Canadian Energy
SERVICES

# Annual Report

**For the Year Ended December 31, 2010**

Year Ended December 31, 2010
As at March 17, 2011

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 audited 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 years ended December 31, 2010 and 2009 and CES' 2010 Annual Information Form. The information contained in this MD&A was prepared up to and including March 17, 2011 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, taxation of trusts, public partnerships and other flow-through entities, 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, 2010 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.*

## CORPORATE CONVERSION TRANSACTION

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 trades on the TSX under the trading symbol "CEU".

This MD&A contains discussion and analysis of the financial condition and results of operations of CES post-Conversion. Therefore certain terms used throughout this MD&A have comparable meaning to those used in previous disclosures under the partnership structure such as shareholder/unitholder and dividend/distribution. For the year ended December 31, 2009, all distributions declared to unitholders were in the form of limited partnership unit distributions and, beginning in 2010, all dividends declared and paid are eligible Canadian dividends. In addition "CES" or the "Company" is used throughout to describe the business undertaken by the Partnership pre-Conversion and for Canadian Energy Services & Technology Corp. post-Conversion.

## BUSINESS OF CES

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, 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 for CES and production chemicals for operators. The PureChem facility is located strategically in Carlyle, SK.

CES' head office and the 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 from its head office in Denver, Colorado; in the mid-continent region through its Champion Drilling Fluids division which is headquartered in Norman, Oklahoma; and in Texas, Louisiana, off-shore Gulf of Mexico and Northeast US through its Fluids Management division headquartered in Houston, Texas. AES has operations in fourteen states with stock point facilities located in Oklahoma, Texas, Pennsylvania, Michigan, Colorado, North Dakota, Louisiana, and Utah.

## NON-GAAP MEASURES

The accompanying audited consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). Certain supplementary information and measures not recognized under Canadian 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:

***EBITDAC*** – means net earnings before interest, taxes, amortization, 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:

| | Three Months Ended December 31, | | Year Ended December 31, | |
|---|---|---|---|---|
| *$000's* | **2010** | 2009 | **2010** | 2009 |
| Net income | **11,664** | 5,857 | **26,259** | 7,515 |
| Add back (deduct): | | | | |
| Amortization | **1,977** | 926 | **6,439** | 3,526 |
| Interest expense, net of interest income | **654** | 204 | **1,663** | 478 |
| Current income tax expense | **119** | - | **315** | - |
| Future income tax expense (recovery) | **1,733** | (2,765) | **5,036** | (2,540) |
| Stock-based compensation | **998** | 124 | **1,791** | 827 |
| Unrealized foreign exchange (gain) loss | **2** | (16) | **10** | 13 |
| Unrealized derivative (gain) loss | **(14)** | 2 | **(24)** | 11 |
| (Gain) loss on disposal of assets | **(12)** | 41 | **(13)** | 110 |
| EBITDAC | **17,121** | 4,373 | **41,476** | 9,940 |

***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 flow, net income, or other measures of financial performance calculated in accordance with Canadian GAAP. Funds flow from operations assists management and investors in analyzing operating performance and leverage. Funds flow from operations is calculated as follows:

| | Three Months Ended December 31, | | Year Ended December 31, | |
|---|---|---|---|---|
| *$000's* | **2010** | 2009 | **2010** | 2009 |
| Cash provided by (used in) operating activities | **3,996** | (2,133) | **(15,594)** | 19,345 |
| Adjust for: | | | | |
| Change in non-cash operating working capital | **12,352** | 6,302 | **55,092** | (9,883) |
| Funds flow from operations | **16,348** | 4,169 | **39,498** | 9,462 |

***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.

These measures do not have a standardized meaning as prescribed by Canadian GAAP 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.

***Well type*** - CES classifies oil and natural gas wells by depth, as follows:

| | |
|---|---|
| *Shallow wells*: | Generally less than 1,000 metres; |
| *Medium wells*: | Generally between 1,000 and 2,500 metres; |
| *Deep wells:* | Generally greater than 2,500 metres; and |
| *Horizontal wells:* | Drilled vertically then horizontally, often with multiple lateral legs, reaching out 500 to 1,500 metres each. |

## FINANCIAL HIGHLIGHTS

| *Summary Financial Results* | Three Months Ended December 31, | | | Year Ended December 31, 2010 | | |
|---|---|---|---|---|---|---|
| *($000's, except per share amounts)* | **2010** | 2009 | % Change | **2010** | 2009 | % Change |
| Revenue | **94,468** | 27,303 | 246.0% | **249,116** | 89,454 | 178.5% |
| Gross margin (1) | **27,465** | 9,160 | 199.8% | **72,173** | 26,712 | 170.2% |
| Gross margin percentage of revenue (1) | **29.1%** | 33.5% | | **29.0%** | 29.9% | |
| Income before taxes | **13,516** | 3,092 | 337.1% | **31,610** | 4,975 | 535.4% |
| *per share – basic (2)* | ***0.75*** | *0.27* | *177.8%* | ***2.09*** | *0.44* | *375.0%* |
| *per share - diluted (2)* | ***0.74*** | *0.26* | *184.6%* | ***2.03*** | *0.44* | *361.4%* |
| Net income | **11,664** | 5,857 | 99.1% | **26,259** | 7,515 | 249.4% |
| *per share – basic (2)* | ***0.65*** | *0.51* | *27.5%* | ***1.74*** | *0.67* | *159.7%* |
| *per share - diluted (2)* | ***0.64*** | *0.50* | *28.0%* | ***1.69*** | *0.66* | *156.1%* |
| EBITDAC (1) | **17,121** | 4,373 | 291.5% | **41,476** | 9,940 | 317.3% |
| *per share – basic (2)* | ***0.96*** | *0.38* | *152.6%* | ***2.75*** | *0.88* | *212.5%* |
| *per share - diluted (2)* | ***0.94*** | *0.37* | *154.1%* | ***2.67*** | *0.88* | *203.4%* |
| Funds flow from operations (1) | **16,348** | 4,169 | 292.1% | **39,498** | 9,462 | 317.4% |
| *per share – basic (2)* | ***0.91*** | *0.36* | *152.8%* | ***2.62*** | *0.84* | *211.9%* |
| *per share - diluted (2)* | ***0.90*** | *0.35* | *157.1%* | ***2.54*** | *0.84* | *202.4%* |
| Dividends declared | **5,042** | 2,787 | 80.9% | **14,040** | 10,759 | 30.5% |
| *per share (2)* | ***0.30*** | *0.24* | *26.3%* | ***0.92*** | *0.95* | *(3.2%)* |
| *per Subordinated Class B Unit* | **-** | - | *0.0%* | **-** | *0.24* | *(100.0%)* |

***Notes:***
*[1] Refer to the "Non-GAAP Measures" for further detail.*
*[2] Prior period comparatives includes both Class A Units and Subordinated Class B Units.*

# OVERVIEW OF FINANCIAL AND OPERATIONAL RESULTS

CES' Q4 2010 and 2010 annual results reflect an increase in activity and revenue across all of CES' business segments as drilling activity rebounded off the lows experienced in 2009 throughout the North American Market ("NAM"). CES' dominant business line, the drilling fluids segment, experienced the most material gains over 2009 as a result of increased industry activity and a continuing industry trend to drill more complex, horizontal wells. CES capitalized on this trend in the WCSB through its leading market share position and in the US through completing two accretive acquisitions (the Champion Drilling Fluids acquisition on November 30, 2009 and the Fluids Management Acquisition completed at the end of Q2 2010, collectively the "US Acquisitions"), and the immediate organic growth in the US that the Company has been able to generate off of these acquired platforms.

