

Q2

Three and six months ended June 30, 2012  
as at August 14, 2012



Canadian Energy  
SERVICES

## MANAGEMENT'S DISCUSSION AND ANALYSIS

*The following management's discussion and analysis ("MD&A") of the financial condition and results of operations should be read in conjunction with the unaudited condensed consolidated financial statements and notes thereto of Canadian Energy Services & Technology Corp., formerly Canadian Energy Services L.P. (collectively "CES" or the "Company"), for the three and six months ended June 30, 2012, and the audited annual consolidated financial statements and notes thereto for the years ended December 31, 2011 and 2010, and CES' 2011 Annual Information Form. The information contained in this MD&A was prepared up to and including August 14, 2012, and incorporates all relevant considerations to that date.*

*Certain statements in this MD&A may constitute forward-looking information or forward-looking statements (collectively referred to as "forward-looking information") which involves known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of CES, or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking information. When used in this MD&A, such information uses such words as "may", "would", "could", "will", "intend", "expect", "believe", "plan", "anticipate", "estimate", and other similar terminology. This information reflects CES' current expectations regarding future events and operating performance and speaks only as of the date of the MD&A. Forward-looking information involves significant risks and uncertainties, should not be read as a guarantee of future performance or results, and will not necessarily be an accurate indication of whether or not such results will be achieved. A number of factors could cause actual results to differ materially from the results discussed in the forward-looking information, including, but not limited to, the factors discussed below. The management of CES believes the material factors, expectations and assumptions reflected in the forward-looking information and statements are reasonable but no assurance can be given that these factors, expectations and assumptions will prove to be correct. The forward-looking information and statements contained in this document speak only as of the date of the document, and CES assumes no obligation to publicly update or revise them to reflect new events or circumstances, except as may be required pursuant to applicable securities laws or regulations.*

*In particular, this MD&A may contain forward-looking information pertaining to the following: future estimates as to dividend levels; capital expenditure programs for oil and natural gas; supply and demand for CES' products and services; industry activity levels; commodity prices; treatment under governmental regulatory and taxation regimes; dependence on equipment suppliers; dependence on suppliers of inventory and product inputs; equipment improvements; dependence on personnel; collection of accounts receivable; operating risk liability; expectations regarding market prices and costs; expansion of services in Canada, the United States and internationally; development of new technologies; expectations regarding CES' growth opportunities in the United States; expectations regarding the performance or expansion of CES' environmental, production chemical, and transportation operations; investments in research and development and technology advancements; access to debt and capital markets; and competitive conditions.*

*CES' actual results could differ materially from those anticipated in the forward-looking information as a result of the following factors: general economic conditions in Canada, the United States, and internationally; demand for oilfield services for drilling and completion of oil and natural gas wells; volatility in market prices for oil, natural gas, and natural gas liquids and the effect of this volatility on the demand for oilfield services generally; competition; liabilities and risks, including environmental liabilities and risks inherent in oil and natural gas operations; sourcing, pricing and availability of raw materials, consumables, component parts, equipment, suppliers, facilities, and skilled management, technical and field personnel; ability to integrate technological advances and match advances of competitors; availability of capital; uncertainties in weather and temperature affecting the duration of the oilfield service periods and the activities that can be completed; changes in legislation and the regulatory environment, including uncertainties with respect to programs to reduce greenhouse gas and other emissions; reassessment and audit risk associated with the Conversion; changes to the royalty regimes applicable to entities operating in the WCSB and the US; access to capital and the liquidity of debt markets; changes as a result of IFRS adoption; fluctuations in foreign exchange and interest rates, and the other factors considered under "Risk Factors" in CES' Annual Information Form for the year ended December 31, 2011, and "Risks and Uncertainties" in this MD&A.*

*Without limiting the foregoing, the forward-looking information contained in this MD&A is expressly qualified by this cautionary statement.*

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### **BUSINESS OF CES**

CES' business model is focused on the design and delivery of technically advanced fluids for the oil and gas industry. CES' business model requires limited re-investment capital to grow. As a result, CES has been able to capitalize on the growing market demand for drilling and production fluids in North America while generating free cash flow. CES returns much of this free cash flow back to shareholders through its monthly dividend.

The core business of CES is to design and implement drilling fluid systems for the North American oil and natural gas industry. CES operates in the Western Canadian Sedimentary Basin ("WCSB") and in various basins in the United States ("US"), with an emphasis on servicing the ongoing major resource plays. The drilling of those major resource plays includes wells drilled vertically, directionally, and, with increasing frequency, horizontally. Horizontal drilling is a technique utilized in tight formations like tight gas, liquids rich gas, tight oil, heavy oil, and in the oil sands. The designed drilling fluid encompasses the functions of cleaning the hole, stabilizing the rock drilled, controlling subsurface pressures, enhancing drilling rates, and protecting potential production zones while conserving the environment in the surrounding surface and subsurface area. CES' drilling fluid systems are designed to be adaptable to a broad range of complex and varied drilling scenarios, to help clients eliminate inefficiencies in the drilling process, and to assist them in meeting operational objectives and environmental compliance obligations. CES markets its technical expertise and services to oil and natural gas exploration and production entities by emphasizing the historical success of both its patented and proprietary drilling fluid systems and the technical expertise and experience of its personnel.

Clear Environmental Solutions ("Clear"), CES' environmental division, provides environmental and drilling fluids waste disposal services primarily to oil and gas producers active in the WCSB. The business of Clear involves determining the appropriate processes for disposing of or recycling fluids produced by drilling operations and to carry out various related services necessary to dispose of drilling fluids.

EQUAL Transport ("EQUAL"), CES' transport division, provides its customers with trucks and trailers specifically designed to meet the demanding requirements of off-highway oilfield work, and trained personnel to transport and handle oilfield produced fluids and to haul, handle, manage and warehouse drilling fluids. EQUAL operates from two terminals and yards located in Edson, Alberta and Carlyle, Saskatchewan.

PureChem Services ("PureChem"), CES' drilling fluid and production chemical manufacturing division, designs, manufactures, and sells specialty drilling fluids to CES, as well as stimulation and production chemicals to operators. The PureChem production facility is strategically located in Carlyle, Saskatchewan.

CES' corporate head office and its sales and services headquarters are located in Calgary, Alberta and its stock point facilities and other operations are located throughout Alberta, British Columbia, and Saskatchewan. CES' indirect wholly-owned subsidiary, AES Drilling Fluids, LLC ("AES"), conducts operations in the United States through four regional divisions: the Rocky Mountain division from its office in Denver, Colorado; the Mid-Continent division from its office in Norman, Oklahoma; the Northeast division from its office in Pittsburgh, PA and the Gulf Coast division from its office in Houston, Texas. The Houston office also serves as the corporate headquarters for AES. AES has operations in thirteen states with stock point facilities located in Oklahoma, Texas, Pennsylvania, West Virginia, Colorado, North Dakota, Louisiana, and Utah.

### **THREE-FOR-ONE STOCK SPLIT**

On June 30, 2011, the Company's shareholders approved a three-for-one split of CES' outstanding common shares (the "Stock Split"). The Stock Split was effected in the form of the issuance of two additional common shares for each share owned by shareholders of record at the close of business on July 13, 2011. The Company's common shares commenced trading on a post-split basis on July 11, 2011, on the Toronto Stock Exchange. All share data and stock-based compensation plans presented herein have been retroactively adjusted to give effect to the stock split.

### **NON-GAAP MEASURES**

The accompanying interim condensed consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). Certain supplementary information and measures not recognized under IFRS or previous GAAP are also provided in this MD&A where management believes they assist the reader in understanding CES' results. These measures are calculated by CES on a consistent basis unless otherwise specifically explained. These measures are further explained as follows:

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**EBITDAC** – means net earnings before interest, taxes, depreciation and amortization, gains and loss on disposal of assets, goodwill impairment, unrealized foreign exchange gains and losses, unrealized derivative gains and losses, and stock-based compensation. EBITDAC is a metric used to assess the financial performance of an entity. Management believes that this metric assists in determining the ability of CES to generate cash from operations. EBITDAC was calculated as follows:

\$000's	Three Months Ended		Six Months Ended	
	June 30, 2012	2011	June 30, 2012	2011
Net income	3,368	5,506	17,070	17,321
Add back (deduct):				
Depreciation in cost of sales	1,920	1,466	3,600	2,788
Depreciation and amortization in general and administrative expenses	950	868	1,851	1,742
Interest expense, net of interest income	995	696	1,970	1,427
Current income tax expense	3,153	2,097	9,108	3,789
Deferred income tax expense	755	1,346	1,354	5,220
Stock-based compensation	1,715	690	2,806	1,497
Unrealized foreign exchange (gain) loss	(64)	(118)	43	(276)
Unrealized derivative gain	(17)	(12)	(130)	(127)
(Gain) loss on disposal of assets	18	(38)	(120)	(86)
<b>EBITDAC</b>	<b>12,793</b>	<b>12,501</b>	<b>37,552</b>	<b>33,295</b>

**Distributable earnings** – means funds flow from operations less maintenance capital. See the definition of funds flow from operations below and the definition of maintenance capital under “Operational Definitions”. Distributable earnings is a measure used by management and investors to analyze the amount of funds available to distribute to shareholders before consideration of funds required for growth purposes. Refer to “Liquidity and Capital Resources – Funds Flow from Operations” for the calculation of distributable earnings.

**Funds flow from operations** – means cash flow from operations before changes in non-cash operating working capital. This measure is not intended to be an alternative to cash provided by operating activities as provided in the consolidated statements of cash flows, comprehensive income, or other measures of financial performance calculated in accordance with IFRS. Funds flow from operations assists management and investors in analyzing operating performance and leverage.

Funds flow from operations is calculated as follows:

\$000's	Three Months Ended		Six Months Ended	
	June 30, 2012	2011	June 30, 2012	2011
Cash provided by operating activities	23,284	11,276	32,816	11,532
Adjust for:				
Change in non-cash operating working capital	(14,554)	(1,398)	(6,258)	17,111
<b>Funds flow from operations</b>	<b>8,730</b>	<b>9,878</b>	<b>26,558</b>	<b>28,643</b>

**Gross margin** – means revenue less cost of sales, which includes cost of product, field labour, and all field related operating costs. Management believes this metric provides a good measure of the operating performance at the field level. It should not be viewed as an alternative to net income.

\$000's	Three Months Ended		Six Months Ended	
	June 30, 2012	2011	June 30, 2012	2011
Gross margin	23,523	22,971	60,881	55,595
as a percentage of revenue	23%	26%	23%	28%
Add back (deduct):				
Depreciation included in cost of sales	1,920	1,466	3,600	2,788
(Gain) loss on disposal of assets included in cost of sales	18	(38)	(120)	(86)
<b>Cash gross margin</b>	<b>25,461</b>	<b>24,399</b>	<b>64,361</b>	<b>58,297</b>
as a percentage of revenue	24%	28%	25%	29%

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**Payout ratio** – means dividends declared as a percentage of distributable earnings. Refer to “Liquidity and Capital Resources – Funds Flow from Operations” for the calculation of the payout ratio.

These measures do not have a standardized meaning as prescribed by IFRS and are therefore unlikely to be directly comparable to similar measures presented by other companies.

### **OPERATIONAL DEFINITIONS**

Operational terms used throughout this MD&A include:

**Expansion capital** – represents the amount of capital expenditure that has or will be incurred to grow or expand the business or would otherwise improve the productive capacity of the operations of the business.

