

**High Arctic Energy Services Inc.**  
**Management's Discussion and Analysis**  
**For the Years Ended December 31, 2013 and 2012**

The following Management's Discussion and Analysis ("MD&A") of High Arctic Energy Services Inc. (the "Corporation" or "High Arctic") should be read in conjunction with the audited consolidated financial statements of High Arctic for the years ended December 31, 2013 and 2012 and the notes contained therein (the "Financial Statements"). This information is available at SEDAR ([www.sedar.com](http://www.sedar.com)). All financial measures presented in this MD&A are in Canadian dollars unless otherwise indicated. This MD&A is dated March 14, 2014.

## **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: general economic and business conditions which will, among other things, impact demand for and market prices for the Corporation's services; expectations regarding the Corporation's ability to raise capital and manage its debt obligations; commodity prices and the impact that they have on industry activity; estimated capital expenditure programs for fiscal 2014 and subsequent periods; projections of market prices and costs; factors upon which the Corporation will decide whether or not to undertake a specific course of operational action or expansion; treatment under governmental regulatory regimes and political uncertainty and civil unrest. 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 above and elsewhere in this MD&A, along with the risk factors set out in the most recent Annual Information Form filed on SEDAR at [www.sedar.com](http://www.sedar.com).

The forward-looking statements contained in this MD&A are expressly qualified in their entirety by this cautionary statement. These statements are given 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.

## **Corporate Profile**

High Arctic is a publicly traded company listed on the Toronto Stock Exchange under the symbol "HWO". The Corporation's principal focus is to provide contract drilling and specialized well completion services, equipment rentals and other services to the oil and gas industry in Canada and Papua New Guinea ("PNG").

High Arctic's largest operation is in Papua New Guinea where it provides contract drilling and specialized well completion services and supplies rig matting, camps and drilling support equipment on a rental basis. The Corporation owns and operates the only heli-portable hydraulic workover rig in PNG and is contracted to operate two heli-portable drilling rigs owned by a large oil and gas company. The Canadian operation is focused on providing snubbing services, nitrogen supplies and equipment on a rental basis to a large number of oil and natural gas exploration and production companies operating in Western Canada.

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**Highlights**

- Revenues increased by 4% to \$152.7 million for 2013 as compared to \$146.2 million for the year ended December 31, 2012.
- Adjusted EBITDA increased by 5% to \$41.5 million for 2013 (2012 - \$39.6 million) and was up 25% to \$12.5 million for the fourth quarter of 2013 (Q4 2012 - \$10.0 million).
- The Corporation renewed its contracts for Rigs 103 and 104 and the drilling support services in PNG. The extensions took effect on July 1, 2013 for a three year term to June 30, 2016.
- High Arctic entered into a contract with a major Canadian global upstream oil and gas company to provide equipment and services to their primary staging area in the southern forelands of PNG.
- High Arctic entered into a contract in December, 2013 with a new customer in PNG to drill two firm wells with spud of the first well targeted for late March, 2014.
- High Arctic increased its monthly dividend to \$0.0125 per share in March, 2013. The annual dividend paid in 2013 was \$7.2 million, which was 20% of funds provided from operations for the twelve months ended December 31, 2013.
- The Corporation constructed its new facility in Grande Prairie, Alberta and will commence operations from the facility in March, 2014.

**Selected Comparative Financial Information**

The following is a summary of selected financial information of the Corporation. All figures are derived from financial information that is prepared or presented in accordance with International Financial Reporting Standards ("IFRS"):

\$ millions (except per share amounts)	Three Months Ended December 31				Year Ended December 31			
	2013	2012	Change	%	2013	2012	Change	%
<b>Revenue</b>	38.7	38.6	0.1	-	152.7	146.2	6.5	4
<b>EBITDA<sup>(1)</sup></b>	11.6	9.8	1.8	18	42.7	38.2	4.5	12
<b>Adjusted EBITDA<sup>(1)</sup></b>	12.5	10.0	2.5	25	41.5	39.6	1.9	5
<b>Operating earnings</b>	7.7	7.1	0.6	8	30.4	28.5	1.9	7
<b>Net earnings</b>	6.4	5.9	0.5	8	24.6	28.8	(4.2)	(15)
per share (basic) <sup>(2)</sup>	0.13	0.13	-		0.51	0.62	(0.11)	
per share (diluted) <sup>(2)</sup>	0.13	0.12	0.01		0.50	0.59	(0.09)	
<b>Funds provided from operations<sup>(1)</sup></b>	10.8	8.7	2.1	24	35.3	34.9	0.4	1
per share (basic) <sup>(2)</sup>	0.22	0.19	0.03		0.73	0.75	(0.02)	
per share (diluted) <sup>(2)</sup>	0.22	0.18	0.04		0.72	0.71	0.01	
<b>Dividends</b>	1.9	1.5	0.4		7.2	4.0	3.2	
<b>Capital expenditures</b>	4.2	2.9	1.3		21.9	19.9	2.0	
<b>Working Capital</b>					41.9	36.6	5.3	14
<b>Total assets</b>					137.1	118.9	18.2	15
<b>Total non-current financial liabilities</b>					6.7	13.7	(7.0)	(51)
<b>Net cash, end of period<sup>(1)</sup></b>					26.9	13.6	13.3	98
<b>Shares outstanding - end of period<sup>(2)</sup></b>					50.0	49.8	0.2	

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

(2) The restricted shares held by a trustee under the Executive and Director Incentive Share Plan are included in the shares outstanding. The number of shares used in calculating the net earnings per share amounts is determined differently as explained in the Financial Statements.

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**Key Financial Measures**

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

**EBITDA**

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

**Adjusted EBITDA**

This measure is used by management to analyze EBITDA (as referred to above) prior to the effect of share-based compensation, gains or losses on sale of assets or investments, foreign exchange gains or losses and excess of insurance proceeds over costs, and is not intended to represent net earnings as calculated in accordance with IFRS.

The following tables provide a quantitative reconciliation of consolidated net earnings to EBITDA and Adjusted EBITDA for the three months and years ended December 31:

(\$ millions)	Three months ended December 31, 2013	Three months ended December 31, 2012	Year ended December 31, 2013	Year ended December 31, 2012
<b>Net earnings for the period</b>	6.4	5.9	24.6	28.8
<b>Add:</b>				
Interest and finance expense	0.2	0.2	0.8	1.0
Income taxes	1.1	1.0	5.0	(1.3)
Amortization	3.9	2.7	12.3	9.7
<b>EBITDA</b>	<b>11.6</b>	<b>9.8</b>	<b>42.7</b>	<b>38.2</b>
<b>Add:</b>				
Share-based compensation	0.4	0.1	0.8	1.4
Loss on sale of property and equipment	-	-	0.3	-
Excess of insurance proceeds over costs	-	-	(2.7)	-
Foreign exchange loss	0.5	0.1	0.4	-
<b>Adjusted EBITDA</b>	<b>12.5</b>	<b>10.0</b>	<b>41.5</b>	<b>39.6</b>

**Oilfield Services Operating Margin**

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

**Oilfield Services Operating Margin %**

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

**Percent of Revenue**

Certain figures are stated as a percent of revenue and are used by management to analyze individual components of expenses to evaluate the Corporation's performance from prior periods and to compare its performance to other companies.