Highlights for the year ended December 31, 2010 in comparison to the year ended December 31, 2009 for CES are as follows:

- On June 30, 2010, CES closed the acquisition of Fluids Management II, Ltd. ("Fluids Management") to acquire all of the drilling fluids business assets of Fluids Management, and certain additional assets relating to Fluids Management from two affiliates of Fluids Management, Brookshire Investment Trust, and Stikley Enterprises, Inc. (collectively the "Fluids Management Acquisition"). The effective date of the Fluids Management Acquisition was June 21, 2010. However, under Canadian GAAP, the revenue and expenses with respect to Fluids Management for the period from the effective date through to the June 30, 2010 closing date were accounted for as a working capital adjustment to the purchase price allocation and were not included in the net earnings of the Company for the three month period ended June 30, 2010. The consolidated operating results of CES include the results from the Fluids Management division in both Q3 and Q4 of 2010.

- CES generated gross revenue of $94.5 million during the fourth quarter of 2010, compared to $27.3 million for the three months ended December 31, 2009, an increase of $67.2 million or 246% on a year-over-year basis. Total gross revenue for 2010 totalled $249.1 million, compared to $89.5 million last year, representing an increase of $159.6 million or 178% on a year-over-year basis. During Q4 2010, gross revenue was $5.58 per diluted share compared to $2.32 per share for Q4 2009, an increase of 141%.

- CES' estimated Canadian Market Share (refer to "Operational Definitions") was approximately 28% for the three months ended December 31, 2010, remaining consistent on a percentage basis with last year at 28% for the three months ended December 31, 2009. Year-to-date, estimated market share in Western Canada has averaged 27%, up 2% from the 25% estimated market share for the year ended December 31, 2009. CES' operating days (refer to "Operational Definitions") in Western Canada were estimated to be 10,054 for the three month period ended December 31, 2010, an increase of 59% from the 6,336 operating days during the same period last year. Year-to-date, operating days in Western Canada were estimated to total 32,313 compared to 19,953 during the same period last year, representing an increase of 62%. Overall industry activity increased approximately 45% from an average monthly rig count in the fourth quarter of 2009 of 273 to 398 during the fourth quarter of 2010 based on CAODC published monthly data for Western Canada. Year–to-date, the CAODC average monthly rig count for Western Canada have averaged 327 as compared to 219 in 2009 representing a year-over-year increase of 49%.

- Revenue from drilling fluids related sales of products and services in Western Canada, gross of intercompany eliminations, was $36.0 million for the three months ended December 31, 2010, compared to $18.5 million for the three months ended December 31, 2009, representing an increase of $17.5 million or 95%. For the year ended December 31, 2010, revenue from drilling fluids related sales of products and services in Western Canada, gross of intercompany eliminations, was $112.3 million compared to $66.9 million for the year ended December 31, 2009, representing an increase of $45.4 million or 68%. Daily average revenue per operating day for the three months ended December 31, 2010, was $3,581 compared to $2,920 for the three months ended December 31, 2009, representing an increase of 23%. For the year ended December 31, 2010, daily average revenue per operating day was $3,478 compared to $3,353 for the year ended December 31, 2009, representing an increase of 4%.

- For the three months ended December 31, 2010, revenue generated in the US from drilling fluid sales of products and services, gross of intercompany eliminations, was $49.3 million with an estimated 8,780 operating days (refer to "Operational Definitions") as compared to last year's revenue of $3.4 million with an estimated 832 operating days during the same period. For 2010, revenue generated in the US, gross of intercompany eliminations, totals $109.7 million as compared to $6.3 million in the previous year representing an increase of $103.4 million. Total operating days for 2010 in the US were 21,091 as compared to 1,364 during 2009. CES' estimated United States Market Share (refer to "Operational Definitions") for the three and twelve months ended December 31, 2010 was estimated to be 6% and 4% respectively Daily average revenue per operating day for the three months ended December 31, 2010, was $5,615 compared to $4,087 for the three months ended December 31, 2009, representing an increase of 37%. For the year ended December 31, 2010, daily average revenue per operating day was $5,201 compared to $4,619 for the year ended December 31, 2009, representing an increase of 13%. The respective increases in activity and revenue in the US in 2010 over 2009 are a result of an improvement in drilling activity in the last half of 2010, but more significantly from the inclusion of the US Acquisitions with the inclusion of six months of Fluids Management activity and a full year of Champion activity during 2010.

- During the fourth quarter of 2010, revenue from trucking operations, gross of intercompany eliminations, totalled $4.7 million, an increase of $1.9 million or 68% from the $2.8 million for the three months ended December 31, 2009. For 2010, revenue from trucking operations totalled $15.3 million as compared to $8.1 million during 2009 representing an increase of $7.2 million or 89%. The respective year-over-year increase is due primarily to the continued expansion of trucking operations in Saskatchewan.

- Clear Environmental Solutions division generated $5.7 million of revenue for the three month period ended December 31, 2010 compared to $2.8 million during the prior year representing an increase of $2.9 million or 104%. Revenue from Clear for the year ended December 31, 2010 totalled $14.0 million as compared to $9.0 million for the same period in 2009, representing an increase of $5.0 million or 56%. Year-over-year, the Clear Environmental division has seen higher overall activity levels and continues to benefit from increased integration with the drilling fluids division, from diversification strategies pursued during 2009 to reduce its exposure to shallow natural gas focused drilling, and general improvement in industry activity levels.

- For the three month period ended December 31, 2010, CES recorded gross margin of $27.5 million or 29% of revenue, compared to gross margin of $9.2 million or 34% of revenue generated in the same period last year. Year-over-year, Q4 margins were lower primarily due to higher overall invert sales in the WCSB as a percentage of total revenue. Invert sales in the WCSB market have a lower gross margin as compared to other product margins of CES. During 2010, CES achieved a gross margin of $72.2 million or 29% of revenue as compared to $26.7 million or 30% in 2009 which is consistent to the prior year comparison on a percentage basis.

- For the three month period ended December 31, 2010, selling, general, and administrative costs were $10.6 million as compared to $4.8 million for the same period in 2009, an increase of $5.8 million. For the year ended December 31, 2010, selling, general, and administrative costs were $31.6 million as compared to $16.8 million for the same period in 2009. Selling, general, and administrative costs are higher on a year-over-year comparison due to a combination of factors including the acquisitions of Champion and Fluids Management in Q4 2009 and Q2 2010, respectively, and significantly higher activity during 2010 as compared to 2009. Included in selling, general, and administrative expenses during the year ended December 31, 2010, are approximately $0.2 million of one-time expenses relating to the Fluids Management Acquisition by the Company (2009 - $0.6 million of one-time costs associated with the Conversion transaction).

- EBITDAC (refer to "Non-GAAP Measures") for the three months ended December 31, 2010 was $17.1 million as compared to $4.4 million for the three months ended December 31, 2009 representing an increase of $12.7 million or 288%. For the year ended December 31, 2010, EBITDAC totalled $41.5 million as compared to $9.9 million in 2009 representing an increase of $31.6 million or 320%.