**Maintenance capital** – represents the amount of capital expenditure that has been or will be incurred to sustain the current level of operations.

**Canadian Market Share** – CES estimates its market share in Canada by comparing, on a semi-weekly basis, active rigs where CES was contracted to provide services to the total active rigs for Western Canada. The number of total active rigs for Western Canada is based on Canadian Association of Oilwell Drilling Contractors (“CAODC”) published data for Western Canada.

**United States Market Share** – CES estimates its market share in the US by comparing, on a semi-weekly basis, active rigs where CES was contracted to provide services to the total active land rigs in the United States. The number of total active rigs in the United States is based on the weekly land based Baker Hughes North American Rotary Rig Count.

**Operating days** – CES estimates its operating days, which are revenue generating days, by multiplying the average number of active rigs where CES was providing drilling fluid services by the number of days in the period.

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### FINANCIAL HIGHLIGHTS

Summary Financial Results (\$'000's, except per share amounts)	Three Months Ended			Six Months Ended		
	June 30,			June 30,		
	2012	2011	% Change	2012	2011	% Change
Revenue	<b>104,129</b>	86,967	20%	<b>260,686</b>	198,506	31%
Gross margin <sup>(1)</sup>	<b>23,523</b>	22,971	2%	<b>60,881</b>	55,595	10%
Gross margin percentage of revenue <sup>(1)</sup>	<b>23%</b>	26%		<b>23%</b>	28%	
Income before taxes	<b>7,276</b>	8,949	(19%)	<b>27,532</b>	26,330	5%
<i>per share – basic</i>	<b>0.13</b>	0.16	(19%)	<b>0.50</b>	0.48	4%
<i>per share - diluted</i>	<b>0.13</b>	0.16	(19%)	<b>0.48</b>	0.47	2%
Net income	<b>3,368</b>	5,506	(39%)	<b>17,070</b>	17,321	(1%)
<i>per share – basic</i>	<b>0.06</b>	0.10	(40%)	<b>0.31</b>	0.32	(3%)
<i>per share - diluted</i>	<b>0.06</b>	0.10	(40%)	<b>0.30</b>	0.31	(3%)
EBITDAC <sup>(1)</sup>	<b>12,793</b>	12,501	2%	<b>37,552</b>	33,295	13%
<i>per share – basic</i>	<b>0.23</b>	0.23	0%	<b>0.68</b>	0.61	11%
<i>per share - diluted</i>	<b>0.22</b>	0.22	0%	<b>0.66</b>	0.60	10%
Funds flow from operations <sup>(1)</sup>	<b>8,730</b>	9,878	(12%)	<b>26,558</b>	28,643	(7%)
<i>per share – basic</i>	<b>0.16</b>	0.18	(11%)	<b>0.48</b>	0.52	(8%)
<i>per share - diluted</i>	<b>0.15</b>	0.18	(17%)	<b>0.46</b>	0.51	(10%)
Dividends declared	<b>8,339</b>	6,573	27%	<b>16,080</b>	12,380	30%
<i>per share</i>	<b>0.15</b>	0.12	25%	<b>0.29</b>	0.23	26%

**Notes:**

<sup>1</sup> Refer to the "Non-GAAP Measures" for further detail.

### OVERVIEW OF FINANCIAL AND OPERATIONAL RESULTS

Highlights for the three and six months ended June 30, 2012, in comparison to the three and six months ended June 30, 2011, for CES are as follows:

- CES generated gross revenue of \$104.1 million during the second quarter of 2012, compared to \$87.0 million for the three months ended June 30, 2011, an increase of \$17.2 million or 20% on a year-over-year basis. Year to date, gross revenue totaled \$260.7 million, compared to \$198.5 million, representing an increase of \$62.2 million or 31% on a year-over-year basis. The year-over-year increases are a result of increases in activity across all of the business segments of CES. Revenue from Canadian operations for the three months ended June 30, 2012, increased \$4.6 million or 17% to \$31.5 million while the US operations contributed to year-over-year revenue gains with a \$12.6 million or 21% increase to \$72.7 million.
- CES' estimated Canadian Market Share (refer to "Operational Definitions") was approximately 30% for the three months ended June 30, 2012, up from 25% for the three months ended June 30, 2011. Year to date, estimated market share in Western Canada averaged 31% as compared to 28% in 2011. CES' operating days were estimated to be 4,779 for the three month period ended June 30, 2012, an increase of 12% from 4,250 operating days during the same period last year. Year to date operating days in Western Canada were estimated to total 20,225 as compared to 17,981 during the same period last year, representing an increase of 12%. Due to the extended break-up in Canada, overall industry activity decreased approximately 3% from an average monthly rig count in Q2 2011 of 190 to 178 based on CAODC published monthly data for Western Canada. Year to date, the CAODC average monthly rig count for Western Canada averaged 359 as compared to 362 in 2011, representing a year-over-year decrease of 1%.
- Revenue from drilling fluids related sales of products and services in Western Canada was \$25.6 million for the three months ended June 30, 2012 compared to \$22.6 million for the three months ended June 30, 2011, representing an increase of \$3.0 million or 13%. For the six month period ended June 30, 2012, revenue from drilling fluids related sales of products

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and services in Western Canada was \$93.7 million compared to \$67.7 million for the six month period ended June 30, 2011, representing an increase of \$26.0 million or 38%. Average revenue per operating day for the three months ended June 30, 2012, was \$5,362 compared to \$5,325 for the three months ended June 30, 2011, representing an increase of 1%. Year-to-date, daily average revenue per operating day was \$4,633 compared to \$3,768 in 2011, representing a year-over-year increase of 23%. Average revenue per operating day has trended upward over the last several years as operators continue to drill more complex, deeper, and longer horizontal wells in the WCSB. These wells require more fluids in general but also more technically advanced fluids in order for the wells to be successfully drilled and cased.

- CES' United States Market Share (refer to "Operational Definitions") for the three months ended June 30, 2012, was estimated to be 6%, consistent with 6% for the three months ended June 30, 2011. Year to date, estimated market share in the United States averaged 6% as compared to 6% in during 2011. Operating days (refer to "Operational Definitions") in the United States were estimated to be 10,255 operating days for the three month period ended June 30, 2012, an increase of 14% from 9,020 operating days during the same period last year. Estimated operating days during the year-to-date period were 20,733 as compared to 18,722 operating days last year, representing an increase of 11%. The year-over-year increase in the Company's US results is due to the continued organic growth achieved in the US.
- Revenue generated in the US from drilling fluid sales of products and services for the three months ended June 30, 2012, was \$72.7 million as compared to the second quarter of 2011 with revenue of \$60.1 million, representing an increase of \$12.6 million or 21% on a year-over-year basis. Year-to-date, revenue generated in the US totals \$149.8 million as compared to \$115.2 million in the previous year representing an increase of \$34.6 million or 30%. Daily average revenue per operating day for the three months ended June 30, 2012, was \$7,087 compared to \$6,659 for the three months ended June 30, 2011, representing an increase of 6%. Year-to-date, daily average revenue per operating day was \$7,223 compared to \$6,154 in 2011, representing a year-over-year increase of 17%. The increase in average revenue per operating day in the US is a result of a similar trend as to what has been experienced in Canada; operators continue to drill more complex, deeper, and longer horizontal wells resulting in the increased usage of fluids and more technically advanced fluids.
- During the second quarter of 2012, revenue from trucking operations, gross of intercompany eliminations, totalled \$3.5 million, an increase of \$1.1 million or 42% from the \$2.5 million for the three months ended June 30, 2011. For the year-to-date period, revenue from trucking operations totalled \$9.6 million as compared to \$8.3 million during 2011 representing an increase of \$1.3 million or 15%. The respective year-over-year increase is due primarily to increased industry activity.
- Clear Environmental Solutions division generated \$2.5 million of revenue for the three month period ended June 30, 2012, an increase of \$0.5 million compared to \$2.0 million during the prior year. Revenue from Clear for the six month period ended June 30, 2012, totalled \$8.1 million as compared to \$7.6 million for the same period in 2011, representing an increase of \$0.5 million or 7%.
- For the three month period ended June 30, 2012, CES recorded gross margin of \$23.5 million or 23% of revenue, compared to gross margin of \$23.0 million or 26% of revenue generated in the same period last year. Year-to-date, gross margin has totalled \$60.9 million or 23% of revenue as compared to \$55.6 million or 28% last year. The decrease in gross margin percentage as compared to the second quarter of 2011 is a result of a several factors. CES' Canadian operations continues to see an increasing amount of invert drilling mud comprising a larger proportion of its aggregate Canadian sales as a result of the increasing trend by operators to use invert to drill horizontal wells. This is further compounded as CES is increasingly required to supply this base oil in response to industry conditions whereas historically operators had been able to acquire the required base oil directly. Base oil is used to build invert drilling mud and is a commodity product that is sold at a relatively low margin compared to other products. The result is that Canadian gross revenues have increased due to higher and more complex horizontal wells but overall gross margin as a percentage is reduced due to a higher proportion of invert sales. CES continues to identify opportunities to address this situation including the building of an invert blending facility at its base in Edson, AB. As well, throughout North American operations, due to the increasing cost of a number of key input products CES continues to face cost inflation on a number of its input products which have not yet been fully passed on to customers. CES will to endeavor to pass on these price increases as appropriate to operators but must manage this prudently given the cash flow challenges currently faced by operators.
- For the three month period ended June 30, 2012, general and administrative expenses were \$15.2 million as compared to \$13.3 million for the comparative period in 2011, an increase of \$1.9 million. As a percentage of revenue for the three months ended June 30, 2012, general and administrative costs were 15% which was comparable to 15% for the second quarter in 2011. For the six month period ended June 30, 2012, general and administrative costs were \$31.4 million as

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compared to \$27.9 million for the same period in 2011, representing an increase of \$3.5 million. As a percentage of revenue for the six months ended June 30, 2012, general and administrative costs were 12% as compared to 14% for the same period in 2011. On an absolute basis, much of the year-over-year increase in general and administrative expenses is due to non-cash expense increases related to stock-based compensation and depreciation and amortization costs. The year-over-year increase of these two non-cash items accounted for \$1.1 million and \$1.5 million of the general and administrative cost increase for the three and six month periods respectively. The remainder of the year-over-year increase in G&A costs is due to a combination of factors including higher staff levels associated with higher activity levels during 2012 as compared to 2011. Included in general and administrative expenses during the three and six months ended June 30, 2012, are stock-based compensation costs of \$1.7 million and \$2.8 million, respectively (2011 - \$0.7 million and \$1.5 million, respectively), and depreciation and amortization costs of \$1.0 million and \$1.9 million, respectively (2011 - \$0.9 million and \$1.7 million, respectively).

