19.9
Transfers	-	(5.7)	16.9	-	-	(11.2)	-
Disposals	(0.1)	(1.0)	-	-	-	-	(1.1)
Effect of foreign exchange	(0.2)	(0.1)	(0.8)	-	-	-	(1.1)
<b>Balance December 31, 2012</b>	<b>2.7</b>	<b>13.1</b>	<b>118.9</b>	<b>3.0</b>	<b>1.2</b>	<b>7.4</b>	<b>146.3</b>
Additions	-	0.1	-	-	-	17.6	17.7
Disposals	(0.3)	-	(5.7)	-	-	-	(6.0)
Transfers	0.2	-	17.7	-	-	(17.9)	-
Effect of foreign exchange	-	-	2.1	-	-	-	2.1
<b>Balance September 30, 2013</b>	<b>2.6</b>	<b>13.2</b>	<b>133.0</b>	<b>3.0</b>	<b>1.2</b>	<b>7.1</b>	<b>160.1</b>

<b>Accumulated amortization and impairments:</b>	<b>Light vehicles</b>	<b>Heavy trucks</b>	<b>Oilfield equipment</b>	<b>Computer hardware and office equipment</b>	<b>Land</b>	<b>Work-in-progress</b>	<b>Total</b>
<b>Balance, January 1, 2012</b>	<b>1.0</b>	<b>14.5</b>	<b>59.3</b>	<b>1.9</b>	<b>-</b>	<b>-</b>	<b>76.7</b>
Amortization for the year	0.4	0.8	8.3	0.2	-	-	9.7
Transfers	-	(5.3)	5.3	-	-	-	-
Disposals	(0.1)	(0.9)	(0.1)	-	-	-	(1.1)
Effect of foreign exchange	-	(0.1)	(0.2)	-	-	-	(0.3)
<b>Balance, December 31, 2012</b>	<b>1.3</b>	<b>9.0</b>	<b>72.6</b>	<b>2.1</b>	<b>-</b>	<b>-</b>	<b>85.0</b>
Amortization for the period	0.3	0.5	7.4	0.2	-	-	8.4
Disposals	(0.1)	-	(4.7)	-	-	-	(4.8)
Effect of foreign exchange	-	-	0.6	-	-	-	0.6
<b>Balance, September 30, 2013</b>	<b>1.5</b>	<b>9.5</b>	<b>75.9</b>	<b>2.3</b>	<b>-</b>	<b>-</b>	<b>89.2</b>

# High Arctic Energy Services Inc.

## Notes to the Condensed Consolidated Interim Financial Statements

For the three and nine months ended September 30, 2013 and 2012

Unaudited - Canadian \$ Millions

### Carrying amounts of property and equipment:

At December 31, 2012	<u>1.4</u>	<u>4.1</u>	<u>46.3</u>	<u>0.9</u>	<u>1.2</u>	<u>7.4</u>	<u>61.3</u>
At September 30, 2013	<u>1.1</u>	<u>3.7</u>	<u>57.1</u>	<u>0.7</u>	<u>1.2</u>	<u>7.1</u>	<u>70.9</u>

## 5 Excess of Insurance Proceeds over Costs

During the nine months ended September 30, 2013, the Corporation incurred damage to certain pieces of equipment which was covered by its insurance provider. The total proceeds received under the insurance policy were \$3.2 million and the net book value of the property damaged was \$0.5 million. The resulting excess of insurance proceeds over costs and net book value of \$2.7 million has been recognized in the determination of net earnings.

## 6 Long-Term Debt

The main components of the Corporation's long-term debt are an available \$30 million revolving loan and a \$5 million revolving operating loan. The maturity date of both main components is August 31, 2015 and no principal payments are required prior to that date. The long-term debt is secured by all of the assets of the Canadian parent and by guarantees given by its material foreign subsidiaries.

The long-term debt 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. The Corporation's existing borrowings are all denominated in Canadian dollars and carry an annual interest rate equal to the lender's prime interest rate plus 1.0% and an annual standby fee of 0.35% on any undrawn portion of the facilities. The effective interest rate on the long-term debt was 4% for the nine months ended September 30, 2013.

During the nine months ended September 30, 2013, the Corporation made total payments of \$7.0 million against the revolving loan.