- CES recorded a net income of $11.7 million for the three month period ended December 31, 2010 as compared to a net income of $5.9 million in the prior year. CES recorded a net income per share of $0.65 ($0.64 diluted) for the three months ended December 31, 2010 versus net income per share of $0.51 ($0.50 diluted) in 2009. For the year ended December 31, 2010, CES recorded net income of $26.3 million, an increase of $18.8 million from the $7.5 million generated for the same period last year. Year-over-year, basic net income per share was $1.74 ($1.69 diluted) as compared with $0.67 ($0.66 diluted) per unit for the same period in 2009. The respective year-over-year increases are largely reflective of the increased industry activity in Canada and the Company's increased activity in the US as a result of the US Acquisitions and the organic growth of their platforms.

- CES continued to maintain a strong balance sheet at December 31, 2010 with positive net working capital of $34.2 million (December 31, 2009 - $11.3 million, December 31, 2008 - $15.8 million) representing a year-over-year increase of $22.9 million. The increase in working capital balances is comprised of a $65.4 million increase in accounts receivable, $21.3 million increase in inventory, $2.1 million increase in prepaid expenses, net of a $25.5 million increase in accounts payable and accrued liabilities, and an additional draw of $35.4 million on the Operating Facility. The maximum available draw on the $80.0 million facility at December 31, 2010, based on the accounts receivable and inventory balances, was $72.1 million (December 31, 2009 - $20.9 million).

- On July 13, 2010, in conjunction with the Fluids Management Acquisition, the Company, through a syndicate of underwriters, completed a bought deal private placement financing (the "Offering"). Pursuant to the Offering, the Company issued a total of 2,905,000 Subscription Receipts at $15.50 per Subscription Receipt for gross proceeds of $45.0 million. On September 7, 2010, the 2,905,000 Subscription Receipts were converted to common shares of the Company. Net proceeds after offering expenses and underwriter's commission of $2.7, were $43.1 million. Proceeds of the bought deal financing were used to repay the US$40.0 million Bridge Loan on July 13, 2010 which was incurred in conjunction with the Fluids Management Acquisition.

# RESULTS FOR THE PERIODS

| | Three Months Ended December 31, | | | |
|---|---|---|---|---|
| *($000's, except per share amounts)* | **2010** | 2009 | $ Change | % Change |
| Revenue | **94,468** | 27,303 | 67,165 | 246.0% |
| Cost of sales | **67,003** | 18,143 | 48,860 | 269.3% |
| Gross margin [1] | **27,465** | 9,160 | 18,305 | 199.8% |
| Gross margin percentage of revenue [1] | **29.1%** | 33.5% | | |
| Selling, general, and administrative expenses | **10,619** | 4,773 | 5,846 | 122.5% |
| Amortization | **1,977** | 926 | 1,051 | 113.5% |
| Stock-based compensation | **998** | 124 | 874 | 704.8% |
| Interest expense | **654** | 204 | 450 | 220.6% |
| Foreign exchange gain | **(277)** | (40) | (237) | 592.5% |
| Financial derivative (gain) | **(10)** | 40 | (50) | N/M |
| Loss (gain) on disposal of assets | **(12)** | 41 | (53) | N/M |
| Income before taxes | **13,516** | 3,092 | 10,424 | 337.1% |
| Current income tax expense | **119** | - | 119 | N/A |
| Future income tax expense (recovery) | **1,733** | (2,765) | 4,498 | (162.7%) |
| Net income | **11,664** | 5,857 | 5,807 | 99.1% |
| *Net income per share – basic* | ***0.65*** | *0.51* | *0.14* | *27.5%* |
| *Net income per share – diluted* | ***0.64*** | *0.50* | *0.14* | *28.0%* |
| EBITDAC [1] | **17,121** | 4,373 | 12,748 | 291.5% |

| *Common Shares Outstanding* | **2010** | 2009 [2] | % Change |
|---|---|---|---|
| End of period | **18,131,829** | 12,417,573 | 46.0% |
| Weighted average | | | |
| - basic | **17,925,661** | 11,576,203 | 54.8% |
| - diluted | **18,168,232** | 11,765,132 | 54.4% |

***Notes:***
[1] *Refer to the "Non-GAAP Measures" for further detail.*
[2] *Prior period comparatives includes both Class A Units and Subordinated Class B Units.*
[3] *Includes long-term portion of vehicle financing, committed loans, and capital leases.*

| *($000's, except per share amounts)* | Year Ended December 31, **2010** | 2009 | $ Change | % Change |
|---|---|---|---|---|
| Revenue | **249,116** | 89,454 | 159,662 | 178.5% |
| Cost of sales | **176,943** | 62,742 | 114,201 | 182.0% |
| Gross margin [(1)] | **72,173** | 26,712 | 45,461 | 170.2% |
| Gross margin percentage of revenue [(1)] | **29.0%** | 29.9% | | |
| Selling, general, and administrative expenses | **31,578** | 16,754 | 14,824 | 88.5% |
| Amortization | **6,439** | 3,526 | 2,913 | 82.6% |
| Stock-based compensation | **1,791** | 827 | 964 | 116.6% |
| Interest expense | **1,663** | 478 | 1,185 | 247.9% |
| Foreign exchange gain | **(894)** | (13) | (881) | N/M |
| Financial derivative (gain) loss | **(1)** | 55 | (56) | N/M |
| Loss (gain) on disposal of assets | **(13)** | 110 | (123) | N/M |
| Income before taxes | **31,610** | 4,975 | 26,635 | 535.4% |
| Current income tax expense | **315** | - | 315 | N/A |
| Future income tax expense (recovery) | **5,036** | (2,540) | 7,576 | (298.3%) |
| Net income | **26,259** | 7,515 | 18,744 | 249.4% |
| *Net income per share – basic* | ***1.74*** | *0.67* | *1.07* | *159.7%* |
| *Net income per share – diluted* | ***1.69*** | *0.66* | *1.03* | *156.1%* |
| EBITDAC [(1)] | **41,476** | 9,940 | 31,536 | 317.3% |

| *Common Shares Outstanding* | **2010** | 2009 [(2)] | 2008 |
|---|---|---|---|
| End of period | **18,131,829** | 12,417,573 | 11,169,801 |
| Weighted average | | | |
| - basic | **17,925,661** | 11,576,203 | 10,391,369 |
| - diluted | **18,168,232** | 11,765,132 | 10,391,369 |

| *Financial Position ($000's)* | **As at** **December 31, 2010** | December 31, 2009 | December 31, 2008 |
|---|---|---|---|
| Net working capital | **34,229** | 11,347 | 15,825 |
| Total assets | **287,637** | 130,699 | 125,261 |
| Long-term financial liabilities [(3)] | **5,220** | 2,557 | 3,474 |
| Shareholders' equity | **171,048** | 92,534 | 76,978 |

***Notes:***
[1] *Refer to the "Non-GAAP Measures" for further detail.*
[2] *Prior period comparatives includes both Class A Units and Subordinated Class B Units.*

***Revenue and Operating Activities***

CES generated gross revenue of $94.5 million during the fourth quarter of 2010, compared to $27.3 million for the three months ended December 31, 2009, an increase of $67.2 million or 246% on a year-over-year basis. During 2010, CES generated gross revenue of $249.1 million as compared to $89.5 million for the same period in 2009, representing an increase of $159.6 million or 178%. The respective year-over-year increases reflect an increase in activity and revenue across all of CES' business segments as drilling activity rebounded off the lows experienced in 2009 throughout the NAM. CES' dominant business line, the drilling fluids segment, experienced the most material gains over 2009 as a result of increased industry activity and a continuing industry trend to drill more complex, horizontal wells. CES capitalized on this trend in the WCSB through its leading market share position and in the US through completing the US Acquisitions, and the immediate organic growth that the Company has been able to generate off of these acquired platforms.