- EBITDAC (refer to "Non-GAAP Measures") for the three months ended June 30, 2012, was \$12.8 million as compared to \$12.5 million for the three months ended June 30, 2011, representing an increase of \$0.3 million or 2%. For the six month period ended June 30, 2012, EBITDAC totalled \$37.6 million as compared to \$33.3 million in 2011 representing an increase of \$4.3 million or 13%. CES recorded EBITDAC per share of \$0.23 (\$0.22 diluted) for the three months ended June 30, 2012 which was consistent with EBITDAC per share of \$0.23 (\$0.22 diluted) in 2011. Year-to-date, CES recorded EBITDAC per share of \$0.68 (\$0.66 diluted) versus EBITDAC per share of \$0.61 (\$0.60 diluted) in 2011. The increase in EBITDAC per share demonstrates CES' continued ability to grow the business with limited dilution to shareholders.
- CES recorded net income of \$3.4 million for the three month period ended June 30, 2012, as compared to \$5.5 million in the prior year, representing a decrease of \$2.1 million or 39%. CES recorded net income per share of \$0.06 (\$0.06 diluted) for the three months ended June 30, 2012 versus \$0.10 (\$0.10 diluted) in 2011, representing a decrease of 40%. For the six month period ended June 30, 2012, CES recorded net income of \$17.1 million, compared with the \$17.3 million generated for the same period last year. Year-over year net income per share was \$0.31 (\$0.30 diluted) as compared with \$0.32 (\$0.31 diluted) per share for the same period in 2011, representing a decrease of \$0.01 or 3% on a per share basis. For the three and six month periods ended June 30, 2012, the respective year-over-year comparison net income was negatively impacted by higher non-cash depreciation and amortization expenses and stock-based compensation as well as higher income tax expense for the quarter.
- The Company has a three year committed credit agreement with a commercial bank providing for a Senior Credit Facility (the "Senior Facility"), permitting it to borrow up to \$120.0 million, subject to the value of certain accounts receivable, inventory, and capital assets. The Senior Facility has a three year term, as of December 21, 2011, and may be extended by one year upon the agreement of the lender and the Company. As a result of high activity levels in Q1 2012, on March 22, 2012, the Company entered into an amending agreement on its Senior Credit Facility (the "Bridge Facility") permitting it to borrow up to an additional \$20.0 million. Terms and conditions, including the borrowing base, prime interest pricing margin, and covenants are consistent with the Company's Senior Facility. The Bridge Facility was drawn in full on March 30, 2012 and is repayable in full on or before September 18, 2012. At June 30, 2012, the Company had drawn \$66.7 million on the Senior Facility (December 2011 – \$93.4 million) and \$20.0 million on the Bridge Facility (December 2011 – \$nil).
- CES continued to maintain a strong statement of financial position or "balance sheet" at June 30, 2012, with positive net working capital of \$147.6 million (December 31, 2011 - \$153.7 million), excluding the \$20.0 million Bridge Facility, representing an decline of \$6.1 million. The decrease in working capital is primarily due to seasonality of the Company's Canadian operations. The decrease in working capital balances is comprised of a \$14.9 million increase in inventory, \$30.9 million decrease in accounts payable and accrued liabilities, net of a \$42.7 million decrease in accounts receivable, a \$2.1 million decrease in prepaid expenses and a \$6.3 million increase in income taxes payable.
- During the second quarter of 2012, CES declared monthly dividends in aggregate of \$0.15 per share for the quarter. This compares to \$0.12 per share for the comparable quarter in 2011. During the second quarter of 2012, the payout ratio averaged 97% as compared to 69% in 2011. For the year-to-date period, the payout ratio averaged 62% compared to 44% during 2011. Management and the Board of Directors review the appropriateness of dividends on a monthly basis, taking into account industry conditions, growth opportunities requiring expansion capital, and management's forecast of distributable earnings and payout ratio.
- On April 12, 2012, the Company's common shares commenced trading in the United States on the highest tier of the OTC market, the OTC International Marketplace ("OTCQX"), under the trading symbol CESDF. OTCQX securities are quoted

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on the OTC Link platform, operated by OTC Markets Group. The OTCQX listing will provide the Company with a cost-effective means of enhancing its visibility and accessibility to U.S. based investors.

### RESULTS FOR THE PERIODS

(\$000's, except per share amounts)	Three Months Ended June 30,			
	2012	2011	\$ Change	% Change
Revenue	104,129	86,967	17,162	20%
Cost of sales	80,606	63,996	16,610	26%
Gross margin <sup>(1)</sup>	23,523	22,971	552	2%
Gross margin percentage of revenue <sup>(1)</sup>	23%	26%		
General and administrative expenses	15,194	13,287	1,907	14%
Finance costs	1,053	735	318	43%
Income before taxes	7,276	8,949	(1,673)	(19%)
Current income tax expense	3,153	2,097	1,056	50%
Future income tax expense	755	1,346	(591)	(44%)
Net income	3,368	5,506	(2,138)	(39%)
Net income per share – basic	0.06	0.10	(0.04)	(40%)
Net income per share – diluted	0.06	0.10	(0.04)	(40%)
EBITDAC <sup>(1)</sup>	12,793	12,501	292	2%
<b>Common Shares Outstanding</b>				
	2012	2011		% Change
End of period	55,681,662	54,803,235		2%
Weighted average				
- basic	55,567,426	54,712,282		2%
- diluted	57,327,933	56,123,443		2%

Financial Position (\$000's)	As at		% Change
	June 30, 2012	December 31, 2011	
Net working capital	127,585	153,660	(17%)
Total assets	364,605	385,351	(5%)
Long-term financial liabilities <sup>(2)</sup>	70,987	96,779	(27%)
Shareholders' equity	211,864	204,060	4%

#### Notes:

<sup>1</sup> Refer to the "Non-GAAP Measures" for further detail.

<sup>2</sup> Includes long-term portion of the Senior Facility, vehicle financing, and finance leases.

## Canadian Energy Services & Technology Corp.

Management's Discussion and Analysis

Three and Six Months Ended June 30, 2012

(\$000's, except per share amounts)	Six Months Ended June 30,			
	2012	2011	\$ Change	% Change
Revenue	<b>260,686</b>	198,506	62,180	31%
Cost of sales	<b>199,805</b>	142,911	56,894	40%
Gross margin <sup>(1)</sup>	<b>60,881</b>	55,595	5,286	10%
Gross margin percentage of revenue <sup>(1)</sup>	<b>23%</b>	28%		
General and administrative expenses	<b>31,381</b>	27,873	3,508	13%
Finance costs	<b>1,968</b>	1,392	576	41%
Income before taxes	<b>27,532</b>	26,330	1,202	5%
Current income tax expense	<b>9,108</b>	3,789	5,319	140%
Future income tax expense	<b>1,354</b>	5,220	(3,866)	74%
Net income	<b>17,070</b>	17,321	(251)	(1%)
Net income per share – basic	<b>0.31</b>	0.32	(0.01)	(3%)
Net income per share – diluted	<b>0.30</b>	0.31	(0.01)	(3%)
EBITDAC <sup>(1)</sup>	<b>37,552</b>	33,295	4,257	13%
<b>Common Shares Outstanding</b>	<b>2012</b>	2011		% Change
End of period	<b>55,681,662</b>	54,803,235		2%
Weighted average				
- basic	<b>55,411,615</b>	54,569,804		2%
- diluted	<b>57,215,261</b>	55,829,581		2%

### Notes:

<sup>1</sup> Refer to the "Non-GAAP Measures" for further detail.

### Revenue and Operating Activities

CES generated gross revenue of \$104.1 million during the first quarter of 2012, compared to \$87.0 million for the three months ended June 30, 2011, an increase of \$17.2 million or 20% on a year-over-year basis. For the six month period ended June 30, 2012, CES generated gross revenue of \$260.7 million as compared to \$198.5 million for the same period in 2011, representing an increase of \$62.2 million or 31%. The respective year-over-year increases reflect higher overall activity levels and revenue across all of CES' business. CES' dominant business line, the drilling fluids segment, experienced the most material gains as a result of increased industry activity and a continuing industry trend to drill more complex, deeper, and longer horizontal wells. These wells require more fluids in general but also more technically advanced fluids in order for the wells to be successfully drilled and cased. CES capitalized on this trend in the WCSB through its leading market share position and in the US as a result of continued organic growth achieved across all of the US divisions.

Of the revenue generated during the second quarter of 2012, \$25.6 million (2011 - \$22.6 million) was generated in the Western Canadian drilling fluids business; \$72.7 million (2011 - \$60.1 million) was generated in the US drilling fluids business; \$2.5 million (2011 - \$2.0 million) was contributed by the Clear environmental division, and \$3.5 million (2011 - \$2.5 million), gross of intercompany eliminations of \$0.2 million (2011 - \$0.2 million), was generated by trucking operations.

For the six month period ended June 30, 2012, \$93.7 million (2011 - \$67.7 million) of revenues were generated in the Western drilling fluids business; \$149.8 million (2011 - \$115.2 million) was generated in the US drilling fluids business; \$8.1 million (2011 - \$7.6 million) was contributed by the Clear environmental division, and \$9.6 million (2011 - \$8.3 million), gross of intercompany eliminations of \$0.4 million (2011 - \$0.4 million), was generated by trucking operations.

According to CAODC published monthly data for Western Canada, the active monthly rig count in Western Canada averaged 178 for the three months ended June 30, 2012, representing a 6% decrease from the average rig count of 190 during the second quarter of 2011. Year-to-date, the CAODC average monthly rig count for Western Canada has averaged 359 compared to 362 in 2011, representing a year-over-year decrease of 1%.

CES estimated operating days (refer to "Operational Definitions") from its drilling fluids services have increased across all segments over the respective 2011 comparatives as follows:

## Canadian Energy Services & Technology Corp.

Management's Discussion and Analysis

Three and Six Months Ended June 30, 2012

	Three Months Ended			Six Months Ended		
	June 30,			June 30,		
	2012	2011	% Change	2012	2011	% Change
Canada	4,779	4,250	12%	20,225	17,981	12%
US	10,255	9,020	14%	20,733	18,722	11%
Total Operating Days	15,034	13,270	13%	40,958	36,703	12%

CES' estimated Canadian Market Share (refer to "Operational Definitions") in Western Canada was 30% for the three months ended June 30, 2012, up from 25% for the three months ended June 30, 2011. Year-to-date CES' estimated market share in Western Canada averaged 31% compared to 28% for the same period in 2011. CES believes its technology focused solutions have resulted in an increased market share in Western Canada as a larger percentage of drilling activity is focused on deeper, horizontal wells and the economics of drilling have become more difficult for operators.

In the United States, CES' estimated United States Market Share (refer to "Operational Definitions") for the three months ended June 30, 2012, was estimated to be 6%, consistent with 6% for the three months ended June 30, 2011. Year-to-date, CES' estimated market share in the United States averaged 6% compared to 6% for the same period in 2011.

Revenue per estimated operating day for the Canadian and US drilling fluids segments have increased over 2011 comparatives as follows:

\$000's	Three Months Ended			Six Months Ended		
	June 30,			June 30,		
	2012	2011	% Change	2012	2011	% Change
Canadian Drilling Fluids	5,362	5,325	1%	4,633	3,768	23%
United States Drilling Fluids	7,087	6,659	6%	7,223	6,154	17%

For the three and six months ended June 30, 2012, CES' top five customers accounted for 47% and 41%, respectively, of total revenue as compared to 40% and 35%, respectively, for the same periods in 2011. Two customers accounted for 30% and 26% of the Company's revenue for the three months ended June 30, 2012 and 2011 respectively. CES' largest customer accounted for 16% and 15% of the Company's revenue for the six months ended June 30, 2012 and 2011 respectively.

Overall, CES' drilling fluid business continues to focus on the ongoing major resource plays and, in particular, horizontal drilling activity predominantly focused on either oil or liquids rich gas targets. Horizontal drilling represents a significantly increasing share of CES' revenue composition as customers continue to apply the technique more frequently in drilling more complex and deeper wells. CES' experience has been that the importance to the operator of efficient drilling fluid systems increases significantly with the depth and complexity of the well drilled, and becomes even more critical as operators drill horizontally.