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**Funds Provided from Operations**

Management believes that, in addition to net cash generated from operating activities as reported in the consolidated statements of cash flows, cash flow from operating activities before working capital adjustments (funds provided from operations) is a useful supplemental measure as it provides an indication of the funds generated by High Arctic's principal business activities prior to consideration of changes in items of working capital.

This measure is used by management to analyze funds provided from operating activities prior to the net effect of changes in items of non-cash working capital, and is not intended to represent net cash generated from operating activities as calculated in accordance with IFRS.

The following tables provide a quantitative reconciliation of net cash generated from operating activities to funds provided from operations for the three months and year ended December 31:

(\$ millions)	Three months ended December 31, 2013	Three months ended December 31, 2012	Year ended December 31, 2013	Year ended December 31, 2012
<b>Net cash generated from operating activities</b>	<b>9.9</b>	<b>10.0</b>	<b>36.8</b>	<b>38.0</b>
<b>Less:</b>				
Net changes in items of non-cash working capital	0.9	(1.3)	(1.5)	(3.1)
<b>Funds provided from operations</b>	<b>10.8</b>	<b>8.7</b>	<b>35.3</b>	<b>34.9</b>

**Debt-to-capitalization ratio**

Debt-to-capitalization ratio is used by management to assess its financial structure and determine how the Corporation is financing its activities. The amount is calculated as total debt divided by the sum of total debt and shareholders' equity.

**Working capital**

Working capital is used by management as another measure to analyze the operating liquidity available to the Corporation. It is defined as current assets less current liabilities.

**Net cash**

Net cash is used by management to analyze the amount by which cash and cash equivalents exceed the total amount of debt. The amount, if any, is calculated as cash and cash equivalents less total gross debt.

The following tables provide a quantitative reconciliation of cash and cash equivalents to net cash as at December 31:

(\$ millions)	December 31, 2013	December 31, 2012
<b>Cash and cash equivalents</b>	33.7	27.4
<b>Less:</b>		
Long-term debt	(6.8)	(13.8)
<b>Net cash</b>	<b>26.9</b>	<b>13.6</b>

**Market capitalization**

Market capitalization is used by management to calculate the approximate fair value of the Corporation's equity based on the trading value of the common shares on the Toronto Stock Exchange and is calculated as the total number of shares outstanding multiplied by the Corporation's share price at a point in time.

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**Overview**

Revenues for 2013 increased by 4% to \$152.7 million compared to \$146.2 million for the year ended December 31, 2012. The growth in revenue for the period was driven by increased activity in PNG with revenues of \$111.9 million for the year ended December 31, 2013 compared to \$99.0 million for the same period in 2012 as a result of having a second active drilling rig operating for a longer period than during the prior year and a larger fleet of rental equipment in 2013.

The operations in PNG generated significantly higher revenue in 2013 which offset the slower activity levels in the Canadian operation. For the year ended December 31, 2013, Canadian revenues decreased by \$6.4 million (14%) from the same period in 2012 due to reduced revenues from both the core snubbing and nitrogen businesses, which was consistent with the overall industry activity slowdown. The operating margins in Canada were adversely affected by the reduced activity levels and by competitive pricing conditions, primarily in the nitrogen operations. Fourth quarter revenue for Canada showed some improvement, increasing to \$12.7 million for 2013 (Q4 2012 - \$10.8 million).

The Corporation continues to generate strong cash flows from its operations. For the year ended December 31, 2013, High Arctic generated \$35.3 million (2012- \$34.9 million) of funds provided from operations. At December 31, 2013, the Corporation had \$26.9 million of net cash on hand (December 31, 2012 - \$13.6 million) and working capital of \$41.9 million (December 31, 2012 - \$36.6 million).

As a result of its continued strong financial results, High Arctic increased its monthly dividend to \$0.0125 per share in March, 2013, a 25% increase from the previous monthly dividends paid. The annual dividend paid in 2013 was \$7.2 million, which was 20% of funds provided from operations for the year ended December 31, 2013.

Adjusted EBITDA increased to \$41.5 million for the year ended December 31, 2013 from \$39.6 million for the same period in 2012.

**Operating Results for the three months and years ended December 31, 2013 and 2012**

Consolidated oilfield services operating margins continued to be strong at 34% of revenue for both 2013 and 2012. The percentage was unchanged year over year as a result of the higher margins associated with rental assets being offset by the lower operating margins in Canada. An overall increase of \$2.1 million was realised in the operating margin for the 2013 fiscal year over 2012.

(\$ millions)	Three Months Ended December 31				Year Ended December 31			
	2013	2012	Change	%	2013	2012	Change	%
<b>Revenue</b>								
Papua New Guinea	26.0	27.8	(1.8)	(6)	111.9	99.0	12.9	13
Canada	12.7	10.8	1.9	18	40.8	47.2	(6.4)	(14)
<b>Total</b>	<b>38.7</b>	<b>38.6</b>	<b>0.1</b>	<b>-</b>	<b>152.7</b>	<b>146.2</b>	<b>6.5</b>	<b>4</b>
<b>Oilfield services expense</b>	<b>23.7</b>	<b>26.2</b>	<b>(2.5)</b>	<b>(10)</b>	<b>101.4</b>	<b>97.0</b>	<b>4.4</b>	<b>5</b>
Percent of revenue	61%	68%			66%	66%		
<b>Oilfield services operating margin</b>	<b>15.0</b>	<b>12.4</b>	<b>2.6</b>	<b>21</b>	<b>51.3</b>	<b>49.2</b>	<b>2.1</b>	<b>4</b>
Percent of revenue	39%	32%			34%	34%		

**Operations in PNG**

Revenue for the PNG operations for the year ended December 31, 2013 increased by 13% to \$111.9 million (2012 - \$99.0) as a result of having two active drillings rigs operating more frequently in 2013 as compared to 2012. Higher matting and equipment rental revenues (2013 - \$24.9 million; 2012 - \$19.1million) due to new equipment placed in service during 2012 and 2013 also contributed to the increase in revenues.