Of the revenue generated during the fourth quarter of 2010, $36.0 million (2009 - $18.5 million) was generated in the Western Canadian drilling fluids business; $49.3 million (2009 - $3.4 million) was generated in the US drilling fluids business; $5.7

million (2009 - $2.8 million) was contributed by the Clear environmental division, and $4.7 million, gross of intercompany eliminations, (2009 - $2.8 million) was generated by trucking operations.

For the year ended December 31, 2010, $112.3 million (2009 - $66.9 million) was generated in the Western Canada drilling fluids business; $109.7 million (2009 - $3.4 million) was generated in the US drilling fluids business; $14.0 million (2009 - $9.0 million) was contributed by the Clear environmental division, and $15.3 million, gross of intercompany eliminations, (2009 - $8.1 million) was generated by trucking operations.

The active CAODC monthly rig count in Western Canada averaged 398 for the three months ended December 31, 2010 based on CAODC published monthly data for Western Canada representing a 45% increase from the average rig count of 273 during the fourth quarter of 2009. Year-to-date, the CAODC average monthly rig count for Western Canada has averaged 327 compared to 219 in 2009, representing a year-over-year increase of 48%.

CES estimated operating days (refer to "Operational Definitions") from its drilling fluids services as follows:

| | Three Months Ended December 31, | | Year Ended December 31, | |
|---|---|---|---|---|
| | **2010** | 2009 | **2010** | 2009 |
| Canada | **10,054** | 6,336 | **32,313** | 19,953 |
| USA | **8,780** | 832 | **21,091** | 1,364 |
| Total Operating Days | **18,834** | 7,168 | **53,404** | 21,317 |

CES' estimated Canadian Market Share (refer to "Operational Definitions") in Western Canada was 28% for the three months ended December 31, 2010 which was comparable to last year's 28% for the three months ended December 31, 2009. Year-to-date, CES' estimated market share in Western Canada averaged 27% compared to 25% for the same period in 2009. 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 deep and horizontal wells and the economics of drilling have become more difficult for operators.

For the three months ended December 31, 2010, revenue generated in the US from drilling fluid sales of products and services was $49.3 million as compared to the previous year's revenue of $3.4 million representing an increase of $45.9 million. Estimated operating days (refer to "Operational Definitions") in the fourth quarter of 2010 were 8,780 as compared to 832 operating days during the same period last year. Year to date, revenue generated in the US totals $109.7 million as compared to $6.3 million in the previous year representing an increase of $103.4 million. Estimated operating days during the year-to-date period were 21,091 as compared to 1,364 operating days last year. In the United States, CES' estimated United States Market Share (refer to "Operational Definitions") for the three and twelve months ended December 31, 2010 was estimated to be 6% and 4% respectively. CES estimates that, at the time of closing the US Acquisitions, it had acquired an aggregate of approximately 3% of the United States Market Share and, as at the date of this MD&A, CES estimates its United States Market Share to be tracking at just under 7%.

Revenue per estimated operating day for the Canadian and US drilling fluids segments was as follows:

| | Three Months Ended December 31, | | Year Ended December 31, | |
|---|---|---|---|---|
| *$000's* | **2010** | 2009 | **2010** | 2009 |
| Canadian Drilling Fluids | **3,581** | 2,920 | **3,478** | 3,353 |
| United States Drilling Fluids | **5,615** | 4,087 | **5,201** | 4,619 |

For the year ended December 31, 2010, the top five customers of CES accounted for approximately 27% of total revenue (2009 – 27%). During the fourth quarter, CES top five customers accounted for 34% of total revenue as compared to 27% in Q4 2009. During 2010, one customer accounted for approximately 11% of the CES' 2010 revenue (Q4 2010 – 15%) as compared to 12% in 2009 (Q4 2009 – 7%).

Overall, CES' drilling fluid business continues to focus on the ongoing major resource plays and, in particular, horizontal drilling. Horizontal drilling represents a significantly increasing share of CES' revenue composition as customers continue to apply the technique more frequently in drilling more complex 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. For the three months ended December 31, 2010, medium and deep drilling represented 11% (2009 – 21%) of drilling fluids revenue and horizontal wells represented 89% (2009 – 77%) of drilling fluids revenue. For the year ended December 31, 2010, medium and deep drilling represented 10% (2009 – 22%) of drilling fluid revenue and horizontal wells represented 86% (2009 -74%).

***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, 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 $27.5 million or 29% of revenue for the three month period ended December 31, 2010 as compared to $9.2 million or 34% of revenue in 2009. Year-over-year, Q4 margins were lower primarily due to higher overall invert sales in the WCSB as a percentage of total revenue. Invert sales in the WCSB market have a lower gross margin as compared to other product margins of CES. Year-to-date, CES achieved a gross margin of $72.2 million or 29% which was consistent with last year's margin of $26.7 million or 30%.

***Selling, General, and Administrative Expenses ("SG&A")***
As CES' business has expanded geographically into the US and as activity levels have risen, so have the associated SG&A expenses to run the business. SG&A for the three month period ended December 31, 2010 was $10.6 million as compared to $4.8 million for the same period in 2009, representing an increase of $5.8 million or 121% year-over-year. For the year ended December 31, 2010, SG&A costs were $31.6 million as compared to $16.8 million for the same period in 2009. Selling, general, and administrative costs are higher on a year-over-year comparison due to a combination of factors including the inclusion of Champion and Fluids Management general and administrative costs during the current year, higher staff levels and the associated compensation costs, and higher activity during 2010 as compared to 2009. Included in selling, general, and administrative expenses during the year ended December 31, 2010 are approximately $0.2 million of one-time expenses relating to the Fluids Management Acquisition by the Company. SG&A costs as a percentage of revenue for the three months ended December 31, 2010, are 11% compared to 17% in 2009. For the year ended December 31, 2010, SG&A costs as a percentage of revenue were 13% compared to 19% for the same period in 2009.

***Amortization***
Amortization of property, equipment, and intangibles totalled $2.0 million for the three month period ended December 31, 2010 as compared to $0.9 million during 2009. For the year ended December 31, 2010, amortization expense totalled $6.4 million as compared to $3.5 million for 2009. The year-over-year increase in amortization expenses is primarily attributable to the expanded operations of CES compared to the previous year including additional trucks and trailers for the trucking division and the increase in amortization of fixed and intangible assets relating to the Company's US Acquisitions.

***Stock-Based Compensation***
Stock-based compensation was $1.0 million for the three months ended December 31, 2010 as compared to $0.1 million during the same period last year. For the year ended December 31, 2010, stock-based compensation totalled $1.8 million as compared to $0.8 million during the same period last year. The respective year-over-year increase is primarily attributable to the issuance of share rights under the new share rights incentive plan.