### Cost of Sales and Gross Margin

Gross margin represents the profit earned on revenue after deducting the associated costs of sales including cost of products, field labour, field related depreciation, and all other related field costs. Margins vary due to a change in product mix, well type, geographic area, and nature of activity (i.e. drilling fluids, trucking, environmental, etc.). Generally, labour costs have less of an impact on CES' margins than other cost elements such as product costs. Use of consultants and the variable component of compensation for employees provide CES with a means to better manage seasonal activity swings as well as overall fluctuations in the demand for CES' products and services.

CES achieved gross margin of \$23.5 million or 23% of revenue for the three month period ended June 30, 2012, as compared to \$23.0 million or 26% of revenue in the second quarter of 2011. The decrease in gross margin percentage as compared to the second quarter of 2011 is a result of a several factors. CES' Canadian operations continues to see an increasing amount of invert drilling mud comprising a larger proportion of its aggregate Canadian sales as a result of the increasing trend by operators to use invert to drill horizontal wells. This is further compounded as CES is increasingly required to supply this base oil in response to industry conditions whereas historically operators had been able to acquire the required base oil directly. Base oil is used to build invert drilling mud and is a commodity product that is sold at a relatively low margin compared to other products. The result is that Canadian gross revenues have increased due to higher and more complex horizontal wells but overall gross margin as a percentage is reduced due to a higher proportion of invert sales. CES continues to identify opportunities to address this situation including the building of an invert blending facility at its base in Edson, AB. As well, throughout North American operations, due to the increasing cost of a number of key input products CES continues to face cost inflation on a number of its

## Canadian Energy Services & Technology Corp.

Management's Discussion and Analysis

Three and Six Months Ended June 30, 2012

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input products which have not yet been fully passed on to customers. CES will endeavor to pass on these price increases as appropriate to operators but must manage this prudently given the cash flow challenges currently faced by operators.

Year-to-date, CES achieved a gross margin of \$60.9 million or 23% of revenue compared to \$55.6 million or 28% of revenue for the same period in 2011.

### ***General and Administrative Expenses ("G&A")***

As CES' activity levels continue to rise, so have the associated G&A expenses to run the business. G&A for the three month period ended June 30, 2012, was \$15.2 million as compared to \$13.3 million for the same period in 2011, representing an increase of \$1.9 million or 14% year-over-year. However, G&A as a percentage of revenue for the three months ended June 30, 2012, was 15% which was comparable to three months ended June 30, 2011 of 15%. Year-to-date, G&A was \$31.4 million as compared to \$27.9 million for the same period in 2011, representing an increase of \$3.5 million or 12%. G&A as a percentage of revenue for the six months ended June 30, 2012, was 12%, compared with 14% for the same period in 2011. On an absolute basis, much of the year-over-year increase in general and administrative expenses is due to non-cash expense increases related to stock-based compensation and depreciation and amortization costs. The year-over-year increase of these two non-cash items accounted for \$1.1 million and \$1.5 million of the general and administrative cost increase for the three and six month periods respectively. The remainder of the year-over-year increase in G&A costs is due to a combination of factors including higher staff levels associated with higher activity levels during 2012 as compared to 2011. Included in general and administrative expenses during the three and six months ended June 30, 2012, are stock-based compensation costs of \$1.7 million and \$2.8 million, respectively (2011 - \$0.7 million and \$1.5 million, respectively), and depreciation and amortization costs of \$1.0 million and \$1.9 million, respectively (2011 - \$0.9 million and \$1.7 million, respectively).

### ***Depreciation and Amortization***

Depreciation and amortization of property and equipment, and intangibles, respectively, totalled \$2.9 million for the three month period ended June 30, 2012, as compared to \$2.3 million for the same period in 2011. For the three months ended June 30, 2012, \$1.9 million (2011 - \$1.5 million) of depreciation was included in cost of sales and \$1.0 million (2011 - \$0.9 million) of depreciation and amortization was included in general and administrative expenses. Year-to-date, depreciation and amortization of property and equipment, and intangibles, respectively, totalled \$5.5 million as compared to \$4.5 million during 2011. For the six months ended June 30, 2012, \$3.6 million (2011 - \$2.8 million) of amortization was included in cost of sales and \$1.9 million (2011 - \$1.7 million) was included in general and administrative expenses. The year-over-year increase in depreciation and amortization expense is primarily attributable to the Company's expanded operations in both Canada and the United States.

### ***Stock-Based Compensation***

Stock-based compensation was \$1.7 million for the three months ended June 30, 2012, as compared to \$0.7 million during the same period last year. Year-to-date, stock-based compensation was \$2.8 million for as compared to \$1.5 million during the same period last year. The respective year-over-year increase is primarily attributable to the issuance of share rights under the share rights incentive plan and restricted share units under the restricted share units plan throughout the latter part of 2011 and the first quarter of 2012.

### ***Finance Costs***

Included in finance costs is interest expense of \$1.0 million for the three months ended June 30, 2012, compared to \$0.7 million, for the second quarter of 2011. Year-to-date, CES incurred interest expense of \$2.0 million, as compared to \$1.5 million during 2011. The respective year-over-year increase is primarily attributable to higher average borrowings on CES' various long-term debt and lease facilities as compared to last year. The Company's interest expense consists of interest expense on vehicle financing loans, capitalized lease facilities, and the Senior Facility.

Finance costs for the three months ended June 30, 2012, include a net foreign exchange loss of \$0.02 million (2011 - \$0.09 million) primarily related to foreign exchange loss on the Company's US denominated cash and accounts payable. For the six months ended June 30, 2012, CES recorded a net foreign exchange loss of \$0.02 million (2011 - a loss of \$0.1 million) primarily related to foreign exchange losses on the Company's US denominated cash balances.

Finance costs for the three and six month periods ended June 30, 2012, include a net realized derivative loss of \$0.04 million and gain of \$0.02 million, respectively (2011 - a gain of \$0.05 million and \$0.17 million), relating to its foreign currency derivative contracts. As of June 30, 2012, the Company had financial derivative liabilities of net \$0.07 million relating to its outstanding derivative contracts.

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CES has a Board approved hedging and derivative policy that sets out the guidelines and parameters management follows when approaching its risk management strategies.

At June 30, 2012, the Company had entered into the following foreign exchange US dollar forward sale contracts to manage its exposure to a portion of expected upcoming US dollar denominated cash flows.

Period	Notional Balance \$000's	Contract Type	Settlement	Average C\$/US\$ Exchange Rate
July 2012	US\$686	Deliverable Forward	Physical Sale	\$0.9635
August 2012	US\$686	Deliverable Forward	Physical Sale	\$0.9936
September 2012	US\$686	Deliverable Forward	Physical Sale	\$1.0004
October 2012	US\$570	Deliverable Forward	Physical Sale	\$1.0435
November 2012	US\$570	Deliverable Forward	Physical Sale	\$1.0437
December 2012	US\$570	Deliverable Forward	Physical Sale	\$1.0302
January 2013	US\$570	Deliverable Forward	Physical Sale	\$1.0072
February 2013	US\$570	Deliverable Forward	Physical Sale	\$1.0077
March 2013	US\$570	Deliverable Forward	Physical Sale	\$1.0073
April 2013	US\$325	Deliverable Forward	Physical Sale	\$1.0298
May 2013	US\$325	Deliverable Forward	Physical Sale	\$1.0304
Total	US\$6,128			\$1.0114

### *Current and Deferred Income Taxes*

During the three and six months ended June 30, 2012, the Company recorded current income tax expense of \$3.2 million and \$9.1 million, respectively, as compared to \$2.1 million and \$3.8 million, respectively, in 2011. The current income tax expense is related to taxable income in Canada and the US for which the Company does not have loss carry forwards to offset. The year-over-year increase in current income tax expense is primarily due to the fact that in 2011, the Company had available non-capital tax loss pools which were utilized to reduce current income taxes. At December 31, 2011, the Company had no non-capital loss pools remaining in the US and limited remaining non-capital tax loss pools in Canada which were subsequently utilized in Q1 2012.

In the second quarter of 2012, the Company recorded a deferred income tax expense of \$0.8 million compared to a deferred income tax expense of \$1.3 million in Q2 2011. Year-to-date, the Company recorded a deferred income tax expense of \$1.4 million compared to \$5.2 million in the prior year. The deferred income tax expense recorded for the three and six months ended June 30, 2012, relates to a combination of changes in the temporary differences as well as the estimated use of the Company's non-capital tax loss pools in both Canada and the United States. The year-over-year decrease in deferred income tax expense is primarily due to the Company having no non-capital loss pools in the US and limited remaining non-capital tax loss pools in Canada during Q1 2012.

### *Net Working Capital*

At June 30, 2012, the Company had positive net working capital of \$147.6 million (December 31, 2011 - \$153.7 million), excluding the \$20.0 million Bridge Facility, representing a decrease of \$6.1 million. The decrease in working capital is primarily due to seasonality of the Company's Canadian operations. The decrease in working capital balances is comprised of a \$14.9 million increase in inventory, \$30.9 million decrease in accounts payable and accrued liabilities, net of a \$42.7 million decrease in accounts receivable, a \$2.1 million decrease in prepaid expenses and a \$6.3 million increase in income taxes payable.

On December 21, 2011, the Company entered into the new three year Senior Facility. In conjunction with the new Senior Facility, the Company repaid its demand operating facility and other outstanding long-term committed loan facilities balances on December 23, 2011. As a result of high activity levels in Q1 2012, on March 22, 2012, the Company entered into an amending agreement on its Senior Facility (the "Bridge Facility") permitting it to borrow up to an additional \$20.0 million. Terms and conditions, including the borrowing base, prime interest pricing margin, and covenants are consistent with the Company's Senior Facility. The Bridge Facility was drawn in full on March 30, 2012 and is repayable in full on or before September 18, 2012. At June 30, 2012, the Company had drawn \$66.7 million on the Senior Facility (December 2011 - \$93.4 million) and \$20.0 million on the Bridge Facility (December 2011 - \$nil).

## Canadian Energy Services & Technology Corp.

Management's Discussion and Analysis  
Three and Six Months Ended June 30, 2012

### Total Current Assets

Total current assets of CES decreased from \$230.6 million at December 31, 2011 to \$200.6 million at June 30, 2012. The decrease is primarily due to seasonal fluctuations in the Canadian operations due to spring break up. The change in current assets consists of an increase of \$14.9 million in inventory balances, offset by a decrease in accounts receivable balances of \$42.7 million and a decrease of \$2.1 million in prepaid expenses.

### Total Long-Term Assets

Total long-term assets increased by \$9.2 million to \$164.0 million at June 30, 2012, from \$154.8 million at December 31, 2011. Of the \$9.2 million increase during the year, notable changes were a \$8.1 million increase in property and equipment, an increase of \$1.4 million in intangible assets and goodwill (net of amortization of intangible assets and the translation of the US dollar-denominated intangible assets and goodwill balances), offset by a \$0.3 million decrease in future income tax assets relating to the use of the Company's non-capital tax loss pools.

### Long-Term Financial Liabilities

CES had long-term debt totalling \$67.8 million at June 30, 2012, compared to \$94.1 million at December 31, 2011, for a decrease of \$26.3 million. At June 30, 2012, long-term financial liabilities were comprised of the following balances:

\$000's	As at	
	June 30, 2012	December 31, 2011
Bridge & Senior Facility	86,736	93,362
Vehicle financing loans	1,904	1,449
	88,640	94,811
Less current portion of long-term debt	(20,867)	(747)
Long-term debt	67,773	94,064

At June 30, 2012, the Company had total finance lease liabilities of \$6.0 million of which \$2.8 million represented the current portion.