During the three months ended December 31, 2013, revenues in PNG decreased by 6% to \$26.0 million (2012 - \$27.8 million) largely attributable to having Rig 104 on warm stack for much of the fourth quarter of 2013.

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High Arctic is currently managing and operating two heli-portable rigs (Rigs 103 and 104) owned by our main customer in PNG. Revenue includes amounts related to the recovery of lease related costs. An equivalent lease cost is included under oilfield services expense. The lease amounts are significant with revenues and expenses each reflecting \$29.1 million for 2013 compared to \$25.9 million for 2012. High Arctic also owns a hydraulic workover rig (Rig 102) and drilling support equipment that it contracts to that customer.

The Corporation has extended its contracts with its major customer in PNG effective July 1, 2013 for a three year term to June 30, 2016. The extensions cover the drilling contracts for Rigs 103 and 104 and the drilling support services contract related to the supply of personnel and rental equipment to support the related drilling operations. Our main PNG customer's drilling program throughout most of 2012 was equivalent to a one drilling rig program. During that time, Rigs 103 and 104 each drilled well locations with the drilling crews always working on the rig actively drilling while a much smaller crew moved the non-active rig to the next well site. The non-active rig earns a much lower day rate that reflects the smaller crews and is referred to as a moving rig.

A full two rig drilling program started in the fourth quarter of 2012 at which time High Arctic added a second drilling crew with the full operating rate starting on November 1, 2012. The operation reverted to a one rig program at the end of April, 2013 and Rig 103 and 104 operated on a shared one rig equivalent basis for the balance of 2013. Rig 104 resumed full time operations in mid-December with our largest PNG customer and is currently expected to operate continuously throughout 2014 and 2015 to drill development oil wells that will replace depleting production, as well as to drill gas wells to continue to provide feedstock for the LNG liquefaction plant.

The Corporation announced in December, 2013 that Rig 103 has been contracted to another customer for the drilling of two wells. The rig and associated equipment are in the process of being transported to the drilling site in anticipation of a spud date late in March, 2014. The firm two well commitment, including mobilisation, is expected to take approximately one year to complete on the current timeline with an option to extend. The equipment included in the agreement comprises Rig 103 and the leap frog package, a 93 man main camp, a 32 man leap frog camp and High Arctic owned drilling support equipment and matting.

Rig 102 was active throughout 2012 and for the first ten months of 2013. Rig 102 remains under contract through May 2014 and is now stacked at a much lower rate while the customer evaluates its future workover and completion needs. High Arctic is currently pursuing other opportunities for Rig 102 with other operators in PNG should the customer decide to release the rig at the end of its contract.

Revenue from PNG's matting and equipment rental business continues to show strong year over year growth. Approximately \$11.0 million was invested in the expansion of the PNG equipment rental business in both 2011 and 2012 and an additional \$10.0 million was similarly invested in 2013. Revenue from the rental fleet increased to \$24.9 million for the year ended December 31, 2013 compared to \$19.1 million for the same period in 2012. PNG's rental fleet consists of Dura-Base® mats, of which High Arctic exited 2013 with approximately 9,600 mats under contract, a heli-portable camp, and various trucks, cranes and other oilfield equipment.

## **Operations in Canada**

Revenue for the Canadian operations decreased by 14% in 2013 to \$40.8 million (2012 - \$47.2). The decrease was attributable to more moderate industry levels of activity experienced during the year as compared to 2012. In addition, despite contracts in hand, no revenue was generated in 2013 from the UB250K unit compared to \$3.4 million earned during the year ended December 31, 2012. In June, 2013 the UB250K workover rig commenced operations; however, a few days into the work both hydraulic power units which are used to supply power to the rig were damaged beyond repair in a fire. No injuries or environmental damage occurred during the incident. Revenue and adjusted EBITDA are down as a result, however; insurance proceeds of \$2.9 million related to the fire have been received.

Total equipment utilization for 2013 was 41% compared to 43% for 2012. Equipment utilization is determined by dividing the number of twelve hour days a unit operates by the total number of days in the relevant period.

The Corporation's largest business line in Canada is its stand alone snubbing services which accounted for revenue of \$29.0 million in 2013 (2012 - \$30.0 million). Utilization rates for the stand alone snubbing units for the year ended December 31 were 36% for 2013 as compared to 33% for 2012; however, there were 17 units available throughout 2012 and the first half of 2013 and only 14 units available during the second half of 2013, due to a reduction in the number of crews so as to scale to existing demand.

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The second largest Canadian product line is nitrogen services which are often supplied in conjunction with snubbing activities. Nitrogen revenue was \$9.9 million for 2013 compared to \$12.0 million for the year ended December 31, 2012. The drop was attributable to competitive pricing pressures associated with the reduced activity levels. Utilization for nitrogen services for 2013 was 53% compared to 60% in 2012 due to the reduced activity levels experienced in the entire oilpatch during the year.

High Arctic has seen an easing in the shortage of experienced field personnel from last year but retaining crews continues to be a challenge, particularly during slower periods as the crews are paid on a day rate basis. Retention of experienced personnel will continue to be a key focus.

**Oilfield Services Expense and Oilfield Services Operating Margin**

(\$ millions)	Three Months Ended December 31				Year Ended December 31			
	2013	2012	Change	%	2013	2012	Change	%
<b>Oilfield services expense</b>	<b>23.7</b>	<b>26.2</b>	<b>(2.5)</b>	<b>(10)</b>	<b>101.4</b>	<b>97.0</b>	<b>4.4</b>	<b>4.5</b>
Percent of revenue	61%	68%			66%	66%		
<b>Oilfield services operating margin</b>	<b>15.0</b>	<b>12.4</b>	<b>2.6</b>	<b>21</b>	<b>51.3</b>	<b>49.2</b>	<b>2.1</b>	<b>4</b>
Percent of revenue	39%	32%			34%	34%		

Oilfield services expense includes both fixed and variable costs that, in total, do not increase or decrease by the same proportion as changes in revenue and activity levels. The Corporation maintains a scalable cost infrastructure wherever possible which adjusts to changing activity and provides substantial operating leverage when activity increases.

Oilfield services expense as a percentage of revenue was 66% for both of the years ended December 31, 2013 and 2012. Operating margins increased in the fourth quarter of 2013 due to a higher percentage of the revenue being earned from higher margin earning sources such as rentals and matting.