	<b>September 30, 2013</b>	<b>December 31, 2012</b>
Principal amount of debt	6.8	13.8
Deferred financing costs (1)	(0.1)	(0.1)
Long-term debt, end of period	<u>6.7</u>	<u>13.7</u>

(1) The transaction costs in connection with the long-term debt are amortized over the remaining term of the long-term debt as financing expenses.

The Corporation remains in compliance with all financial covenants under its long-term debt agreement.



# High Arctic Energy Services Inc.

## Notes to the Condensed Consolidated Interim Financial Statements

For the three and nine months ended September 30, 2013 and 2012

Unaudited - Canadian \$ Millions

### 7 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, 2013		Year ended December 31, 2012	
	Shares	\$	Shares	\$
Balance, beginning of period	47,995,322	167.4	46,080,262	166.1
Issuance of shares	157,740	0.4	430,440	0.8
Normal course issuer bid	(105,470)	(0.2)	(285,380)	(1.0)
Vested restricted shares (note 8)	1,778,000	1.0	1,770,000	1.5
Common shares outstanding	49,825,592	168.6	47,995,322	167.4
Restricted shares outstanding (note 8)	32,000	0.1	1,810,000	1.1
Total common and restricted shares outstanding	49,857,592	168.7	49,805,322	168.5

#### Issuance of Shares

For the nine months ended September 30, 2013, a total of 157,740 stock options were exercised (year ended December 31, 2012 – 430,440) for shares of the Corporation (see Note 8).

#### Normal Course Issuer Bid

On May 13, 2013, 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 Corporation can purchase up to 2,492,716 common shares for cancellation subject to a daily purchase limit of 11,634 common shares. The Bid commenced on May 28, 2013 and will terminate on May 27, 2014. During the nine months ended September 30, 2013, 105,470 common shares were purchased and cancelled pursuant to the Bid. In 2012, 285,380 common shares were purchased under the terms of a previous Normal Course Issuer Bid.

#### Dividends

On May 17, 2012, the Corporation instituted a dividend policy and the first monthly dividend was paid on June 14, 2012. 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, 2013, the Corporation declared dividends of \$5.3 million (2012 – \$2.5 million), being \$0.107 per common share, of which \$0.6 million was payable at the end of the period (December 31, 2012 - \$0.5 million).

# High Arctic Energy Services Inc.

## Notes to the Condensed Consolidated Interim Financial Statements

For the three and nine months ended September 30, 2013 and 2012

Unaudited - Canadian \$ Millions

### (b) Per Share Amounts

The following tables summarize 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, 2013		Nine months ended September 30, 2012	
	Number of Shares	Earnings per Share	Number of Shares	Earnings per Share
Weighted average number of common shares used in basic earnings per share	48,223,829	\$0.38	46,809,151	\$0.49
<b>Adjustments for:</b>				
Dilution effect of options and restricted shares	356,622	(0.01)	2,195,436	(0.02)
Weighted average number of common shares used in diluted earnings per share	48,580,451	\$0.37	49,004,587	\$0.47
	Three months ended September 30, 2013		Three months ended September 30, 2012	
	Number of Shares	Earnings per Share	Number of Shares	Earnings per Share
Weighted average number of common shares used in basic earnings per share	48,594,425	\$0.16	46,775,208	\$0.14
<b>Adjustments for:</b>				
Dilution effect of options and restricted shares	408,232	-	2,304,413	(0.01)
Weighted average number of common shares used in diluted earnings per share	49,002,657	\$0.16	49,079,621	\$0.13

## 8 Share-based Compensation

### Stock Option Plan

The Corporation has a Stock Option Plan under which options to purchase common shares may be granted to directors, management and key employees. A total of 4,985,759 options (being 10% of all outstanding shares) are available for grants. At September 30, 2013, a total of 1,420,660 options are outstanding and expire at various dates up to 2018, at amounts that range from \$0.75 to \$2.43 per share. These options are exercisable over a term of 5 years and are generally subject to a three year vesting period with 40% exercisable by the holder after the first anniversary date, 70% after the second anniversary date and 100% after the third anniversary date. The options have an average remaining contractual life of 3.37 years and 460,910 options are currently vested and eligible to be exercised.