\$000's	As at	
	June 30, 2012	December 31, 2011
Finance lease obligations	5,999	5,077
Less current portion of finance lease obligations	(2,785)	(2,362)
Long-term finance lease obligations	3,214	2,715

During the three and six month period ended June 30, 2012, the Company made long-term scheduled debt and lease repayments totalling \$1.1 million and \$1.9 million respectively on its finance leases, vehicle debt, and credit facilities.

### Shareholders' Equity

Shareholders' equity increased from \$204.1 million at December 31, 2011 to \$211.9 million at June 30, 2012. The year-to-date increase in shareholders' equity during the period is primarily attributable to the \$17.1 million in net income of CES, \$4.4 million relating to the issuance of equity, a \$2.2 million increase to contributed surplus as a result of stock-based compensation expense, and a \$0.2 million decrease in accumulated other comprehensive loss relating to the translation of the Company's wholly owned US subsidiary, offset by \$16.1 million of dividends declared by the Company during the first six months of 2012.

## SEGMENTED RESULTS

In Q2 2012, CES operated in two geographical segments: Canada and the United States. Geographical information relating to the Company's activities is as follows:

\$000's	Revenue			
	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Canada	31,453	26,902	110,930	83,297
United States	72,676	60,065	149,756	115,209
Total	104,129	86,967	260,686	198,506

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The year-over-year increase in the Company's results is due to operators continuing to drill more complex, deeper, and longer horizontal wells, which require more fluids in general but also more technically advanced fluids in order for the wells to be successfully drilled and cased, combined with higher overall activity levels as a result of organic growth achieved across all of the Canadian and US divisions.

In Q2 2012, CES had three reportable operating segments as determined by management: Drilling Fluids, Trucking, and Environmental Services. The Drilling Fluids segment designs and implements drilling fluid systems for the oil and natural gas industry in the WCSB and in the US through its wholly owned subsidiary, AES. The Trucking segment (EQUAL) is comprised of heavy duty trucks, trailers, and tanker trailers used in hauling drilling fluids to locations and hauling produced fluids for operators. The Environmental Services segment consists of Clear Environmental Services which provides environmental and drilling fluids waste disposal services to oil and gas producers in the WCSB. At this time, the results of the PureChem division are not separately disclosed and are included as part of the Drilling Fluids segment. Selected summary financial information relating to the operational segments is as follows:

Three Months Ended June 30, 2012					
<i>Segmented Information (\$000's)</i>	Drilling Fluids <sup>(2)</sup>	Trucking	Environmental Services	Intercompany Eliminations	Total
Revenue	98,302	3,539	2,484	(196)	104,129
Cost of sales	75,331	4,094	1,377	(196)	80,606
Gross margin	22,971	(555)	1,107	-	23,523
Income before taxes	8,121	(979)	134	-	7,276
EBITDAC <sup>(1)</sup>	12,725	(266)	334	-	12,793

Three Months Ended June 30, 2011					
<i>Segmented Information (\$000's)</i>	Drilling Fluids <sup>(2)</sup>	Trucking	Environmental Services	Intercompany Eliminations	Total
Revenue	82,696	2,485	1,985	(199)	86,967
Cost of sales	60,214	2,792	1,189	(199)	63,996
Gross margin	22,482	(307)	796	-	22,971
Income before taxes	9,752	(734)	(69)	-	8,949
EBITDAC <sup>(1)</sup>	12,058	327	116	-	12,501

Six Months Ended June 30, 2012					
<i>Segmented Information (\$000's)</i>	Drilling Fluids <sup>(2)</sup>	Trucking	Environmental Services	Intercompany Eliminations	Total
Revenue	243,449	9,578	8,108	(449)	260,686
Cost of sales	185,642	9,742	4,870	(449)	199,805
Gross margin	57,807	(164)	3,238	-	60,881
Income before taxes	27,295	(904)	1,141	-	27,532
EBITDAC <sup>(1)</sup>	34,291	1,354	1,907	-	37,552

Six Months Ended June 30, 2011					
<i>Segmented Information (\$000's)</i>	Drilling Fluids	Trucking	Environmental Services	Intercompany Eliminations	Total
Revenue	182,954	8,328	7,583	(359)	198,506
Cost of sales	131,600	6,885	4,785	(359)	142,911
Gross margin	51,354	1,443	2,798	-	55,595
Income before taxes	24,877	608	845	-	26,330
EBITDAC <sup>(1)</sup>	30,478	1,608	1,209	-	33,295

### Notes:

<sup>1</sup> Refer to the "Non-GAAP Measures" for further detail.

<sup>2</sup> Results from PureChem operations have been included in the Drilling Fluids segment.

## **Canadian Energy Services & Technology Corp.**

Management's Discussion and Analysis

Three and Six Months Ended June 30, 2012

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### ***Drilling Fluids Segment***

For the three months ended June 30, 2012, revenue from the Drilling Fluids segment totalled \$98.3 million compared to \$82.7 million for the three months ended June 30, 2011, representing an increase of \$15.6 million or 19%. For the three months ended June 30, 2012, revenue per operating day for the Drilling Fluids Segment totalled \$6,539 compared to \$6,232 for the three months ended June 30, 2011. Year-to-date revenue from the Drilling Fluids Segment totalled \$243.4 million as compared to \$183.0 million last year representing an increase of \$60.5 million or 33% on a year over year basis. Year-to-date revenue per operating day for the Drilling Fluids Segment totalled \$5,944 compared to \$4,985 for the same period in 2011. Average revenue per operating day has trended upward over the last several years as operators continue to drill more complex, deeper, and longer horizontal wells. These wells require more fluids in general but also more technically advanced fluids in order to be successfully drilled and cased. For additional details regarding the Company's market share and operating days for the three and six months ended June 30, 2012, refer to "Overview of Financial and Operational Results" and "Results for the Period" sections above. Gross margins for the Drilling Fluids segment for the three and six months ended June 30, 2012 were \$22.3 million and \$57.8 million respectively compared to \$22.5 million and \$51.4 million in the prior year. EBITDAC for the three and six months ended June 30, 2012 was \$12.7 million and \$34.3 million respectively compared to \$12.1 million and \$30.5 million in the prior year.

### ***Trucking Segment***

Revenue from the Trucking segment, gross of intercompany eliminations, was \$3.5 million for the three month period ended June 30, 2012, as compared to \$2.5 million during last year representing an increase of \$1.0 million or 42%. Year-to-date, the Trucking segment had total revenue, gross of intercompany eliminations, of \$9.6 million as compared to \$8.3 million during the same period in 2011 representing an increase of \$1.3 million or 15%. Gross margins for the Trucking segment for the three and six months ended June 30, 2012 were -\$0.6 million and -\$0.2 million respectively compared to -\$0.3 million and \$1.4 million in the prior year. EBITDAC for the three and six months ended June 30, 2012 was -\$0.3 million and \$1.4 million respectively compared to \$0.3 million and \$1.6 million in the prior year.

### ***Environmental Services Segment***

Revenue from the Environmental Services segment was \$2.5 million for the three month period ended June 30, 2012, compared to \$2.0 million generated for the same period of 2011, representing an increase of \$0.5 million or 25%. Year-to-date revenue for the Environmental Services totalled \$8.1 million as compared to \$7.6 million in 2011, representing an increase of \$0.5 million or 7%. Gross margins for the Environmental Services segment for the three and six months ended June 30, 2012 were \$1.1 million and \$3.2 million respectively compared to \$1.2 million and \$2.8 million in the prior year. EBITDAC for the three and six months ended June 30, 2012 was \$0.3 million and \$1.9 million respectively compared to \$0.1 million and \$1.2 million in the prior year. The Environmental Services segment continues to expand its operational base and is pursuing more complex opportunities in the oil sands and horizontal drilling.

## Canadian Energy Services & Technology Corp.

Management's Discussion and Analysis

Three and Six Months Ended June 30, 2012

### QUARTERLY FINANCIAL SUMMARY

(\$000's, except per share amounts)	Three Months Ended			
	Jun 30, 2012	Mar 31, 2012	Dec 31, 2011	Sep 30, 2011
Revenue	<b>104,129</b>	156,557	138,793	121,958
Gross margin <sup>(1)</sup>	<b>23,523</b>	37,358	37,300	30,520
Net income	<b>3,368</b>	13,702	14,873	9,501
<i>per share— basic</i>	<b>0.06</b>	0.25	0.27	0.17
<i>per share— diluted</i>	<b>0.06</b>	0.24	0.26	0.17
EBITDAC <sup>(1)</sup>	<b>12,793</b>	24,759	24,426	18,601
<i>per share— basic</i>	<b>0.23</b>	0.45	0.44	0.34
<i>per share— diluted</i>	<b>0.22</b>	0.43	0.43	0.33
Funds flow from operations <sup>(1)</sup>	<b>8,730</b>	17,828	22,705	17,315
<i>per share— basic</i>	<b>0.16</b>	0.32	0.41	0.32
<i>per share— diluted</i>	<b>0.15</b>	0.31	0.40	0.31
Dividends declared	<b>8,339</b>	7,741	7,156	6,582
<i>per share</i>	<b>0.15</b>	0.14	0.13	0.12
<i>Shares Outstanding</i>				
End of period	<b>55,681,662</b>	55,381,861	55,138,435	54,842,035
Weighted average – basic	<b>55,567,426</b>	55,255,804	55,001,647	54,834,583
Weighted average – diluted	<b>57,327,933</b>	57,102,551	56,870,630	56,244,549

(\$000's, except per share amounts)	Three Months Ended			
	Jun 30, 2011	Mar 31, 2011	Dec 31, 2010	Sep 30, 2010
Revenue	86,967	111,539	94,468	78,398
Gross margin <sup>(1)</sup>	22,971	32,624	26,281	21,695
Net income	5,506	11,815	9,427	7,184
<i>per share— basic</i>	0.10	0.22	0.18	0.15
<i>per share— diluted</i>	0.10	0.21	0.17	0.14
EBITDAC <sup>(1)</sup>	12,501	20,792	17,124	13,453
<i>per share— basic</i>	0.23	0.38	0.32	0.29
<i>per share— diluted</i>	0.22	0.37	0.31	0.26
Funds flow from operations <sup>(1)</sup>	9,878	18,765	16,381	12,784
<i>per share— basic</i>	0.18	0.34	0.30	0.27
<i>per share— diluted</i>	0.18	0.34	0.30	0.24
Dividends declared	6,573	5,807	5,042	3,786
<i>per share</i>	0.12	0.11	0.10	0.08
<i>Shares Outstanding</i>				
End of period	54,803,235	54,479,985	54,395,487	53,202,537
Weighted average – basic	54,712,282	54,425,742	53,776,982	46,656,015
Weighted average – diluted	56,123,443	55,809,750	54,504,694	52,651,985

#### Notes:

<sup>1</sup> Refer to the "Non-GAAP Measures" for further detail.

#### Seasonality of Operations

The Western Canadian drilling industry is subject to seasonality with activity usually peaking during the winter months in the fourth and first quarters of any given calendar year. As temperatures rise in the spring, the ground thaws and becomes unstable, resulting in government road bans which severely restrict activity in the second quarter. These seasonal trends typically lead to quarterly fluctuations in Canadian operating results and working capital requirements which should be considered in any quarter

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over quarter analysis of the Company. As the drilling fluids business expands in the US and as the production chemical business is built out, it is expected that the overall seasonality of the Company's operations will be less pronounced.