**Oilfield services expenses by nature**

(\$ millions)	Three Months Ended December 31		Year Ended December 31	
	2013	2012	2013	2012
Personnel costs and personnel related costs	10.7	12.3	44.9	48.4
Drilling rig and other rental costs	7.1	7.6	30.6	26.5
Material and supplies cost	3.6	3.6	16.1	12.4
Equipment operating and maintenance costs	2.2	2.4	8.8	8.5
Other	0.1	0.3	1.0	1.2
<b>Total</b>	<b>23.7</b>	<b>26.2</b>	<b>101.4</b>	<b>97.0</b>

In light of the softer activity levels in Canada, management continues to focus on controlling expenses, although margins tend to drop with activity as fixed costs cannot be easily reduced.

**General and Administration**

(\$ millions)	Three Months Ended December 31			Year Ended December 31		
	2013	2012	Change	2013	2012	Change
<b>General and Administration</b>	<b>2.5</b>	<b>2.4</b>	<b>0.1</b>	<b>9.8</b>	<b>9.6</b>	<b>0.2</b>
Percent of revenue	6%	6%		6%	7%	

General and administration expenses (G&A) for the three months and year ended December 31, 2013 were virtually unchanged from 2012 as a percentage of revenues as High Arctic continues to monitor its controllable costs.

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**Share-based Compensation**

(\$ millions)	Three Months Ended December 31			Year Ended December 31		
	2013	2012	Change	2013	2012	Change
<b>Share-based compensation</b>	<b>0.4</b>	<b>0.1</b>	<b>0.3</b>	<b>0.8</b>	<b>1.4</b>	<b>(0.6)</b>
Percent of revenue	<1%	<1%		<1%	1%	

Share-based compensation expense of \$0.8 million for the year ended December 31, 2013 is the result of a decrease of \$0.6 million expense related to the executive and director share incentive plan. There was no change in the share-based compensation expense for the stock option plan in 2013 from 2012. The higher amount reported for 2012 is attributable to the graded vesting formula used to amortize the calculated benefit amount over the vesting period which weights a higher portion of the benefit to the first year of each grant.

**Amortization**

(\$ millions)	Three Months Ended December 31			Year Ended December 31		
	2013	2012	Change	2013	2012	Change
<b>Amortization</b>	<b>3.9</b>	<b>2.7</b>	<b>1.2</b>	<b>12.3</b>	<b>9.7</b>	<b>2.6</b>
Percent of revenue	10%	7%		8%	7%	

Amortization increased for 2013 due to expenditures on property, plant and equipment made by High Arctic that were placed in service in 2013.

**Foreign Exchange Loss**

(\$ millions)	Three Months Ended December 31			Year Ended December 31		
	2013	2012	Change	2013	2012	Change
<b>Foreign exchange loss</b>	<b>0.5</b>	<b>0.1</b>	<b>0.4</b>	<b>0.4</b>	<b>-</b>	<b>0.4</b>
Percent of revenue	<1%	<1%		<1%		

The Corporation has exposure to U.S. dollar revenues and expenses, primarily through its operations in PNG, to local currencies including the Kina in PNG and to the current assets (cash and cash equivalents) and current liabilities denominated in U.S. dollars held in Canada. The translation of foreign operations with a functional currency different from that of the Corporation, being primarily the U.S. dollar based operations in PNG, is translated into Canadian dollars and resulting changes are recognised in other comprehensive income as cumulative translation adjustments. However, gains and losses recorded by the Canadian parent on its U.S. dollar cash accounts and on any U.S. dollar denominated intercompany balances must be recognised in the statement of earnings and comprehensive income while the offsetting amount on the intercompany balances recorded for the foreign subsidiary is recorded as a cumulative translation adjustment. Such gains and losses are non-cash items as they are purely intercompany offsetting amounts. In 2012, the U.S. dollar was fairly stable relative to the Canadian dollar. Throughout 2013, the Canadian dollar lost its value against the U.S. dollar which resulted in a small foreign exchange loss.

**Interest and Finance Expense**

(\$ millions)	Three Months Ended December 31			Year Ended December 31		
	2013	2012	Change	2013	2012	Change
<b>Interest and finance expense</b>	<b>0.2</b>	<b>0.2</b>	<b>-</b>	<b>0.8</b>	<b>1.0</b>	<b>(0.2)</b>
Percent of revenue	<1%	<1%		<1%	<1%	

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The principal amount of the senior debt was \$6.8 million at December 31, 2013 compared to \$13.8 million at December 31, 2012. High Arctic repaid \$7.0 million of its long term debt in 2013. The interest rate applicable to the senior debt is based on the prime rate plus a spread. (See Long Term Debt)

**Income Taxes**

(\$ millions)	Three Months Ended December 31			Year Ended December 31		
	2013	2012	Change	2013	2012	Change
<b>Current income tax expense</b>	1.5	1.0	0.5	5.5	3.7	1.8
Percent of revenue	4%	3%		4%	3%	
<b>Deferred income tax recovery</b>	(0.4)	-	(0.4)	(0.5)	(5.0)	4.5

The current income tax expense relates to current taxes payable on services provided in PNG.

Earnings retained by subsidiaries that may be subject to dividend withholding taxes in the country of origin upon repatriation amounted to \$56.5 million as at December 31, 2013. The average dividend withholding rate is estimated to be 17%. No provision has been made for withholding and other taxes that would become payable on the distribution of these earnings because the Corporation controls the relevant entities and has no committed plans to repatriate the earnings in the foreseeable future.

High Arctic is not currently taxable in Canada as a result of significant available tax pools. The Corporation uses the liability method of tax allocation in accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on the income tax consequences attributable to the difference between amounts recorded in the financial statements and their respective tax bases, using a substantially enacted tax rate. High Arctic has recognised a deferred tax asset of \$5.0 million as a result of determining that sufficient certainty exists to support recognising \$20 million of its existing tax pools based on estimated future taxable profits. The Corporation does not expect to be taxable in Canada for the foreseeable future as a result of its available tax pools and believes that future taxable income projections continue to support the deferred tax asset recognised.

At each reporting period, the Corporation assesses its ability to utilize the deductible temporary differences based on its history of profitability, the current industry activity in Canada and the expectation of future taxable profitability. In 2013, the Corporation recognised \$1.6 million of Canadian timing differences (2012 - \$2.5 million) based on its taxable income produced in the year and expects to recognise approximately \$1.5 million in 2014. The deductible temporary differences for which no benefit has been booked that relate to the available Canadian tax pools are as follows:

	2013	2012
<b>Property and equipment</b>	2.3	9.8
<b>Non- capital losses</b>	73.7	71.8
<b>Capital losses</b>	5.4	5.4
<b>Financing costs</b>	3.1	4.1
<b>Total</b>	<b>84.5</b>	<b>91.1</b>

**Outstanding Share Data**

**Common Shares**

The Corporation's authorized share capital consists of an unlimited number of common shares and an unlimited number of preferred shares. As at December 31, 2013, there were 50,045,592 issued and outstanding common shares. Since then 16,200 options to purchase shares have been exercised and as of the date of this MD&A, there were 50,061,792 issued and outstanding common shares. Both numbers include 32,000 shares held in the Executive and Director Share Incentive Plan (see Note 14 of the Financial Statements) that have not yet vested and which may be cancelled under certain circumstances related to a three year vesting period.