***Interest Expense***
CES had interest expense of $0.7 million for the three months ended December 31, 2010 compared to $0.2 million for Q4 2009. For 2010, interest expense totalled $1.7 million as compared to $0.5 million in 2009. The respective year-over-year increase is primarily attributable to higher average borrowings on CES' various long-term debt, operating loan facility and lease facilities as compared to last year. The Company's interest expense consists of interest expense on vehicle financing loans, the committed facilities, capitalized lease facilities, and the operating loan facility. Included in interest expenses is interest charges of $0.1 million relating to the Bridge Loan facility used to finance the Fluids Management Acquisition which was repaid on July 13, 2010.

***Foreign Exchange Gains and Losses***
For the year ended December 31, 2010, CES recorded a net foreign exchange gain of $0.9 million primarily related to foreign exchange gains on the Company's US denominated cash balances and on the repayment of the Bridge Loan financing.

Effective January 1, 2010, the Company changed the classification of its US foreign subsidiary operations, AES, from integrated to self-sustaining and as a result, the operations of AES included in the consolidated financial statements subsequent to that date have been translated using the current rate method as opposed to the previously used temporal method. Under the current rate method of translation, revenues and expenses of the subsidiary are translated at the rate in effect at the time of the transactions while assets and liabilities are translated at the current exchange rate in effect at the balance sheet date. Upon consolidation of the US operations, translation gains and losses due to fluctuations in the foreign currency exchange rates are deferred on the consolidated balance sheet as a separate component of Accumulated Other Comprehensive Income ("AOCI"). Accumulated other comprehensive loss forms part of Shareholders' Equity and represents the cumulative unrealized foreign exchange losses on the translation of its US operations. This change in translation method has been applied prospectively effective January 1, 2010 and resulted in a foreign exchange loss of $0.2 million being deferred and recorded as AOCI as at January 1, 2010.

***Realized and Unrealized Derivative Gains and Losses***

For the three month period and year ended December 31, 2010, CES recorded a derivative gain of $0.01 million and $0.001 million respectively (2009 – loss of $0.04 million and $0.04 million respectively) relating to its foreign currency derivative contracts. For the three month period and year ended December 31, 2010, CES recorded an unrealized gain of $0.014 million and $0.024 million respectively (2009 - $0.002 million and $0.011 million respectively) relating to its foreign currency derivative contracts. The gains were incurred as a result of the relative appreciation of the US dollar vis-à-vis the Canadian dollar over the year. As of December 31, 2010, the Company had a financial derivative asset of $0.025 million relating to its outstanding derivative contracts.

CES has a Board approved hedging policy that sets out the guidelines and parameters management follows when approaching its hedging strategies. At December 31, 2010, the Company had entered into the following foreign exchange US dollar forward purchase contracts to manage its exposure to upcoming US dollar denominated purchases pursuant to its Canadian operations:

| Period | Notional Balance $000's | Contract Type | Settlement | Average C$/US$ Exchange Rate |
|---|---|---|---|---|
| January 2011 | US$215 | Deliverable Forward | Physical Purchase | $1.0259 |
| February 2011 | US$589 | Deliverable Forward | Physical Purchase | $1.0118 |
| Total | US$804 | | | $1.0156 |

At December 31, 2010, the Company had entered into the following foreign exchange US dollar forward sale contracts to manage its exposure to upcoming US dollar denominated cash flows expected to, in part, fund the Company's anticipated future monthly shareholder dividends:

| Period | Notional Balance $000's | Contract Type | Settlement | Average C$/US$ Exchange Rate |
|---|---|---|---|---|
| January 2011 | US$360 | Deliverable Forward | Physical Sale | $1.0088 |
| February 2011 | US$360 | Deliverable Forward | Physical Sale | $1.0094 |
| March 2011 | US$360 | Deliverable Forward | Physical Sale | $1.0100 |
| April 2011 | US$360 | Deliverable Forward | Physical Sale | $1.0107 |
| May 2011 | US$360 | Deliverable Forward | Physical Sale | $1.0116 |
| June 2011 | US$360 | Deliverable Forward | Physical Sale | $1.0122 |
| July 2011 | US$360 | Deliverable Forward | Physical Sale | $1.0129 |
| August 2011 | US$360 | Deliverable Forward | Physical Sale | $1.0138 |
| September 2011 | US$360 | Deliverable Forward | Physical Sale | $1.0146 |
| October 2011 | US$360 | Deliverable Forward | Physical Sale | $1.0153 |
| November 2011 | US$360 | Deliverable Forward | Physical Sale | $1.0163 |
| December 2011 | US$260 | Deliverable Forward | Physical Sale | $1.0102 |
| Total | US$4,220 | | | $1.0122 |

***Current and Future Income Taxes***
Effective January 1, 2010, as a result of the Conversion, the Company converted from a limited partnership structure to a corporate structure. As a result, CES is subject to federal and provincial income taxes in Canada and to federal and state income taxes in the United States to the extent that they are not sheltered by existing tax pools. Previously, the income earned directly by the Partnership in Canada was taxed at the Partnership unitholder level and as such provisions for current income tax were not made by CES. Effective January 1, 2010, the income of CES will be subject to tax and accordingly future income taxes have been recorded relating to temporary differences expected to reverse after this date.

A future income tax asset of $15.5 million has been recognized, relating to the Company's non-capital tax loss pools and other tax credits, and a deferred tax credit in the amount of $12.7 million has been recognized with the difference of $2.8 million representing the consideration paid to Nevaro in connection with the Conversion. A future tax asset has not been recognized with respect to the Company's capital tax loss pools due to the uncertainty of realization. The deferred tax credit will be amortized in proportion to the corresponding future income tax asset as the tax pools are utilized. Please see Changes in Accounting Policies and IFRS discussion on page 22 for the expected change to treatment in 2011 under IFRS.

During the fourth quarter, the Company recorded future income tax expense of $1.7 million compared to a future income tax recovery of $2.8 million in 2009. For the year ended December 31, 2010, the Company recorded a future income tax expense of $5.0 million compared to a future income tax recovery of $2.5 million in 2009. The future income tax expense during the current year 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. During the year ended December 31, 2010, the Company recorded current income tax expense of $0.3 million (2009 - $nil) relating to taxable income in Canada and the US in which the Company does not have loss carry forwards.

***Net Working Capital***
At December 31, 2010, the Company had positive net working capital of $34.2 million (December 31, 2009 - $11.3 million, December 31, 2008 – $15.8 million) representing a year-over-year increase of $22.9 million. The increase in working capital balances is comprised of a $65.4 million increase in accounts receivable, $21.3 million increase in inventory, $2.1 million increase in prepaid expenses, net of a $25.5 million increase in accounts payable and accrued liabilities, and a net additional draw of $35.4 million on its Operating Facility. The maximum available draw on the $80.0 million facility at December 31, 2010, based on the accounts receivable and inventory balances, was $72.1 million (December 31, 2009 - $20.9 million).

***Total Current Assets***
Total current assets of CES increased from $45.7 million at December 31, 2009 to $134.6 million at December 31, 2010. The increase is primarily due to an increase in accounts receivable balances of $65.4 million, an increase of $21.3 million in inventory balances, and an increase of $2.1 million in prepaid expenses. The increase reflects both higher activity levels in Q4 2010 as well as the Fluids Management Acquisition at June 30, 2010.