# High Arctic Energy Services Inc.

## Notes to the Condensed Consolidated Interim Financial Statements

For the three and nine months ended September 30, 2013 and 2012

Unaudited - Canadian \$ Millions

	Number of Options	Weighted Average Exercise Price (\$)
<b>Total Outstanding January 1, 2012</b>	<b>1,244,910</b>	<b>1.24</b>
Granted	748,000	1.54
Exercised	(430,440)	0.98
Forfeited	(343,300)	1.58
Expired	(14,370)	12.04
<b>Total Outstanding December 31, 2012</b>	<b>1,204,800</b>	<b>1.29</b>
Granted	390,000	2.20
Exercised	(157,740)	1.02
Forfeited	(15,700)	1.18
Expired	(700)	0.96
<b>Total Outstanding September 30, 2013</b>	<b>1,420,660</b>	<b>1.58</b>

Exercise Price Range	Options Outstanding			Exercisable Options	
	Number of Options	Remaining Contractual Life (Years)	Weighted Average Exercise Price (\$)	Number of Options	Weighted Average Exercise Price (\$)
\$0.75 to \$1.02	340,660	2.11	0.99	220,510	0.98
\$1.03 to \$1.35	350,000	3.26	1.27	128,000	1.27
\$1.36 to \$1.92	320,000	3.66	1.73	112,400	1.74
\$1.93 to \$2.43	410,000	4.30	2.20	-	-
<b>Total Outstanding September 30, 2013</b>	<b>1,420,660</b>	<b>3.37</b>	<b>1.58</b>	<b>460,910</b>	<b>1.24</b>

Share-based compensation is a non-cash item and is measured in accordance with a prescribed formula. Share-based compensation expense recognized by the Corporation for the Stock Option Plan for the three and nine months ended September 30, 2013 was nil and \$0.1 million, respectively (2012 - \$0.2 million and \$0.5 million). The fair values of stock options granted in 2013 have been estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

	2013
Average fair value per option granted	\$1.13
Average expected life (years)	3.5
Expected volatility (%)	70 – 109
Expected forfeiture rate (%)	28
Average risk-free interest rate (%)	1.24
Expected distribution yield (%)	8.0

# High Arctic Energy Services Inc.

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### Share Incentive Plan

On June 29, 2010, the shareholders approved an Executive and Director Share Incentive Plan (the "EDSIP"). The maximum number of common shares initially available for issuance by the Corporation under the EDSIP was 7,578,444 common shares of which 218,444 common shares remain available for issue at September 30, 2013. These shares are issued in trust for the benefit of designated beneficiaries and vest to each designated beneficiary over a 3 year period. The designated beneficiaries of the restricted common shares held in trust have full voting, liquidity, dividend and other related rights similar to the holders of the unrestricted issued common shares. The shares are not freely tradable prior to vesting and any shares that do not meet the vesting conditions are returned by the trustee to the Corporation for cancellation. The number of restricted shares granted is reflected under the total issued and outstanding common shares while the value of these shares will be included in the common share capital amount as they vest over the 3 year vesting period with an equivalent share based compensation amount recorded. A share-based compensation amount for the common shares issued under the EDSIP is measured as the number of common shares multiplied by the trading price of the Corporation's common shares at the time of the grant and that amount is amortized over the vesting period. Each vesting period is treated as a separate tranche for measurement of the non-cash share-based compensation expense. The share-based compensation for each tranche is expensed based on the vesting date for that tranche resulting in a proportionally greater amount being recognized in the earlier periods.

In September 2010, the Corporation issued 7,100,000 shares under the EDSIP to a trustee for the benefit of designated directors and executive management. These incentive shares have a three year vesting period with 40% vested on April 1, 2011, 30% on September 1, 2012 and 30% on September 1, 2013 and a share capital amount of \$0.825 per share has been recorded as the related share-based compensation expense was recognized. In March 2011 a further 200,000 shares were granted under the EDSIP and have a three year vesting period with 40% vesting on December 31, 2011, 30% on December 31, 2012 and 30% on December 31, 2013 and a share capital amount of \$1.05 per share will be recorded as the related share-based compensation expense is recognized. In July 2012, an additional 40,000 shares were granted under the EDSIP which have a three year vesting period with 40% vesting on June 8, 2013, 30% on June 8, 2014 and 30% on June 8, 2015 and a share capital amount of \$1.60 per share will be recorded as the related share-based compensation expense is recognized. In February, 2013, 20,000 of the shares granted in 2012 were forfeited. In April 2013, an additional 20,000 shares were granted under the EDSIP which have a three year vesting period with 40% vesting on April 1, 2014, 30% on April 1, 2015 and 30% on April 1, 2016 and a share capital amount of \$2.35 per share will be recorded as the related share-based compensation expense is recognized.