# High Arctic Energy Services Inc.

## Management's Discussion and Analysis

### For the Years Ended December 31, 2013 and 2012

#### **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 "2013 Bid"). High Arctic may purchase up to 2,492,716 common shares for cancellation subject to a daily purchase limit of 11,634 common shares. The 2013 Bid commenced on May 28, 2013 and will terminate on May 27, 2014. A total of 105,470 common shares were purchased from the commencement of the 2013 Bid to December 31, 2013 and cancelled at a cost of \$0.2 million.

On March 21, 2012, 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 "2012 Bid"). The 2012 Bid commenced on March 23, 2012 and terminated on March 22, 2013. During 2012, a total of 285,380 common shares were purchased and cancelled pursuant to the 2012 Bid at a cost of \$0.5 million. No shares were acquired in 2013 pursuant to the 2012 Bid.

#### **Options**

As at December 31, 2013, there were 2,455,660 options outstanding to acquire common shares of the Corporation at an average exercise price of \$2.30 per share. Since then, 16,200 options have been exercised, 25,000 options have been granted at a price of \$3.55 per share and 21,100 options have expired resulting in 2,443,060 options outstanding at an average exercise price of \$2.34 per share as of the date of this MD&A.

#### **Market Capitalization**

The Corporation's common shares trade on the Toronto Stock Exchange under the symbol HWO. The closing price of the shares on March 13, 2014 was \$3.86 per share. Based upon the issued common shares on that date of 50,061,792, the Corporation has an approximate market capitalization of \$193.2 million.

## **Liquidity and Capital Resources**

#### **Selected Capitalization Data:**

(\$ millions except financial ratios)	December 31, 2013	December 31, 2012	Change
Current assets <sup>(1)</sup>	60.0	52.2	7.8
Current liabilities <sup>(2)</sup>	18.1	15.6	2.5
Working capital <sup>(3)</sup>	41.9	36.6	5.3
Working capital ratio <sup>(4)</sup>	3.3:1	3.3:1	-
Total debt	6.8	13.8	(7.0)
Total debt-to-capitalization percentage <sup>(5)</sup>	5.7%	13.5%	(7.8%)
Cash and cash equivalents	33.7	27.4	6.3
Net cash <sup>(6)</sup>	26.9	13.6	13.3

- Notes: (1) *Calculated as all current assets.*  
(2) *Calculated as current liabilities excluding the current portion of long-term debt.*  
(3) *Calculated as current assets (as defined above) less current liabilities (as defined above).*  
(4) *Calculated as current assets (as defined above) divided by current liabilities (as defined above).*  
(5) *Calculated as total debt divided by the sum of total debt and shareholders' equity.*  
(6) *Net cash is calculated as the amount by which cash and cash equivalents exceeds total debt.*

The Corporation manages its capital structure so as to provide the capital to meet the requirements of its business and instill confidence in investors, creditors and the capital markets. The debt leverage is an important metric used by management to assess the capital structure. Management believes that the total debt-to-capitalization ratio and the debt to adjusted EBITDA ratio are well within reasonable and prudent levels. Total debt to 12-month trailing Adjusted EBITDA was 0.16 at December 31, 2013 suggesting a capacity for further borrowing to provide the flexibility for growth in the business. The Corporation has a credit facility (see "Credit Facility" below) from which up to \$35 million may be drawn on a revolving basis, subject to the applicable borrowing base margin requirements.

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The Corporation generated net cash from operating activities of \$9.9 million for the three months ended December 31, 2013 (2012 - \$10.0 million) and \$36.8 million for the 2013 fiscal year (2012 - \$38.0 million). The cash balance and available undrawn credit facilities provide adequate liquidity to meet the Corporation's expected operating needs. The Corporation had a cash balance of \$33.7 million as at December 31, 2013, much of which is targeted for capital expenditures, and believes it has sufficient cash to meet its needs for the foreseeable future.

**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 High Arctic and by guarantees given by its material foreign subsidiaries.

The long-term debt 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 debt. The effective interest rate on the long-term debt was 4% for the year ended December 31, 2013.

The \$5 million revolving operating loan facility may be drawn based on 75% of the Corporation's eligible Canadian accounts receivable (85% in the case of investment grade receivables), less certain priority claims, and 90% of eligible foreign accounts receivable insured by the Export Development Corporation or other insurer approved by the lender.

During 2013, the Corporation made payments of \$7.0 million against its outstanding long-term debt. As at December 31, 2013, the Corporation had long-term debt of \$6.8 million, leaving \$28.2 million of undrawn revolving capacity. The revolving facility does not require principal repayments prior to maturity so the entire amount is classified as long-term at December 31, 2013. The cash and cash equivalents at December 31, 2013 exceeded total debt by \$26.9 million.

As of the date of this MD&A, long term debt is \$6.8 million. The Corporation remains in compliance with all financial covenants under its long-term debt agreement.

**Accounts Receivable**

The aging of accounts receivables is as follows:

	December 31, 2013	December 31, 2012
Less than 31 days	21.0	13.9
31 to 60 days	0.6	2.4
61 to 90 days	0.6	1.7
Greater than 90 days	0.3	1.5
Allowance for doubtful accounts	(0.6)	(0.5)
<b>Total</b>	<b>21.9</b>	<b>19.0</b>

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

Canadian dollar	7.4	6.7
United States dollar	14.5	12.3
<b>Total</b>	<b>21.9</b>	<b>19.0</b>

The allowance for doubtful accounts provision is based on an individual account by account analysis and the customer's prior credit history. The Corporation's normal credit terms are net 30 days.

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**Cash Flows**

**Operating Activities**

Funds provided from operations in the year ended December 31, 2013 were \$35.3 million (2012 - \$34.9 million). After working capital adjustments, net cash generated from operating activities during 2013 was \$36.8 million compared to \$38.0 million for 2012. The changes in working capital for the quarter are considered normal, reflecting the differences in activity levels in business between the periods and the quarters that immediately preceded them. The risks associated with the Corporation's accounts receivable are viewed as normal for the industry and management assesses the creditworthiness of its customers on an ongoing basis.