***Total Long-Term Assets***
Total long-term assets of CES increased by $68.1 million to $153.1 million at December 31, 2010 from $85.0 million at December 31, 2009 (December 31, 2008 – $66.6 million). Of this increase, $56.9 million related to the Fluids Management Acquisition on June 30, 2010 including $7.8 million of fixed assets and $49.1 million related to the value allocated to customer relations, other intangibles, and goodwill. Property and equipment increased by an additional $7.7 million and future income tax assets increased by $15.5 million, primarily as a result of the Conversion, offset by the use of the Company's non-capital tax loss pools in 2010 of $5.8 million,

***Bridge Loan***
In conjunction with the Fluids Management Acquisition, the Company arranged a US$40.0 million bridge financing (the "Bridge Loan") to initially finance the cash portion of the purchase price for the period between the closing of the Fluids Management Acquisition on June 30, 2010 and the closing of the bought deal financing on July 13, 2010. On July 13, 2010, the Bridge Loan was fully repaid. Interest paid on the Bridge Loan totalled $0.1 million.

***Long-Term Financial Liabilities***
CES had long-term debt totalling $3.6 million at December 31, 2010 compared to $2.6 million at December 31, 2009, for an increase of $1.0 million during the year. During the year ended December 31, 2010, the Company obtained additional financing of $3.4 million offset by long-term scheduled debt and lease repayments totalling $1.8 million. During the three month period ended December 31, 2010, the Company made long-term scheduled debt and lease repayments totalling $0.4 million on its capital leases, vehicle debt, and credit facilities. At December 31, 2010, long-term financial liabilities were comprised of vehicle

financing loans totalling $1.6 million and committed facilities totalling $3.6 million, net of the current portion of long-term debt of $1.6 million.

| *$000's* | **December 31, 2010** | December 31, 2009 |
|---|---|---|
| Vehicle financing loans | **1,633** | 1,464 |
| Committed loan facilities | **3,507** | 2,199 |
| | **5,140** | 3,663 |
| Less current portion of long-term debt | **(1,584)** | (1,106) |
| Long-term debt | **3,556** | 2,557 |

At December 31, 2010, the Company had capital lease liabilities of $2.7 million, net of the current portion of $1.1 million, for an increase of $2.7 million compared to December 31, 2009. The majority of this increase occurred in Q1 2010 with the $2.0 million draw on the Company's $2.0 million non-revolving loan facility and a $2.1 million sales and lease back transaction.

| *$000's* | **December 31, 2010** | December 31, 2009 |
|---|---|---|
| Capital lease obligations | **2,736** | - |
| Less current portion of capital lease obligations | **(1,072)** | - |
| Long-term capital lease obligations | **1,664** | - |

***Subordinated Convertible Debenture***

The subordinated convertible debenture (the "Debenture") issued in conjunction with the acquisition of Champion Drilling Fluids Inc. for $6.6 million was converted to into 791,776 common shares of CES at a fixed conversion price of $8.37 per common share on January 4, 2010. The common shares issued are subject to escrow provisions with one-third of the escrowed shares being released, subject to industry standard conditions including a change of control of CES, on each of the first, third, and third anniversaries of closing of the Champion acquisition.

***Shareholders' Equity***

Shareholders' equity increased from $92.5 million at December 31, 2009 (December 31, 2008 - $77.0) to $171.0 million at December 31, 2010. The year-over-year increase in shareholders' equity during the period is primarily attributable to $26.3 million in net income of CES; $21.5 million relating to the deemed accounting value attributed to the 1,289,370 common shares issued by the Company pursuant to the Fluids Management Acquisition: $1.8 million relating to stock-based compensation expense: proceeds of $5.4 million relating to the exercise of stock options; and $43.1 million in net proceeds from the Company's July 13, 2010 private placement of Subscription Receipts. This is offset by $14.0 million of dividends declared by the Company during the year. The 1,289,370 common shares issued in relation to the Fluids Management Acquisition are subject to escrow provisions with one-third of the escrowed shares being released, subject to industry standard conditions including a change of control of CES, on each of the first, third, and third anniversaries of the closing of the Fluids Management acquisition.

| *Shareholders' Equity $000's* | **Year Ended December 31, 2010** |
|---|---|
| Shareholders' equity, beginning of the year | 92,534 |
| Net income for the year | 26,259 |
| Equity issue, net of share issue costs and tax | 43,066 |
| Consideration for acquired business | 21,468 |
| Issued on conversion of Debenture | 6,627 |
| Subordinate convertible Debenture | (6,627) |
| Issued pursuant to Option Plan | 5,353 |
| Stock-based compensation | 1,791 |
| Dividends declared | (14,040) |
| Accumulated other comprehensive loss | (5,383) |
| Shareholders' equity, end of the year | 171,048 |

## SEGMENTED RESULTS

In 2010, 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 Western Canadian Sedimentary Basin and in the United States through its 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 mostly to oil and gas producers active in the shallow natural gas producing areas of Alberta and in Alberta's oil sands. Selected summary financial information relating to the operational segments is as follows:

| | **Three Months Ended December 31, 2010** | | | | |
|---|---|---|---|---|---|
| *Segmented Information ($000's)* | **Drilling Fluids** | **Trucking** | **Environmental Services** | **Intercompany Eliminations** | **Total** |
| Revenue | **84,308** | **4,743** | **5,692** | **(275)** | **94,468** |
| Cost of sales | **60,221** | **3,213** | **3,844** | **(275)** | **67,003** |
| Gross margin | **24,087** | **1,530** | **1,848** | **-** | **27,465** |
| Income before taxes | **12,342** | **811** | **363** | **-** | **13,516** |
| EBITDAC [(1)] | **14,773** | **1,291** | **1,057** | **-** | **17,121** |

| | Three Months Ended December 31, 2009 | | | | |
|---|---|---|---|---|---|
| *Segmented Information ($000's)* | Drilling Fluids | Trucking | Environmental Services | Intercompany Eliminations | Total |
| Revenue | 21,895 | 2,827 | 2,846 | (265) | 27,303 |
| Cost of sales | 14,957 | 1,630 | 1,821 | (265) | 18,143 |
| Gross margin | 6,938 | 1,197 | 1,025 | - | 9,160 |
| Income before taxes | 2,112 | 613 | 367 | - | 3,092 |
| EBITDAC [(1)] | 2,900 | 924 | 549 | - | 4,373 |

| | **Year Ended December 31, 2010** | | | | |
|---|---|---|---|---|---|
| *Segmented Information ($000's)* | **Drilling Fluids** | **Trucking** | **Environmental Services** | **Intercompany Eliminations** | **Total** |
| Revenue | **220,991** | **15,296** | **13,960** | **(1,131)** | **249,116** |
| Cost of sales | **159,181** | **9,812** | **9,081** | **(1,131)** | **176,943** |
| Gross margin | **61,810** | **5,484** | **4,879** | **-** | **72,173** |
| Income before taxes | **27,293** | **2,704** | **1,613** | **-** | **31,610** |
| EBITDAC [(1)] | **34,721** | **4,415** | **2,340** | **-** | **41,476** |

| | Year Ended December 31, 2009 | | | | |
|---|---|---|---|---|---|
| *Segmented Information ($000's)* | Drilling Fluids | Trucking | Environmental Services | Intercompany Eliminations | Total |
| Revenue | 73,148 | 8,117 | 9,004 | (815) | 89,454 |
| Cost of sales | 52,362 | 5,515 | 5,680 | (815) | 62,742 |
| Gross margin | 20,786 | 2,602 | 3,324 | - | 26,712 |
| Income before taxes | 3,499 | 835 | 641 | - | 4,975 |
| EBITDAC [(1)] | 6,678 | 1,897 | 1,365 | - | 9,940 |