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

	Nine months ended September 30, 2013	Year ended December 31, 2012
Balance, beginning of period	1,810,000	3,540,000
Grant of common shares	20,000	40,000
Vested common shares	(1,778,000)	(1,770,000)
Forfeitures	(20,000)	-
Balance, end of period	<u>32,000</u>	<u>1,810,000</u>

For the three and nine months ended September 30, 2013, the Corporation incurred share based compensation expense of \$0.1 million and \$0.3 million, respectively (2012 - \$0.3 million and \$0.8 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. A forfeiture rate of 11.8 % has been assumed in the share based compensation expense assumptions.

# High Arctic Energy Services Inc.

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### 9 Expenses

	Three months ended		Nine months ended	
	September 30		September 30	
	2013	2012	2013	2012
<b>Oilfield services expenses by nature:</b>				
Personnel costs	10.1	13.2	34.2	36.1
Drilling rig and other rental costs	7.1	5.2	23.5	18.9
Material and supplies cost	4.6	2.5	12.5	8.8
Equipment operating and maintenance costs	2.1	2.4	6.6	6.1
Other	0.3	0.3	0.9	0.9
<b>Total</b>	<b>24.2</b>	<b>23.6</b>	<b>77.7</b>	<b>70.8</b>
<b>General and administrative expenses by nature:</b>				
Personnel costs	1.6	1.4	5.0	5.1
Facility costs	0.3	0.2	0.8	0.7
Professional, legal and consulting fees	0.1	0.2	0.5	0.6
Leases	0.1	0.2	0.4	0.5
Other	0.2	0.1	0.6	0.3
<b>Total</b>	<b>2.3</b>	<b>2.1</b>	<b>7.3</b>	<b>7.2</b>

### 10 Supplemental Cash Flow Information

Changes in non-cash working capital is comprised of:

	Three months ended		Nine months ended	
	September 30		September 30	
	2013	2012	2013	2012
Accounts receivable	(1.1)	(3.1)	0.8	-
Inventory and prepaid expenses	0.6	(0.6)	-	(0.7)
Accounts payable and accrued liabilities	0.3	0.9	(0.6)	3.3
Income taxes receivable and payable	0.8	0.7	2.2	(0.8)
<b>Total</b>	<b>0.6</b>	<b>(2.1)</b>	<b>2.4</b>	<b>1.8</b>

# High Arctic Energy Services Inc.

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### 11 Related Party Transactions

In April, 2011 High Arctic made loans to certain directors and officers of the Corporation in the total aggregate amount of \$1.1 million. The purpose of the loans was to assist the directors and officers with the payment of Canadian income taxes arising on the issuance of common shares of the Corporation under the Corporation's EDSIP (see Note 9). The principal amount of each loan bears interest at an annual rate of 2%. Each loan is fully payable on the earlier of (i) thirty days after the date that a Borrower ceases to be an employee or director of the Corporation and (ii) April 15, 2014. As at September 30, 2013, the amount outstanding related to these loans was \$0.3 million (December 31, 2012 - \$0.4 million).

### 12 Contingent Liabilities and Contingent Assets

#### Accounts Receivable

The Corporation has commenced litigation against a customer with respect to collection of a receivable for services rendered outside Canada. The Corporation believes it has made an adequate provision for the possibility of non-collectable amounts. The customer has made a number of allegations and initiated a counter claim of \$5 million concerning performance issues and the cashing of the letter of credit in the amount of \$1 million by the Corporation. The Corporation has not recorded an accrual in relation to the counter claim as management believes that the claim is without merit and not probable.

#### 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 inventory to the customer. The Corporation believes it currently has sufficient inventory on hand to meet that obligation and accordingly no provision has been made for any potential shortfall.