**Investing Activities**

For the year ended December 31, 2013, capital expenditures were \$21.9 million (2012 – \$19.9 million). Most of the capital expenditures in 2013 were directed at upgrades for the Canadian Stand-Alone fleet, construction of a new facility in Grande Prairie, Alberta and for continued expansion of PNG's rental equipment fleet.

During the year ended December 31, 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 net book values of \$2.7 million has been recognised in the determination of net earnings.

**Financing Activities**

**Dividends**

In 2012, the Corporation instituted a dividend policy and the first monthly dividend of \$0.01 per common share (including the restricted shares) was paid on June 14, 2012. Dividends are recorded as a liability on the date of declaration by the Corporation's Board of Directors. High Arctic increased its monthly dividend to \$0.0125 per share in March, 2013, a 25% increase from the previous monthly dividends paid. The annual dividends declared for 2013 of \$7.2 million was 20% of funds provided from operations for the year ended December 31, 2013.

During the year ended December 31, 2013, the Corporation declared dividends of \$7.2 million (2012 - \$4.0 million), of which \$0.6 million was payable as of the year end (2012 - \$0.5 million). To the date of this MD&A, dividends totalling \$0.025 per common share (\$1.25 million) have been declared for 2014.

**Industry Indicators and Market Trends in Papua New Guinea**

The following table provides information for the last eight quarters to assist with the understanding of the PNG oilfield services industry and the effect that commodity prices have on industry activity levels. In addition, the Corporation's international financial results are impacted by fluctuations in the U.S. dollar to Canadian dollar exchange rate. Commodity prices have been higher and more stable in PNG than in Canada, especially for natural gas which are forecasted to remain above US\$10/Mmbtu.

	2013				2012			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
<b>Oil and natural gas prices</b>								
<b>Average for the period</b>								
Brent Crude Oil (US \$ /bbl)	\$109	\$110	\$103	\$112	\$110	\$109	\$109	\$119
IPE Britain NBP Natural Gas (US\$ /Mmbtu)	\$11.37	\$10.15	\$10.00	\$10.47	\$10.62	\$9.00	\$8.99	\$9.01
<b>US/Canadian dollar exchange rate</b>	1.05	1.04	1.03	0.99	1.01	1.01	0.99	1.00

The Corporation's PNG activity is based on longer term, U.S. dollar denominated contracts and thus is less affected in the short term by the volatility of oil and gas prices. The U.S./Canadian dollar exchange rate has been stable during the past two

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years with the US dollar trading at a premium of approximately 3% for 2013. The Corporation benefits when the US dollar is valued at a premium to the Canadian dollar. This differential created a positive impact on the PNG financial results reported in Canadian dollars as compared to 2012.

The activity levels of our major customer in PNG is less dependent on short term fluctuations in oil and gas prices and instead is based on long term decisions, particularly with its significant interest in a large scale LNG project currently under construction. Substantially all of their existing production is crude oil with the price tied more closely to Brent crude oil prices, rather than West Texas pricing, and we understand that their gas output is contracted at a price tied to world oil prices on an energy equivalent basis.

### Industry Indicators and Market Trends in Canada

The following table provides information for the last eight quarters to assist with the understanding of the Canadian oilfield services industry and the effect that commodity prices have on industry activity levels.

	2013				2012			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
<b>Oil and natural gas prices</b>								
<b>Average for the period</b>								
West Texas Intermediate (US \$ /bbl)	\$97	\$106	\$94	\$94	\$88	\$92	\$93	\$103
AECO (C\$ /Mmbtu)	\$3.52	\$2.43	\$3.50	\$3.08	\$3.22	\$2.29	\$1.90	\$2.17
<b>Other industry indicators</b>								
Well completions in Western Canada <sup>(1)</sup>	3392	2711	1,683	3,102	3,687	2,835	2,107	3,121
Gas well drilling in Western Canada <sup>(1)</sup>	610	289	282	447	489	388	346	632
Average drilling rig utilization rates <sup>(1)</sup>	45%	41%	18%	61%	44%	42%	22%	68%

(1) Source: Canadian Association of Oilwell Drilling Contractors (CAODC) or Nickle's Daily Oil Bulletin

Increases or decreases in the price of oil and natural gas can materially impact spending on drilling and well completion activities in Canada. High Arctic's business activity depends on the overall drilling and well completion activity in the industry and therefore on the level of spending by oil and gas companies. The Canadian oilfield services sector is cyclical and is significantly affected by the activity levels of exploration and production companies.

The trend to more field activity being directed at oil projects continues given the relative strength of oil prices. Natural gas prices were weak throughout much of 2013, although prices improved in the fourth quarter due in part to cold weather in North America increasing demand. The AECO reference natural gas price averaged \$3.13 per MMBtu in 2013 compared to \$2.30 in 2012. Although the average price for 2013 was higher, activity levels are not expected to significantly change until a higher price is sustained for a significantly longer period of time. During 2013, the Canadian industry continued to experience year over year drops in the number of well completions with the trend most visible in gas wells which represented only 15% of wells drilled in 2012 and 2013 as compared to 43% in 2010 and 28% in 2011. The effect has been muted by the increase in the complexity and depth of the wells that is leading to more time being spent on the completion of each well.

High Arctic's Canadian activity levels are tied more closely to gas drilling activity and the associated well completions. The weakness in natural gas prices has led Canadian producers to focus on liquids rich natural gas developments as the associated liquids or condensates, such as ethane, butane and propane, typically attract prices tied to oil prices making them attractive at current oil prices. This trend to target the liquids rich areas is expected to continue as long as oil prices remain at or near their current levels. In addition, Asian energy companies are increasingly investing in Canada providing needed capital, long term outlooks and encouraging liquid natural gas ("LNG") deliveries into Asian markets. When one or more LNG export facilities are approved for construction in British Columbia, we expect drilling activity to increase and with it, demand for the Corporation's completion services.

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**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:

\$ (millions, except per share amounts)	Dec 31, 2013	Sep 30, 2013	Jun 30, 2013	Mar 31, 2013	Dec 31, 2012	Sep 30, 2012	Jun 30, 2012	Mar 31, 2012
<b>Revenue</b>	38.7	36.3	32.9	44.8	38.6	35.8	29.6	42.2
<b>Adjusted EBITDA</b>	12.5	9.8	6.6	12.6	10.0	10.1	5.2	14.3
<b>Net earnings</b>	6.4	7.7	2.1	8.4	5.9	6.5	5.7	10.7
per share – basic	0.13	0.16	0.04	0.17	0.12	0.14	0.12	0.23
per share – diluted	0.13	0.16	0.04	0.17	0.12	0.13	0.12	0.22
<b>Funds provided from operations</b>	10.8	8.2	5.1	11.2	8.7	9.4	3.4	13.4

In Canada, frozen ground during the winter months tends to provide an optimal environment for drilling activities and consequently the first quarter is typically the strongest. As warm weather returns in the spring, the winter's frost comes out of the ground rendering many secondary roads incapable of supporting the weight of heavy equipment until they have thoroughly dried out. Road bans, which are generally imposed in the spring, restrict the transportation of heavy equipment onto customer locations which reduces demand for services in the Canadian operation and, therefore, the second quarter is generally the weakest quarter of the year for Canada. The activities in Papua New Guinea are not subject to seasonal variations. Heavy rainfall and dense clouds in the mountains provide operational challenges throughout the year but do not curtail operations totally.