### LIQUIDITY AND CAPITAL RESOURCES

At June 30, 2012, the Company had net working capital of \$147.6 million (December 31, 2011 - \$153.7 million), excluding the \$20.0 million Bridge Facility, representing a decrease of \$6.1 million.

On December 21, 2011, the Company entered into a new three year credit agreement with a Canadian commercial bank and its US based affiliate providing for the new Senior Facility, permitting it in aggregate to borrow up to \$120.0 million, subject to the value of certain accounts receivable, inventory, and capital assets. In conjunction with the Senior Facility, the Company repaid its demand operating facility and outstanding long-term loan facilities balances on December 23, 2011.

As a result of high activity levels in Q1 2012, on March 22, 2012, the Company entered into an amending agreement to its Senior Credit Facility permitting it to borrow up to an additional \$20.0 million (the "Bridge Facility"). Terms and conditions, including the borrowing base, prime interest pricing margin, and covenants are consistent with the Company's Senior Facility. The Bridge Facility was drawn in full on March 30, 2012 and is repayable in full on or before September 18, 2012.

The Senior Facility is secured by: (a) in respect of Canadian Energy Services L.P. (the "Partnership"), Canadian Energy Services Inc. (the "General Partner"), CES and CES Operations Ltd., guarantees and general security agreements creating a security interest in all present and after-acquired personal property of the Partnership, the General Partner, CES and CES Operations Ltd., respectively, and (b) in respect of AES and AES Drilling Fluids Holdings, LLC ("AES Holdco"), guarantees and pledge and security agreements creating a security interest in all present and after-acquired personal property of AES and AES Holdco, respectively.

At June 30, 2012, CES had a net draw of \$66.7 million on its Senior Facility (December 31, 2011 - \$93.4) and \$20.0 million on the Bridge Facility (December 2011 - \$nil). The maximum available draw on the Senior Facility and Bridge Facility at June 30, 2012, based on eligible accounts receivable, inventory, and certain capital asset balances, was \$116.1 million (December 31, 2011 - \$120.0 million). Amounts drawn on the Senior Facility incur interest at the bank's prime rate plus an applicable pricing margin ranging from 0.75% to 2.25% or at the Banker's Acceptance or LIBOR rate plus an applicable pricing margin ranging from 1.75% to 3.25%. The Senior Facility has standby fees ranging from 0.40% to 0.73%. The pricing margin ranges on the Senior Facility are based on a sliding scale of funded debt to EBITDA ratio.

In conjunction with the Senior Facility, the following are some of the key financial covenants imposed on CES:

- The quarterly debt to tangible net worth must not exceed 2.50 to 1.00. The ratio of debt to tangible net worth is calculated as total liabilities per the consolidated financial statements, less future income taxes, less any indebtedness that has been subordinated and postponed to the bank, and less any leases characterized as operating leases divided by the total of stated capital, contributed surplus, retained earnings, and any indebtedness that has been subordinated and postponed to the bank, less any intangible asset, and less any future income tax assets.
- The quarterly current assets to current liabilities ratio must not be less than 1.25 to 1.00. The ratio of current assets to liabilities is calculated as total current assets per the consolidated financial statements divided by current liabilities per the consolidated financial statements excluding the current portion of long-term debt and capital lease obligations and any indebtedness that has been subordinated and postponed to the bank.
- The ratio of Funded Debt to Trailing EBITDA must not exceed 3.00 to 1.00, as calculated on a rolling four-quarter basis.
- The Company shall not make any dividend payments to shareholders upon the occurrence and during the continuance of or the making of which would give rise to or cause i) an Event of Default or ii) any event or condition which, with the giving of notice, lapse of time or upon declaration or determination being made (or any combination thereof), would constitute an Event of Default.

As at June 30, 2012, and as of the date of this MD&A, CES was in compliance with the terms and covenants of its lending agreements.

In addition to the above Senior Facility, CES has the following loan and leasing facilities:

- Bank Leasing Facility of up to \$5.0 million of which \$5.0 million has been drawn on to date. As of June 30, 2012, the Company had an outstanding balance owing on these lease facilities of \$3.6 million. The Company's floating interest

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rate leases are for terms ranging to March 2014 with interest on the Company's lease facilities at the bank's prime rate of interest plus 1.75%, resulting in monthly payments of approximately \$0.06 million. The Company's fixed interest rate leases are for terms ranging to March 2016 with interest on the Company's lease facilities at a weighted average rate of 4.74%, resulting in monthly payments of approximately \$0.1 million.

- Vehicle finance leases are secured by each related vehicle and incur interest at rates up to 9.07%, with a weighted average rate of approximately 6.26%, and have termination dates ranging from July 2012 through April 2017. At June 30, 2012, outstanding vehicle loans totalled \$2.4 million as compared to \$2.4 million at December 31, 2011.
- Vehicle financing are secured by each related vehicle and incur interest at rates up to 8.71%, with a weighted average rate of approximately 5.48%, and have termination dates ranging from December 2012 through October 2015. At June 30, 2012, outstanding vehicle loans totalled \$1.9 million as compared to \$1.4 million at December 31, 2011.

The following table details the remaining contractual maturities of the Company's financial liabilities as of June 30, 2012:

\$000's	Payments Due By Period <sup>(1)</sup>					Total
	Less than 3 months	3 months to 1 year	1-2 years	2-5 years	5+ years	
Accounts payable and accrued liabilities	40,204	-	-	-	-	<b>40,204</b>
Dividends payable <sup>(2)</sup>	2,784	-	-	-	-	<b>2,784</b>
Financial derivative liability	65	-	-	-	-	<b>65</b>
Income taxes payable	-	6,324	-	-	-	<b>6,324</b>
Long-term debt at fixed interest rates <sup>(3)</sup>	147	720	687	350	-	<b>1,904</b>
Long-term debt at floating interest rates <sup>(3)</sup>	-	20,000	-	66,736	-	<b>86,736</b>
Finance lease obligations at fixed interest rates <sup>(3)</sup>	128	658	826	1,216	-	<b>2,828</b>
Finance lease obligations at floating interest rates <sup>(3)</sup>	325	1,674	959	213	-	<b>3,171</b>
Office operating leases	384	1,586	1,442	2,617	-	<b>6,029</b>
Total	44,037	30,962	3,914	71,132	-	<b>150,045</b>

<sup>(1)</sup> Payments denominated in foreign currencies have been translated at the respective period end exchange rate

<sup>(2)</sup> Dividends declared as of June 30, 2012

<sup>(3)</sup> Long-term debt and finance lease obligations reflect principal payments and excludes any associated interest portion

Generally, credit and equity markets have continued to improve over the last two years. However, in the event that CES' lender is unable to, or chooses not to fund, it would impair CES' ability to operate until alternative sources of financing were obtained as access to the Senior Facility is critical to the effective execution of CES' business plan. To date, CES has not experienced any funding issues or restrictions on expanding its debt facilities when required.

At the time of the release of this MD&A, management is satisfied that CES has sufficient liquidity and capital resources to meet the long-term payment obligations of its outstanding loans and commitments. CES assesses its requirements for capital on an ongoing basis and there can be no guarantee that CES will not have to obtain additional capital to finance the expansion plans of the business or to finance future working capital requirements. In the event that it is required, based on the market conditions at the time, it may be difficult to issue additional equity or increase credit capacity and the cost of any new capital may exceed historical norms and/or impose more stringent covenants and/or restrictions on CES. In addition, despite relatively buoyant crude oil prices, natural gas prices continue to remain very weak in terms of historical norms. Continued weak natural gas prices may negatively impact the demand for the Company's products and services in the future. As a result, there continues to be a focus on evaluating credit capacity, credit counterparties, and liquidity by CES to ensure its ability to be able to meet its ongoing commitments and obligations.

#### **Cash Flows from Operating Activities**

For the three months ended June 30, 2012, cash flow from operating activities was an inflow of \$23.3 million compared to \$11.3 million during the prior year. Funds flow from operations (refer to "Non-GAAP Measures" for further detail), which takes into consideration changes in non-cash working capital, for the three months ended June 30, 2012, was a \$8.7 million inflow as compared to \$9.9 million during 2011.

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<i>\$000's</i>	Three Months Ended June 30,		Six Months Ended June 30,	
	<b>2012</b>	2011	<b>2012</b>	2011
Cash provided by operating activities	<b>23,284</b>	11,276	<b>32,816</b>	11,532
Adjust for:				
Change in non-cash operating working capital	<b>(14,554)</b>	(1,398)	<b>(6,258)</b>	17,111
Funds flow from operations	<b>8,730</b>	9,878	<b>26,558</b>	28,643

### *Cash Flows from Investing Activities*

For the three months ended June 30, 2012, net cash outflows from investing activities totalled \$5.2 million compared to \$2.5 million for the comparative prior year period.

For the three months ended June 30, 2012, gross property and equipment asset additions were \$5.2 million of which \$0.5 million related to vehicle financing or leases for net expenditures of \$4.6 million. CES had \$0.2 million of additions related to maintenance capital and \$5.0 million of additions related to expansion capital gross of vehicle financing.

Expansion capital expenditures in Q2 2012 were higher than historical norms as a result of a number of capital projects that had been initiated in Q4 2011 and Q1 2012 and were on-going during the quarter. These included the expansion of the tank farm and invert blending facility in Edson, AB, and the Company's PureChem facility in Carlyle, SK and the building of three new warehouse and fluids storage facilities to service the Eagleford shale in Texas, the Utica shale in Ohio, the Bakken in North Dakota and the other necessary equipment required to support these facilities and the corresponding expanded operations. Of this, notable additions during the three month period ended June 30, 2012, included \$0.5 million on the purchase of tanks; \$0.8 million of warehouse, field, and processing equipment; \$0.6 million of vehicles; \$0.8 million of trucks and trailers; and \$2.0 million of warehouse related construction and expansion costs.

Details of investment made in property and equipment are as follows:

<i>\$000's</i>	Three Months Ended June 30,		Six Months Ended June 30,	
	<b>2012</b>	2011	<b>2012</b>	2011
Expansion capital	<b>5,003</b>	2,598	<b>11,647</b>	7,732
Maintenance capital	<b>153</b>	320	<b>640</b>	734
Total investment in property and equipment	<b>5,156</b>	2,918	<b>12,287</b>	8,466
Vehicle financing and leases	<b>(541)</b>	(315)	<b>(1,750)</b>	(1,234)
Capital expenditures	<b>4,615</b>	2,603	<b>10,537</b>	7,232
Change in non-cash investing working capital	<b>706</b>	(157)	<b>398</b>	539
Cash used for investment in property and equipment	<b>5,321</b>	2,446	<b>10,935</b>	7,771

In general, the long-term capital investments required for CES to execute its business plan are not significant in relation to the total revenue and earnings generated, and the majority of capital expenditures are made at the discretion of CES based on the timing and the expected overall return on the investment.

### *Cash Flows from Financing Activities*

For the three months ended June 30, 2012, cash flow from financing activities totalled a cash outflow of \$18.1 million compared to \$8.9 million during the comparative prior year period. For the three month period ended June 30, 2012, CES repaid \$1.1 million of its long-term debt and lease balances, paid dividends to shareholders totalling \$8.3 million, repaid \$10.2 million, net of foreign exchange variances, on its Senior Facility. This was offset by cash proceeds of \$1.5 million relating to the exercise of stock options.