#### Other

The Corporation has posted a performance bond of approximately US\$3.8 million in respect of a contract with a customer in the Middle East region. The expiry date of the performance bond is March 30, 2014. The Corporation could be liable for contractual damages if the contract was breached and is at risk for a draw on all or a portion of the performance bond regardless of the merits. The term of the contract has ended and the Corporation is in the process of completing the formalities required to secure the release of the performance bond. The customer has not asserted any performance breaches to date but is demanding strict compliance with their requirements to release the performance bond. No amount has been accrued for any contractual damages or unrecovered performance bond as management believes that any payment is not probable.

### 13 Capital Disclosures

The Corporation's capital structure is comprised of shareholders' equity and the long term debt less cash and cash equivalents.

	September 30, 2013	December 31, 2012
Shareholders' equity	104.0	88.6
Total long-term debt, gross of financing costs	6.8	13.8
Cash and cash equivalents	(28.7)	(27.4)
<b>Total Capitalization</b>	<b>82.1</b>	<b>75.0</b>

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

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.

# High Arctic Energy Services Inc.

## Notes to the Condensed Consolidated Interim Financial Statements

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The Corporation's loan facilities are subject to four financial covenants, which are reported to the lender on a quarterly basis. These financial covenants are used by management to monitor capital and to assess the funds available to commit for capital expenditures. The main focus is on the Maximum Funded Debt to EBITDA and the Minimum Fixed Charge Coverage Ratios, which are measures defined under the loan agreement that have no prescribed meaning under IFRS. The Corporation remains in compliance with all financial covenants under its long-term debt agreement.

## 14 Financial Instruments and Risk Management

### **Fair Value of Financial Assets and Liabilities**

Accounts receivable, cash and cash equivalents and loans due from related parties are designated as loans and receivables and recorded at amortized cost, which approximates fair value due to the short-term nature of the instruments. Accounts payable and accrued liabilities, dividends payable 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.

#### **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 three and nine months ended September 30, 2013 a one percent change in interest rates on the loan facility would have amounted to a \$nil and \$0.1 million change, respectively, in net earnings as a result of changes in interest (2012 - \$nil and \$0.1 million).

#### **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 operations are transacted in U.S. dollars through foreign subsidiaries and the Corporation does not engage in foreign currency hedging. For the three and nine month periods ended September 30, 2013, a 1% nominal change in the value of the Canadian dollar relative to the U.S. dollar would have resulted in a \$0.4 million (2012 - \$0.3 million) change in other comprehensive income as a result of changes in foreign exchange.

#### **Commodity Price Risk**

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

#### **Risk of Foreign Operations**

The Corporation operates in international locations, including Papua New Guinea, which displays characteristics of an emerging market. Operations in these countries may be subject to a variety of risks including, but not limited to: currency fluctuations, devaluations and exchange controls; inflation; uncertain political and economic conditions resulting in unfavourable government actions such as unfavourable legislation or regulation, trade restrictions, unfavourable tax enforcement or adverse tax policies; the denial of contract rights; and social unrest, acts of terrorism or armed conflict. To attempt to mitigate these risks, the Corporation employs personnel with extensive experience in the international marketplace, supplemented with qualified local staff. Management is unable to predict the extent or duration of these risks or quantify their potential impact.

# High Arctic Energy Services Inc.

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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. The impact of any challenges cannot be reliably estimated and may be significant to the financial position or overall operations of the Corporation.

### 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.

The Corporation's accounts receivable are predominantly with customers who explore for and develop petroleum and natural gas reserves and are subject to normal industry credit risks. The Corporation assesses the credit worthiness of its customers on an ongoing basis and monitors the amount and age of balances outstanding.

The Corporation views the credit risks on these amounts as normal for the industry. The carrying amount of accounts receivable represents the maximum credit exposure on this balance. The Corporation has a wide range of customers comprised of small independent, intermediate and large multinational oil and gas producers. Notwithstanding its large customer base, the Corporation has two significant customers. Services are provided to the first significant customer in Papua New Guinea. That customer represents approximately 66% and 67% of the Corporation's revenue for the three and nine months ended September 30, 2013 (2012 – 61% and 58%) and 56% of its accounts receivable at that date (2012 – 50%). The second significant customer is a major Canadian exploration and production company which represents approximately 10% and 8% of the Corporation's revenue for the three and nine months ended September 30, 2013 (2012 – 12% and 15%) and 6% of the Corporation's accounts receivable at that date (2012 – 5%). The services provided to the different economic and geographic territories reduce the risk of concentrating a significant portion of its revenue from a single customer. Management has assessed the two customers as creditworthy and the Corporation has had no history of collection issues with either customer.