***Notes:***
[1] *Refer to the "Non-GAAP Measures" for further detail.*

***Drilling Fluids Segment***
For the three months ended December 31, 2010, revenue from the Drilling Fluids segment totalled $84.3 million compared to $21.9 million for the three months ended December 31, 2009 representing an increase of $62.4 million or 285%. For 2010, revenue from the Drilling Fluids Segment totalled $221.0 million as compared to $73.1 million last year representing an increase of $147.8 million or 202% on a year over year basis. For the three months ended December 31, 2010, revenue per operating day for the Drilling Fluids Segment totalled $4,476 compared to $3,055 for the three months ended December 31, 2009. For 2010, revenue per operating day for the Drilling Fluids Segment totalled $4,183 as compared to $3,431 in 2009.

CES' estimated Canadian Market Share (refer to "Operational Definitions") was approximately 28% for the three months ended December 31, 2010, remaining consistent with last year at 28% for the three months ended December 31, 2009. Year to date, estimated market share in Western Canada has averaged 27% as compared to 25% in during 2009. CES' operating days (refer to "Operational Definitions") in Western Canada were estimated to be 10,054 for the three month period ended December 31, 2010, an increase of 59% from the 6,336 operating days during the same period last year. CES's year over year increase in operating days would have been greater but operating days were severely curtailed in September 2010 due to wet weather that forced many operators to postpone work. For 2010, operating days in Western Canada were estimated to total 32,313 compared to 19,953 during the same period last year, representing an increase of 62%. Overall industry activity increased approximately 46% from an average monthly rig count of 273 during the fourth quarter of 2009 to 398 during the fourth quarter of 2010 based on CAODC published monthly data for Western Canada. For 2010, the CAODC average monthly rig count for Western Canada has averaged 327 as compared to 219 in 2009 representing a year-over-year increase of 49%.

In the United States, estimated operating days for 2010 were 21,091 as compared to 1,364 operating days last year. The respective year-over-year increases in activity and revenue in the US in 2010 compared to 2009 are primarily due to the two accretive US Acquisitions and the organic growth that the Company has been able to generate off of these platforms. CES' estimated United States Market Share (refer to "Operational Definitions") for the three and twelve months ended December 31, 2010 was estimated to be 6% and 4% respectively.

Gross margin for the Drilling Fluids segment was $24.1 million or 29% for the three months ended December 31, 2010 as compared to $6.9 million or 32% during the prior year. Year-over-year, Q4 margins were lower primarily due to higher overall invert sales in the WCSB as a percentage of total revenue. Invert sales in the WCSB market have a lower gross margin as compared to other product margins of CES. For 2010, the Drilling Fluids segment achieved a gross margin of $61.8 million or 28% compared to $20.8 million or 28% last year.

***Trucking Segment***
Revenue from the Trucking segment, gross of intercompany eliminations, was $4.7 million for the three month period ended December 31, 2010 as compared to $2.8 million during last year representing an increase of $1.9 million or 68%. For 2010, the Trucking segment had total revenue, gross of intercompany eliminations, of $15.3 million as compared to $8.1 million during the same period in 2009 representing an increase of $7.2 million or 89%. For 2010, gross margin for the Trucking segment was $5.5 million or 36% of revenue compared to last year's gross margin of $2.6 million or 32%. Year-over-year, trucking margins have improved in part as a result of increased economies of scale achieved in the Carlyle, Saskatchewan trucking operations with the continued expansion of its operations.

***Environmental Services Segment***
Revenue from the Environmental Services segment was $5.7 million for the three month period ended December 31, 2010 as compared to $2.8 million generated for the same period of 2009 representing an increase of $2.9 million or 104%. For 2010, revenue for the Environmental Services totalled $14.0 million as compared to $9.0 million in 2009 representing an increase of $5.0 million or 56%. During the fourth quarter, gross margin from the Environmental Services segment was $1.8 million or 32% of revenue as compared to $1.0 million or 36% for the same period during 2009. Year-to-date, the gross margin from the Environmental Services Segment averaged 35% which has decreased slightly from last year at 37% in 2009. During 2009, the Environmental Services segment was negatively impacted as a result of the significant decline in shallow natural gas focused drilling in the WCSB. However, the Environmental Services segment has focused on expanding its operational base and is pursuing opportunities in the oil sands and horizontal drilling which has, in turn, helped support revenue growth in 2010.

## QUARTERLY FINANCIAL SUMMARY

| | Three Months Ended | | | |
|---|---|---|---|---|
| *($000's, except per share amounts)* | Dec 31, 2010 | Sep 30, 2010 | Jun 30, 2010 | Mar 31, 2010 |
| Revenue | **94,468** | 78,398 | 27,212 | 49,038 |
| Gross margin (1) | **27,465** | 22,741 | 6,500 | 15,467 |
| Net income (loss) (4) | **11,664** | 8,090 | (960) | 7,465 |
| *per share – basic (2)* | ***0.65*** | *0.52* | *(0.07)* | *0.56* |
| *per share – diluted (2)* | ***0.64*** | *0.46* | *(0.07)* | *0.55* |
| EBITDAC (1) (4) | **17,121** | 13,453 | 1,378 | 9,532 |
| *per share – basic (2)* | ***0.96*** | *0.87* | *0.10* | *0.71* |
| *per share – diluted (2)* | ***0.94*** | *0.77* | *0.10* | *0.71* |
| Funds flow from operations (1) | **16,348** | 12,763 | 1,069 | 9,326 |
| *per share – basic (2)* | ***0.91*** | *0.82* | *0.08* | *0.70* |
| *per share – diluted (2)* | ***0.90*** | *0.73* | *0.08* | *0.69* |
| Dividends declared | **5,042** | 3,786 | 2,798 | 2,414 |
| *per share (2)* | ***0.30*** | *0.24* | *0.20* | *0.18* |
| *Shares Outstanding (2)* | | | | |
| End of period | **18,131,829** | 17,734,179 | 14,764,179 | 13,469,809 |
| Weighted average – basic | **17,925,661** | 15,552,005 | 13,486,011 | 13,367,833 |
| Weighted average – diluted | **18,168,232** | 17,550,662 | 13,486,011 | 13,519,021 |

| | Three Months Ended | | | |
|---|---|---|---|---|
| *($000's, except per share amounts)* | Dec 31, 2009 | Sep 30, 2009 | Jun 30, 2009 | Mar 31, 2009 |
| Revenue | 27,303 | 19,219 | 12,634 | 30,298 |
| Gross margin (1) | 9,160 | 6,085 | 3,422 | 8,045 |
| Net income (loss) | 5,857 | 718 | (1,214) | 2,154 |
| *per share– basic and diluted (2)* | *0.50* | *0.06* | *(0.11)* | *0.19* |
| EBITDAC (1) (3) | 4,373 | 2,004 | (45) | 3,608 |
| *per share – basic and diluted (2)* | *0.37* | *0.18* | - | *0.32* |
| Funds flow from operations (1) (3) | 4,169 | 1,922 | (94) | 3,465 |
| *per share – basic and diluted (2)* | *0.35* | *0.17* | *(0.01)* | *0.31* |
| Dividends declared | 2,787 | 2,683 | 2,647 | 2,642 |
| *per share* | *0.24* | *0.24* | *0.24* | *0.24* |
| *Shares Outstanding (2)* | | | | |
| End of period | 12,417,573 | 11,378,055 | 11,140,301 | 11,119,801 |
| Weighted average – basic | 11,576,203 | 11,224,912 | 11,140,301 | 11,124,245 |
| Weighted average – diluted | 11,765,132 | 11,297,312 | 11,140,301 | 11,144,745 |