**Outlook**

The previously announced contract to mobilise Rig 103 for a new major customer in PNG continues to ramp up. The rig and associated equipment are in the process of being transported to the drilling site in anticipation of a spud date late in March. The two firm wells are expected to take approximately one year to drill including the mobilisation period and the customer has an option to extend for up to two more wells. The equipment included in the agreement comprises Rig 103 and a leap frog rig, together with the rig camps and High Arctic owned drilling support equipment and matting.

It is anticipated that Rig 104 will be operational for all of 2014 drilling development oil wells to replace depleting production, as well as drilling gas wells to continue to provide feedstock for the LNG liquefaction plant.

After working continuously throughout 2012 and through the first ten months of 2013, Rig 102 is now stacked at a much lower rate while the customer evaluates its future workover and completion needs. Rig 102 remains under contract through May 2014. High Arctic is currently marketing rig 102 to other operators in PNG.

The logistics and materials handling contract with a major Canadian global upstream oil and gas company to provide equipment, services and manpower to their primary staging area in southern forelands of PNG is now fully operational and providing the necessary support required by the customer. This staging area provides both ship and helicopter borne logistics and materials support to the drilling activities in the area. The client is pleased with the development of the site and has indicated there may be future expansion opportunities as a result.

During the past two years, High Arctic has significantly grown its equipment rental business in PNG serving an increasing base of customers. At the beginning of 2013, the Corporation had approximately 7,000 mats under contract and with several new contracts added throughout the year, has increased that to the current amount of nearly 10,000. The Corporation believes that the PNG market is currently well supplied with mats but opportunities for further growth in rentals are anticipated in the latter part of 2014 as drilling activity expands.

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The PNG LNG project is on schedule to deliver first gas towards the end of 2014. The long term outlook in PNG continues to be favourable as the LNG production will be an important cash flow stream available to be invested in new projects. Recently, our main customer and another major have each announced deals to acquire interests in a large scale undeveloped gas resource that is expected to underpin a major new LNG development or expansion. In addition to the wells that Rig 103 is targeted to drill, development of that gas resource should create demand for additional drilling rigs. The continued investment into PNG gas development should increase demand for oilfield services which High Arctic is well positioned to deliver.

While activity levels for the fourth quarter of 2013 improved for High Arctic compared to the prior year, it is expected that our 2014 Canadian activity levels will be similar to those experienced in 2013 for both the snubbing and nitrogen service lines. Although there is speculation in the market that activity in the fourth quarter of 2014 associated with BC LNG development may start to accelerate, it is still early to make plans around those predictions. The longer term impact of the cold North American winter on gas storage levels and gas prices is also yet to be determined.

The Board of Directors has approved an initial capital budget of \$19 million for 2014 with \$13 million directed towards growth capital and the remainder to maintenance capital expenditures. In PNG, growth spending in 2014 will include Dura-Base® matting and other pieces of rental equipment to support operations. High Arctic is currently evaluating potential opportunities for the deployment of Dura-Base® matting solutions elsewhere in the world and has budgeted for the purchase of an initial inventory of five hundred new mats. In Canada, growth spending includes one new 170K Stand-Alone Snubbing Unit which is designed for certain unique well completions tasks and will help to ensure that the Company remains the snubbing market leader in the Western Canadian Sedimentary Basin. The Corporation continues to invest in high pressure BOP (blow out preventer) rental equipment as it is a good fit with our core business lines. It is anticipated that revenues generated from the 2014 capital expenditures will be realised no sooner than the fourth quarter.

## **Customer Concentration**

The Corporation's account receivables are predominantly with customers who explore for and develop petroleum reserves and are subject to normal industry credit risks. The Corporation assesses the credit worthiness of its customers on an ongoing basis and monitors the amount and age of outstanding balances. 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 65% of the Corporation's revenue for year ended December 31, 2013 (2012 – 62%) and 45% of its accounts receivable at that date (2012 – 42%). The second significant customer is a major Canadian exploration and production company which represents approximately 9% of the Corporation's revenue for the year ended December 31, 2013 (2012 – 12%) and 2% of the Corporation's accounts receivable at that date (2012 – 5%). Management has assessed the two customers as creditworthy and the Corporation has had no history of collection issues with either customer.

## **Contingent Liability and Commitment**

### **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.

### **Property and Equipment**

As at December 31, 2013, the Corporation had approximately \$2.4 million of planned expenditures for the purchase of capital assets which were not yet recorded because the assets will be delivered in 2014.

## **Cancellation of Performance Bond**

On March 13, 2014, a performance bond posted by the Corporation in respect of a contract in the Middle East region was returned to the Corporation in full, without payment or draw down. The underlying letters of credit have been cancelled.

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**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 contractual maturities of financial liabilities in their future undiscounted amounts as at December 31, 2013:

	1 Year	2-3 Years	4-5 Years	Beyond 5 Years	Total
Accounts payable	15.5	-	-	-	15.5
Dividends payable	0.6				0.6
Long-term debt and related interest	0.3	6.9	-	-	7.2
<b>Total</b>	<b>16.4</b>	<b>6.9</b>	<b>-</b>	<b>-</b>	<b>23.3</b>

**Lease Obligations**

The Corporation has entered into long-term premise leases for operating facilities in Canada. These leases are operating leases and the remaining length of the lease terms are up to one and a half 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 December 31, 2013 are:

	1 Year	2-3 Years	4-5 Years	Beyond 5 Years	Total
Facility lease commitments	0.4	0.1	-	-	0.5
<b>Total lease commitments</b>	<b>0.4</b>	<b>0.1</b>	<b>-</b>	<b>-</b>	<b>0.5</b>

**Risk Management and Uncertainties**

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

- volatility in global supply and demand and market prices for oil and natural gas and the effect of these volatilities on the demand for oilfield services generally;
- uncertainties in weather affecting the duration of the service periods and the activities that can be completed, including the seasonality that affects industry activity in Canada;
- reduction in industry activity levels in western Canada, primarily due to a recent period of lower natural gas prices (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 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;

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- 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 the risk that necessary capital cannot be acquired on a timely basis, on reasonable terms to the Corporation, or at all. The covenants and security granted under its credit facility could limit its ability to obtain additional financing in the future on a timely basis to take advantage of business opportunities that may arise.