CES calculated distributable earnings based on funds flow from operations (refer to the "Non-GAAP Measures") and the payout ratio (refer to the "Non-GAAP Measures") based on the level of dividends declared as follows:

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\$000's	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Cash provided by (used in) operating activities	<b>23,284</b>	11,276	<b>32,816</b>	11,532
Adjust for:				
Change in non-cash operating working capital	<b>(14,554)</b>	(1,398)	<b>(6,258)</b>	17,111
Funds flow from operations <sup>(1)</sup>	<b>8,730</b>	9,878	<b>26,558</b>	28,643
Maintenance capital <sup>(2)</sup>	<b>(153)</b>	(320)	<b>(640)</b>	(734)
Distributable earnings <sup>(1)</sup>	<b>8,577</b>	9,558	<b>25,918</b>	27,909
Dividends declared	<b>8,339</b>	6,573	<b>16,080</b>	12,380
Payout ratio <sup>(1)</sup>	<b>97%</b>	69%	<b>62%</b>	44%

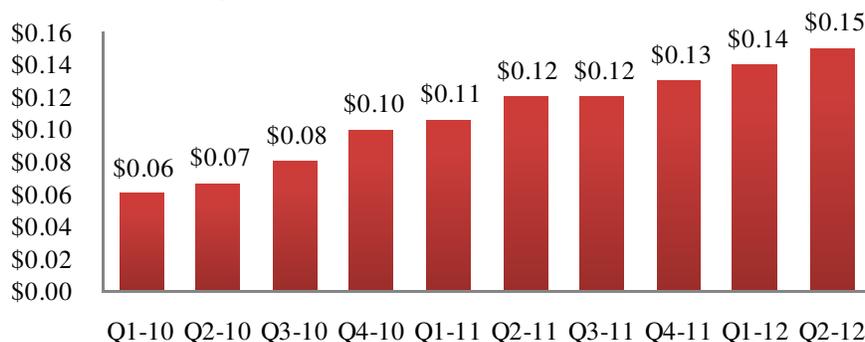
### Notes:

<sup>1</sup> Refer to the "Non-GAAP Measures" for further detail.

<sup>2</sup> Refer to the "Operational Definitions" for further detail.

Distributable earnings were \$8.6 million for the three months ended June 30, 2012, as compared to \$9.6 million for the same period in 2011. During the second quarter of 2012, the payout ratio (refer to the "Non-GAAP Measures") was 97% compared to 69% for the second quarter of 2011. Year-to-date, distributable earnings were \$25.9 million, as compared to \$27.9 million in 2011. For the six months ended June 30, 2012, the payout ratio (refer to the "Non-GAAP Measures") was 62% compared to 44% for the same period of 2011.

### QUARTERLY DIVIDEND GROWTH



### Dividend Policy

During the second quarter of 2012, CES declared monthly dividends of \$0.05 per share for a total of \$0.15 per share for the quarter. This compares to \$0.12 per share for the comparable quarter in 2011.

The Company declared dividends to holders of common shares for the six months ended June 30, 2012, as follows:

\$000's except per share amounts	Dividend Record Date	Dividend Payment Date	Per Common Share	Total
January	Jan 31	Feb 15	\$0.045	<b>2,483</b>
February	Feb 29	Mar 15	0.045	<b>2,489</b>
March	Mar 31	Apr 13	0.050	<b>2,769</b>
April	Apr 30	May 15	0.050	<b>2,776</b>
May	May 31	Jun 15	0.050	<b>2,779</b>
June	Jun 30	Jul 15	0.050	<b>2,784</b>
Total dividends declared during the period			\$0.290	<b>16,080</b>

Through the course of the year, monthly dividends declared as a proportion of net earnings and cash flow from operations will vary significantly based on the activity levels of the Company's operations. During periods of higher activity, dividends declared as a percentage of net income and cash flow from operations will decrease, and likewise, during lower activity periods

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dividends declared as a percentage of net income and cash flow from operations will increase. Dividends are funded by cash provided by operating activities. During periods of insufficient cash availability, due to either the seasonality of the business or changes in the level of working capital, dividends may be funded through CES' surplus cash reserves or by accessing CES' credit facilities.

Management and the Board of Directors review the appropriateness of dividends on a monthly basis taking into account applicable solvency requirements under corporate legislation; current and anticipated industry conditions; and, particularly, growth opportunities requiring expansion capital and management's forecast of distributable funds and Payout Ratio. Although, at this time, CES intends to continue to make cash dividends to shareholders, these dividends are not guaranteed. In addition, future expansion, investments and acquisitions may be funded internally by withholding a portion of cash flow in conjunction with, or in replacement, of external sources of capital such as debt or the issuance of equity. To the extent that CES withholds cash flow to finance these activities, the amount of cash dividends to shareholders may be reduced. Alternatively, to the extent that CES' sustainable operating after tax cash flow improves, the amount of cash dividends to shareholders may be increased. Over the long-term, CES' business model has historically shown it can support a large proportion of cash flow from operations being paid out as a dividend as the long-term expansion capital investments and maintenance capital expenditures required for CES to execute its business plan have not been significant in relation to the total revenue and earnings generated.

Subsequent to June 30, 2012, CES declared a monthly dividend of \$0.05 per common share to shareholders of record at July 31, 2012, for the month of July 2012.

### **Shareholders' Equity**

As of June 30, 2012, CES had a total of 55,681,662 common shares outstanding. As of the date of this MD&A, CES had a total of 55,707,662 common shares outstanding.

### **Stock-based Compensation**

As at June 30, 2012, a total of 5,568,166 common shares were reserved for issuance under the Company's Option Plan, Share Rights Incentive Plan, and Restricted Share Unit Plan of which 2,373,637 remained available for grant.

#### *a) Option Plan, formerly referred to as the Partnership Unit Option Plan*

At June 30, 2012, a total of 84,200 (December 31, 2011 – 115,000) options were outstanding at a weighted average exercise price of \$2.49. As at June 30, 2012, a total of 84,200 options were exercisable at a weighted average price of \$2.49. As of the date of this MD&A, there were a remaining 84,200 options outstanding. As a result of the Conversion effective January 1, 2010, all prior grants under the Option Plan will continue based on the terms and conditions of the original grant and all outstanding options issued under the Option Plan will be exercisable for new common shares of CES on a one for one basis. No new grants shall be made under the Option Plan.

#### *b) Share Rights Incentive Plan ("SRIP")*

At June 30, 2012, a total of 2,523,088 Share Rights were outstanding (December 31, 2011 – 2,987,602) at a weighted average exercise price of \$6.40 (assuming all SRIP's are exercised at their respective original exercise price) of which 587,000 were exercisable. As of the date of this MD&A, an aggregate of 2,497,088 Share Rights remaining outstanding, of which 579,000 have vested.

#### *c) Restricted Share Unit Plan ("RSU")*

At June 30, 2012, a total of 587,242 Restricted Share Units were outstanding (December 31, 2011 – 310,030) at a weighted average price of \$11.84, none of which were vested. As of the date of this MD&A, an aggregate of 587,242 Restricted Share Units remain outstanding, none of which have vested.

### **Commitments / Contractual Obligations**

At June 30, 2012, CES had the following additional commitments not included as liabilities on its statement of financial position:

<i>\$000's</i>	<b>2012 - 6 months</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>Total</b>
Office and facility rent	1,069	1,715	1,230	1,133	882	<b>6,029</b>

Payments denominated in foreign currencies have been translated at the respective period end exchange rates

As of the date of this document, given its financial position, CES anticipates it will be able to meet these commitments as necessary.

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The Company is involved in litigation and disputes arising in the normal course of operations. Management is of the opinion that any potential litigation it is aware of will not have a material adverse impact on the Company's financial position or results of operations and therefore the commitment table does not include any commitments for any outstanding litigation and any potential claims.

### **CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS**

As a routine element of the financial statement preparation process, management is required to make estimates and assumptions based on information available as at the financial statement date. These estimates and assumptions affect the reported amounts of assets and liabilities, the possible disclosure of contingent assets and liabilities at the date of the unaudited interim condensed consolidated financial statements and the reported amounts of revenue and expenses for the period.

Although estimates and assumptions must be made during the financial statement preparation process, it is management's opinion that none of the estimates or assumptions were highly uncertain at the time they were made. The most significant estimates in CES' condensed consolidated financial statements have been set out in the Company's MD&A for the year ended December 31, 2011, and its audited annual consolidated financial statements and notes thereto for the year ended December 31, 2011.

### **RECENT ACCOUNTING PRONOUNCEMENTS**

During the six months ended June 30, 2012, there were no revised standards or amendments to IFRS issued. Refer to the Company's December 31, 2011 MD&A for the recent accounting pronouncements for which the Company is continuing to evaluate the impact of adopting these standards.

### **CORPORATE GOVERNANCE**

#### ***Disclosure Controls and Procedures***

Disclosure controls and procedures have been designed to provide reasonable assurance that information required to be reported by CES is gathered, recorded, processed, summarized and reported to senior management, including the President and Chief Executive Officer and Chief Financial Officer of CES, to allow timely decisions regarding required public disclosure by CES in its annual filings, interim filings or other reports filed or submitted in accordance with Canadian securities legislation.

#### ***Internal Controls over Financial Reporting***

Management of CES is responsible for establishing and maintaining internal controls over financial reporting for CES to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with International Financial Reporting Standards. There have been no changes to CES' internal controls over financial reporting during the three months ended June 30, 2012 that have materially affected, or are reasonably likely to materially affect, its internal controls over financial reporting.

It should be noted that while the President and Chief Executive Officer and Chief Financial Officer believe that CES' disclosure controls and procedures and internal controls over financial reporting provide a reasonable level of assurance that they are effective, they do not expect that the disclosure controls and procedures or internal control over financial reporting will prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

For information regarding the corporate governance policies and practices of CES, the Reader should refer to CES' 2011 Annual Report, CES' Annual Information Form dated March 8, 2012 in respect of the year ended December 31, 2011, and CES' Information Circular in respect to the June 14, 2012 Annual General and Special Meeting of shareholders each of which are available on the CES' SEDAR profile at [www.sedar.com](http://www.sedar.com).

### **RISKS AND UNCERTAINTIES AND NEW DEVELOPMENTS**

The drilling industry is cyclical and the business of CES is directly affected by fluctuations in the level and complexity of oil and natural gas exploration and development activity carried on by its clients. In Canada, drilling activity is seasonal and, in turn, throughout North America it is directly affected by a variety of factors including: weather; oil, natural gas, and natural gas liquids prices; access to capital markets; and government policies including, but not limited to, royalty, environmental, and industry regulations. Any prolonged or significant decrease in energy prices, economic activity, or adverse change in government regulations could have a significant negative impact on exploration and development drilling activity in North

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America and, in turn, demand for CES' products and services.

Crude oil prices have weakened over the last quarter and are likely to continue to face volatility in the face of macro-economic forces. In addition, many operators in the WCSB have been challenged by crude oil pricing differentials versus world benchmarks such as Brent and West Texas Intermediate. Natural gas prices have remained weak since late 2008 and have declined to ten year lows in recent months. Despite the volatility of commodity prices, CES has experienced an increase in the demand for its services in 2010, 2011 and into the first half of 2012 as operators have expanded the use of horizontal drilling combined with multi-stage fracking completion techniques. In addition, more capital and drilling activity has been migrating away from dry gas towards either oil or liquids rich natural gas targets over this period. However, North American rig counts are at a relative peak with high utilization rates and with most equipment capable of drilling horizontal wells being fully deployed. Similar to previous industry cycles, the industry has a relative shortage of equipment and labour which has driven up the costs to operators to drill and complete wells. Higher drilling and completion costs to operators affect the economics of drilling wells, and heightens the risk that drilling activity could slow if operators' access to capital is reduced or the price of crude oil falls further or the price of natural gas remains at these very depressed levels, restricting their cash flow.