### Liquidity Risk

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

The following are the contractual maturities of financial liabilities, including interest, in their future fair value amounts:

September 30, 2013	Beyond 5				Total
	1 Year	2-3 Years	4-5 Years	Years	
Accounts payable	14.4	-	-	-	14.4
Dividends payable	0.6	-	-	-	0.6
Long-term debt	0.3	7.0	-	-	7.3
<b>Total</b>	<b>15.3</b>	<b>7.0</b>	<b>-</b>	<b>-</b>	<b>22.3</b>



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December 31, 2012	Beyond 5				Total
	1 Year	2-3 Years	4-5 Years	Years	
Accounts payable	14.6	-	-	-	14.6
Dividends payable	0.5	-	-	-	0.5
Long-term debt	0.6	14.2	-	-	14.8
<b>Total</b>	<b>15.7</b>	<b>14.2</b>	<b>-</b>	<b>-</b>	<b>29.9</b>

## 15 Commitments

### Lease Obligations

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

The minimum lease payments for the next five years as at September 30, 2013 are:

	Beyond 5				Total
	1 Year	2-3 Years	4-5 Years	Years	
Facility lease commitments	0.5	0.2	-	-	0.7
<b>Total lease commitments</b>	<b>0.5</b>	<b>0.2</b>	<b>-</b>	<b>-</b>	<b>0.7</b>

### Grande Prairie Building

In 2012, the Corporation signed a contract in the amount of \$3.0 million to construct new premises in 2013 for its Grande Prairie offices and facilities of which \$2.9 had been incurred by September 30, 2013.

## 16 Seasonality of Operations

The Corporation's Canadian oilfield services operations are seasonal in nature and are impacted by weather conditions that may hinder the Corporation's ability to access locations or move heavy equipment. The lowest activity levels are experienced during the second quarter of the year when road weight restrictions are in place and access to well sites in Canada is reduced.

# High Arctic Energy Services Inc.

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### 17 Operating Segments

The Corporation operates one business of providing oilfield services to customers. This business has the following geographic characteristics for the three and nine months ended September 30:

	Three months ended Sept. 30		Nine months ended Sept. 30	
	2013	2012	2013	2012
<b>Revenue</b>				
Papua New Guinea	27.7	22.6	85.9	71.2
Canada	8.6	13.2	28.1	36.4
<b>Total</b>	<b>36.3</b>	<b>35.8</b>	<b>114.0</b>	<b>107.6</b>
Oilfield services expense	24.2	23.6	77.7	70.8
<b>Oilfield services margin</b>	<b>12.1</b>	<b>12.2</b>	<b>36.3</b>	<b>36.8</b>
General and administration	2.3	2.1	7.3	7.2
Amortization	3.0	2.4	8.4	7.0
Share-based compensation	0.1	0.5	0.4	1.3
Loss on sale of property and equipment	0.3	-	0.3	-
Excess of insurance proceeds over costs	(2.7)	-	(2.7)	-
Foreign exchange loss	(0.3)	(0.2)	(0.1)	(0.1)
<b>Operating earnings</b>	<b>9.4</b>	<b>7.4</b>	<b>22.7</b>	<b>21.4</b>
			<b>As at September 30, 2013</b>	<b>As at December 31, 2012</b>
<b>Current assets</b>				
Canada			28.4	28.4
Papua New Guinea			23.6	23.8
			<b>52.0</b>	<b>52.2</b>
<b>Non-current assets</b>				
Canada			41.1	36.7
Papua New Guinea			34.8	30.0
			<b>75.9</b>	<b>66.7</b>
<b>Total assets</b>			<b>127.9</b>	<b>118.9</b>
<b>Current liabilities</b>				
Canada			4.9	4.4
Papua New Guinea			11.4	11.2
			<b>16.3</b>	<b>15.6</b>
<b>Non-current liabilities</b>				
Canada			6.7	13.7
Papua New Guinea			0.9	1.0
			<b>7.6</b>	<b>14.7</b>
<b>Total liabilities</b>			<b>23.9</b>	<b>30.3</b>

Included in the current assets attributed to Canada as at September 30, 2013 is \$16.6 million (December 31, 2012 - \$8.9 million) held in a bank account in Singapore.