Where additional financing is raised by the issuance of common shares or securities convertible into common shares, control of the Corporation may change and shareholders may suffer dilution to their investment.

***Liquidity Risk***

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

***Customer Concentration***

Please refer to "Customer Concentration" section above.

***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 its long-term debt is a floating rate credit facility and fluctuates in response to changes in the prime interest rates. For the year ended December 31, 2013, a 1% nominal change in the interest charged to the Corporation under its credit facility would have changed interest expense by \$0.1 million (2012 - \$0.1 million).

***Income Tax Risk***

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

The Corporation must file tax returns in the foreign jurisdictions in which it operates. The tax laws and the prevailing assessment practices are subject to interpretation and the foreign authorities may disagree with the filing positions adopted by the Corporation. The impact of any challenges cannot be reliably estimated and may be significant to the financial position or overall operations of 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.

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***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 default increases due to reductions in customers' cash flows. 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, 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.

***Foreign Exchange Rate Risk***

Foreign currency risk is the risk that a variation in the exchange rate between Canadian and foreign currencies will affect the Corporation's results. The majority of the Corporation's international revenue and expenses are transacted in U.S. dollars and the Corporation does not actively engage in foreign currency hedging. For the Year ended December 31, 2013, a 1% nominal change in the value of the Canadian dollar relative to the U.S. dollar would have resulted in a \$0.5 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. The commodity prices affect the levels of drilling activity, particularly with respect to natural gas, which primarily affects the Canadian business. The Corporation mitigates this exposure with its diversification into international operations not dependent on the Canadian oil and gas industry.

***Dependence on Suppliers***

High Arctic sources supplies and materials from a variety of suppliers throughout the world. Failure of suppliers to deliver supplies and materials in a timely and efficient manner would be detrimental to the Corporation's ability to maintain the expected level of service to its customers. High Arctic attempts to mitigate this risk by maintaining good relations with key suppliers and having access to alternative suppliers. However, if the current suppliers are unable to provide the supplies and materials, or otherwise fail to deliver products in the quantities required, any resulting delays in the provision of services to our clients could have a material adverse effect on our results of operations and our financial condition.

***Competition***

The Corporation's continued success partially depends upon developing and implementing technological advances in its equipment and services and the ability to match advances of competitors. The oilfield services industry is highly competitive and the Corporation competes with a substantial number of companies. Reduced levels of activity in the oil and gas industry can intensify competition, which will have an effect on the Corporation's ability to generate revenue and earnings.

***Other***

Additional risk factors relating to the Corporation are also outlined in the most recent Annual Information Form filed on SEDAR at [www.sedar.com](http://www.sedar.com).

**Critical Accounting Estimates and Judgments**

Details of the critical accounting estimates and judgments used by management in the preparation of the Corporation's Financial Statements may be found in the notes to the audited consolidated financial statements of the Corporation for the year ended December 31, 2013.

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## **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 Executive and Director Share Incentive Plan. The principal amount of each loan bears interest at an annual rate of 2%. As at December 31, 2013, these loans were fully repaid (December 31, 2012 - \$0.4 million outstanding).

## **Changes in Accounting Policies**

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

Effective January 1, 2013, the Corporation has adopted the following new and revised standards, along with any consequential amendments. 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 19: *Employee Benefits*
- IAS 27: *Separate Financial Statements*
- IAS 28: *Investments in Associates and Joint Ventures*

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.

## **Future Accounting Policies**

There are no IFRS or IFRIC interpretations that are effective for the first time for the fiscal year beginning on or after January 1, 2014 that would be expected to have a material impact on the Corporation.

In May 2013, the IASB released an amendment to IAS 36, *Impairment of Assets*. This amendment requires entities to disclose how the fair value, less costs of disposal, has been measured when an impairment loss has been recognised or reversed. The amendment is effective January 1, 2014 and will have no material effect on the Corporation's financial statements except for additional disclosure requirements.

## **Disclosure Controls and Procedure**

The Chief Executive Officer and the Chief Financial Officer have designed, or have caused to be designed under their supervision, the Corporation's 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 ("DC&P") are designed to provide reasonable assurance that material information required to be disclosed in its annual filings, interim filings or other reports filed by it under securities legislation is accurate and complete and filed within the time periods required and that information required to be disclosed is accumulated and communicated to the appropriate members of management to allow timely decisions regarding required disclosure.

The Chief Executive Officer and the Chief Financial Officer oversee this design and evaluation process and have concluded, based on their evaluation as at December 31, 2013, that the design and operation of the Corporation's DC&P, as defined by

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National Instrument 52-109 Certification of Disclosure in Issuers' Annual and Interim Filings, were effective. The Chief Executive Officer and the Chief Financial Officer have individually signed certifications to this effect.

High Arctic will continue to evaluate the DC&P and will make modifications when necessary. There were no changes in the Corporation's DC&P during the year ended December 31, 2013 which have materially affected, or are reasonably likely to materially affect High Arctic's DC&P.

**Internal Controls Over Financial Reporting**

Internal control over financial reporting ("ICFR"), as defined in National Instrument 52-109, means a process designed by, or under the supervision of, an issuer's certifying officers, and effected by the issuer's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the issuer's GAAP and includes those policies and procedures that: (i) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the issuer; (ii) are designed to provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with the issuer's GAAP, and that receipts and expenditures of the issuer are being made only in accordance with authorizations of management and directors of the issuer; and (iii) are designed to provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the issuer's assets that could have a material effect on the annual financial statements or interim financial reports.

Management is responsible for designing and evaluating the effectiveness of ICFR, under the supervision of the CEO and CFO. No changes were made to ICFR during the year ended December 31, 2013 that have materially affected, or are reasonably likely to materially affect, ICFR. The CEO and CFO of the Corporation directed the assessment of the design and operating effectiveness of the Corporation's internal controls over financial reporting as at December 31, 2013, and, based on that assessment, have concluded that ICFR was effective throughout 2013 and as at December 31, 2013.

It should be noted that a control system, including the Corporation's DC&P and ICFR, no matter how well conceived, can provide only reasonable, but not absolute, assurance that the objectives of the control system will be met, and it should not be expected that the Corporation's DC&P and ICFR will prevent all errors or fraud.

**Additional Information**

Additional information on the Corporation, including the most recent Annual Information Form filed, may be found on SEDAR at [www.sedar.com](http://www.sedar.com).