The Western Canadian drilling industry is subject to seasonality with activity usually peaking during the winter months in the fourth and first quarters of any given calendar year. As temperatures rise in the spring, the ground thaws and becomes unstable, resulting in government road bans which severely restrict activity in the second quarter. These seasonal trends typically lead to quarterly fluctuations in Canadian operating results and working capital requirements which should be considered in any quarter over quarter analysis of the Company. As the drilling fluids business expands in the US and as the production chemical business is built out, it is expected that the overall seasonality of the Company's operations will be less pronounced.

The ability of CES to sell and expand its services will also depend upon the ability to attract qualified personnel as needed. Over the past few years, the demand for skilled oilfield employees and drilling fluid technicians has been high and the supply has been limited. The unexpected loss of CES' key personnel or the inability to retain or recruit skilled personnel could have an adverse effect on CES' results. CES addresses this risk by:

- attracting well trained and experienced professionals;
- offering competitive compensation at all levels;
- ensuring a safe working environment with clearly defined standards and procedures; and
- offering its employees both internal and external training programs.

CES takes its health, safety, and environmental responsibilities seriously and has instituted standards, policies, and procedures to address these risks. In addition, CES maintains insurance policies with respect to its operations providing coverage over what it considers to be material insurable risks.

Significant changes in the oil and gas industry including economic conditions, environmental regulations, government policy, and other factors may adversely affect CES' ability to realize the full value of its accounts receivable. In addition, a concentration of credit risk exists in trade accounts receivable since they are predominantly with companies operating in the WCSB, Texas and the Mid-continent regions, and Northeast regions of the US. CES continues to attempt to mitigate the credit risk associated with its customer receivables by performing credit checks as considered necessary, managing the amount and timing of exposure to individual customers, reviewing its credit procedures on a regular basis, and reviewing and actively following up on older accounts. CES does not anticipate any significant issues in the collection of its customer receivables at this time outside of those which have already been provided for. However, if low natural gas prices persist, or if crude oil prices fall, or volatile capital markets return, there would be a risk of increased bad debts. It is not possible at this time to predict the likelihood, or magnitude, of this risk.

The provincial governments of Alberta, British Columbia, Manitoba, and Saskatchewan collect royalties on the production from Crown lands. These fiscal royalty regimes are reviewed and adjusted from time to time by the respective governments for appropriateness and competitiveness. As an example, during 2009 and 2010, changes were announced to the royalty regimes and/or drilling incentive programs in Alberta and British Columbia. These changes, as well as the potential for future changes in these and other jurisdictions, add uncertainty to the outlook of the oilfield services sector.

CES' US footprint and size of operations continues to increase. US expansion provides CES with upside potential and reduces certain risks through diversification of operations. It also exposes the Company to additional specific risks including: integration risks of the acquired businesses; currency risk with added exposure to the US dollar; regulatory risks associated with

## Canadian Energy Services & Technology Corp.

Management's Discussion and Analysis

Three and Six Months Ended June 30, 2012

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environmental concerns with respect to drilling activity in Northeast US; and the future impact of increased regulatory requirements on drilling activity in the Gulf of Mexico are examples of specific US risks faced by the Company.

The volatility in the financial markets over the past three to four years has impacted the general availability of both credit and equity financing in the marketplace. The current sovereign debt issues ongoing in Europe and the generally tepid economic forecasts for the North American and world economy result in continued uncertainty. It may prove to be difficult under future market conditions to issue additional equity or increase credit capacity without significant costs. In addition, should CES' senior lender be unable to, or choose not to, fund it would impair CES' ability to operate, as access to funds from its Senior Facility is critical to the effective execution of the business. CES has not experienced any funding issues under its debt facilities to date.

Effective January 1, 2010, Canadian Energy Services L.P. (the "Partnership") and Canadian Energy Services Inc. (the "General Partner") completed a transaction with Nevaro Capital Corporation ("Nevaro") which resulted in the Partnership converting from a publicly-traded Canadian limited partnership to a publicly-traded corporation formed under the Canada Business Corporations Act (the "Conversion"). The Conversion resulted in the unitholders of the Partnership becoming shareholders of Canadian Energy Services & Technology Corp. ("CES" or the "Company") with no changes to the underlying business operations. CES undertook the Conversion as the limited partnership structure restricted the ability for CES to grow in the United States. Pursuant to the Limited Partnership Agreement in place, only persons who were residents in Canada, or, if partnerships were Canadian partnerships, in each case for purposes of the Tax Act, could own Class A Units of CES. CES proactively assessed several options available to expand its equity holding base beyond Canadian residents. In addition, in order to satisfy conditions of the Champion acquisition, CES was required to alter its legal structure. The resulting decision of CES was to pursue the Conversion. The steps pursuant to which the Conversion was effected were structured to be tax deferred to CES and unitholders based on current legislation. If amendments to existing legislation are proposed or announced, there is a risk that the tax consequences of the Conversion to CES and the unitholders may be materially different than the tax consequences contemplated. While CES is confident in its position, there is a possibility that regulators could challenge the tax consequences of the Conversion or prior transactions of Nevaro or legislation could be enacted or amended, resulting in different tax consequences than those contemplated. Such a challenge or legislation could potentially affect the availability or quantum of the tax basis or other tax accounts of CES. On March 4, 2010, the Minister of Finance (Canada) announced certain amendments to the Income Tax Act (Canada) to restrict the ability to utilize tax losses in transactions, which are similar to the Conversion, where units of a publicly-traded trust or partnership are exchanged for shares of a corporation. However, the amendments as announced are intended to apply to transactions undertaken after March 4, 2010, and as such should not apply to the Conversion. It should be noted that in Q4 2011 CES received a letter from the Canada Revenue Agency ("CRA") requesting information in order to review the Conversion and CES is in the process of providing information requested by the CRA.

Reference should be made to CES' Annual Information Form dated March 8, 2012 for the period ended December 31, 2011, and in particular to the heading "Risk Factors" for further risks associated with the business, operations, and structure of CES which is available on CES' SEDAR profile at [www.sedar.com](http://www.sedar.com).

## OUTLOOK

CES' Q2 2012 results reflect an increase in activity and revenue across all of CES' business segments over the comparable period in 2011. CES' dominant business line, the drilling fluids segment, experienced the most material gains as a result of the continuing industry trend to drill more complex, deeper and longer horizontal wells. CES has benefited from this trend as these types of wells require more fluids in general, but also more technically advanced fluids in order to be successfully drilled and cased. The result is the drilling fluids portion of the typical well cost has increased, while the average well cost has also increased. Based on the reported well economics of the different North American play types and the reported drilling plans of operators, this trend looks to continue in 2012.

CES' strategy is to utilize its patented and proprietary technologies and superior execution to increase market share in North America. As a larger percentage of the wells being drilled require more complex drilling fluids to best manage down hole conditions, drilling times and costs, CES will leverage its superior customer service and its unique products like its patented Seal-AX<sup>TM</sup> and PolarBond<sup>TM</sup> lines along with its proprietary ABS40<sup>TM</sup>, PureStar<sup>TM</sup> and Liquidrill<sup>TM</sup>/Tarbreak products to demonstrate its superior performance. CES believes that its unique value proposition in this increasingly complex drilling environment makes it the premier independent drilling fluids provider in North America.

With the increase in activity in the WCSB, the EQUAL Transport division has also experienced growth. It is expected this business will continue to be economically viable and may be expanded further as attractive opportunities emerge.

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The PureChem Services division manufactures and sells drilling fluid chemicals and production chemicals. PureChem began operations with the opening of its chemical blending facility in February 2011. PureChem is a complimentary business to both CES' drilling fluids business and EQUAL's production hauling businesses in Canada. CES' strategy is to continue to build out PureChem from its southeast Saskatchewan roots, through both organic growth off of our established North American platforms and through strategic fit acquisitions.

The Clear Environmental Solutions division continues to complement CES' core drilling fluids business. The Environmental Services division has focused on expanding its operational base in the WCSB and is pursuing opportunities in the oil sands and horizontal drilling markets.

As drilling has become more complex, advanced down-hole technologies are becoming increasingly important in driving success for operators. CES will continue to invest in research and development to be a leader in technology advancements in the drilling fluids and production chemical markets. CES operates three separate lab facilities located in Carlyle, Saskatchewan; Calgary, Alberta; and Houston, Texas. CES also leverages third party partner relationships to drive innovation in the fluids business.

On a corporate level, CES continually assesses integrated business opportunities that will keep CES competitive and enhance profitability. However, all acquisitions must meet our stringent financial and operational metrics. CES will also closely manage its dividend levels and capital expenditures in order to preserve its financial strength, its low capital re-investment model and its strong liquidity position.

CES had positive results in Q2 2012 over Q2 2011, and CES remains very optimistic about the long-term prospects of its business. However, over the last quarter, crude oil prices and the various natural gas liquids which are priced in relation to crude oil have weakened; oil price differentials have widened; and natural gas prices continue to remain very weak, making the economics of drilling more challenging. Lower commodity prices have constrained operator's cash flow and taxed their available credit lines, while at the same time access to capital through the equity markets has become more difficult. All of these factors affect the amount of capital available to drill wells which will likely constrain drilling activity in the near-term.

### **ADDITIONAL INFORMATION**

Additional information related to CES can be found on the System for Electronic Document Analysis and Retrieval (SEDAR) at [www.sedar.com](http://www.sedar.com). Information is also accessible on CES' web site at [www.canadianenergyservices.com](http://www.canadianenergyservices.com).

## Canadian Energy Services & Technology Corp.

### Management's Discussion and Analysis Information

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#### STOCK EXCHANGE LISTINGS

The Toronto Stock Exchange  
Trading Symbol: CEU

#### OTCQX

Trading Symbol: CESDF

#### BOARD OF DIRECTORS

Kyle D. Kitagawa<sup>1</sup>  
Chairman

Colin D. Boyer<sup>1,2</sup>

John M. Hooks<sup>2</sup>

D. Michael G. Stewart<sup>1</sup>

Thomas J. Simons

Rodney Carpenter

James (Jim) G. Sherman

<sup>1</sup>Member of the Audit Committee

<sup>2</sup>Member of the Governance and  
Compensation Committee

#### OFFICERS

Thomas J. Simons  
President & Chief Executive Officer

Craig F. Nieboer, CA  
Chief Financial Officer

Kenneth E. Zinger  
Canadian President & Chief Operating Officer

Kenneth D. Zandee  
Vice President, Marketing

Scott R. Cochlan  
Corporate Secretary

#### AUDITORS

Deloitte & Touche LLP.  
Chartered Accountants, Calgary, AB

#### BANKERS

HSBC Bank Canada, Calgary, AB

#### SOLICITORS

Torys LLP, Calgary, AB  
Crowe & Dunlevy, Oklahoma City, OK

#### REGISTRAR & TRANSFER AGENT

Computershare Investor Services Inc.  
Calgary, AB and Toronto, ON

#### CORPORATE OFFICE

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#### DIVISIONS

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Fax: 403-229-1306

EQUAL Transport  
18029 – Highway 10 East  
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Phone: 780-728-0067  
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#### US OPERATIONS

##### DIVISIONS

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