***Notes:***
*1 Refer to the "Non-GAAP Measures" for further detail.*
*2 Prior period comparatives includes both Class A Units and Subordinated Class B Units.*
*3 Prior year balances recomputed to conform to current year financial statement presentation.*
*4 For the three months ended December 31, 2009, includes $0.6 million of one-time Conversion related transaction costs*

***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 and third quarter until equipment is moved for winter drilling programs in the fourth 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 performance of the Company. If the business continues to expand in the US, it is expected that the overall seasonality of the Company's operations will be less pronounced in future periods.

# LIQUIDITY AND CAPITAL RESOURCES

At December 31, 2010, the Company had net working capital of $34.2 million (December 31, 2009 - $11.3 million, December 31, 2008 - $15.8 million) representing a year-over-year increase of $22.9 million.

At December 31, 2010, CES had a net draw of $44.2 million on its revolving demand operating facility ("Operating Facility") (December 31, 2009 - $8.8 million). The maximum available draw on the $80.0 million Operating Facility at December 31, 2010, based on the accounts receivable and inventory balances, was $72.1 million (December 31, 2009 - $20.9 million).

The maximum draw available under the Operating Facility is subject to the value of certain accounts receivable and inventory balances. The Operating Facility bears interest at the bank's prime rate plus 1.25% and has a standby rate of 0.35% on any unused portion of the facility.

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

1. Non-revolving committed loan facility 1. As of December 31, 2010, there was $1.4 million outstanding (December 31, 2009 - $1.5 million) on the loan. The loan is repayable in fixed monthly principal payments of $9,725 plus interest at the bank's prime rate plus 1.40%. The loan has a remaining term of three years (April 2013), with the bank reserving the right to extend the term by two additional five year periods at its discretion.
2. Non-revolving committed loan facility 2. As of December 31, 2010, there was $0.5 million outstanding (December 31, 2009 - $0.7 million) on the loan. The loan has a remaining term of three years (April 2013) with fixed monthly principal payments of $16,667 plus interest at the bank's prime rate of interest plus 1.40%.
3. Non-revolving demand loan facility 3. As of December 31, 2010, there was $1.6 million outstanding (December 31, 2009 - $Nil million) on the loan. The loan has a remaining term of four years (March 2014) with fixed monthly principal payments of $41,667 plus interest at the bank's prime rate of interest plus 1.40%.
4. Bank Leasing Facility of up to $5.0 million of which $2.1 million has been drawn on to date. As of December 31, 2010, the Company had an outstanding balance owing on these lease facilities of $1.6 million. The Company's leases are for terms ranging from March 2013 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.

In conjunction with the Fluids Management Acquisition, the Company arranged a US$40.0 million bridge financing (the "Bridge Loan") to initially finance the cash portion of the purchase price for the period between the closing of the Fluids Management Acquisition on June 30, 2010 and the closing of the Offering on July 13, 2010. On July 13, 2010, the Bridge Loan was fully repaid. Total interest paid on the Bridge Loan was $0.1 million.

The Company's debt and lease facilities, including the Operating Facility, and the Bridge Loan are secured by general security agreements creating a first priority security interest in all present and after-acquired personal property of Canadian Energy Services & Technology Corp., Canadian Energy Services Inc., the Partnership and each of its subsidiaries, an unlimited corporate guarantee of the indebtedness, obligations and liabilities of the Partnership to the bank given by each of the General Partner, Canadian Energy Services & Technology Corp., and each of the Partnership's subsidiaries, together with demand collateral mortgages on the Partnership's Edson, Alberta and Carlyle, Saskatchewan properties.

In conjunction with the increase in the Operating Facility on October 19, 2010, the financial covenants were amended. These facilities now impose the following financial covenants 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 excluding the Bridge Loan 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 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.

- 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 December 31, 2010, and as of the date of this MD&A, CES was in compliance with the terms and covenants of its lending agreements.

Vehicle financing loans are secured by each related vehicle and incur interest at rates up to 8.78%, with a weighted average rate of 6.08%, and have termination dates ranging from February 2011 to August 2013. At December 31, 2010, outstanding vehicle loans totalled $1.7 million which was comparable to the $1.5 million at December 31, 2009.

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 operating line funding is critical to the effective execution of CES' business plan. To date, CES has not experienced any funding issues under its debt facilities.

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. 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. The volatility in the financial markets since mid-2008 has impacted the availability of both credit and equity in the marketplace. Although financial markets have improved over the last year and a half, in the event that it is required, 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 the improvements in crude oil prices, natural gas prices continue to remain relatively 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 has been a greater emphasis 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 December 31, 2010, cash flow from operating activities was an inflow of $4.0 million compared to an outflow of $2.1 million during the prior year. For the year ended December 31, 2010, cash flow from operating activities was an outflow of $15.6 million compared to an inflow of $19.3 million in 2009. Funds flow from operations (Refer to "Non-GAAP Measures" for further detail), which takes into consideration changes in non-cash operating working capital, for the three months ended December 31, 2010 was a $16.3 million inflow as compared to $4.2 million during 2009. For the year ended December 31, 2010, funds flow from operations was a $39.5 million inflow as compared to $9.5 million during 2009.

| | Three Months Ended December 31, | | Year Ended December 31, | |
|---|---|---|---|---|
| *$000's* | **2010** | 2009 | **2010** | 2009 |
| Cash provided by (used in) operating activities | **3,996** | (2,133) | **(15,594)** | 19,345 |
| Adjust for: | | | | |
| Change in non-cash operating working capital | **12,352** | 6,302 | **55,092** | (9,883) |
| Funds flow from operations | **16,348** | 4,169 | **39,498** | 9,462 |

***Cash Flows From Investing Activities***

For the year ended December 31, 2010, cash flow from investing activities totalled a cash outflow of $55.9 million compared to a cash outflow of $12.5 million during 2009. During the three months ended December 31, 2010, net cash outflows from investing activities totalled $5.3 million compared to $10.2 million for the three months ended December 31, 2009.

For the three months ended December 31, 2010, $5.9 million was spent on property and equipment (net of $1.3 million in vehicle financing and leases). CES had $0.9 million of additions related to maintenance capital and $6.4 million of additions related to expansion capital gross of vehicle financing. Notable additions during the three month period ended December 31, 2010 included $0.7 million of vehicles, $1.8 million on the purchase of a selected real estate assets, including a new warehouse and buildings, associated with the Fluids Management Acquisition, and an additional $1.3 million towards construction of the Company's PureChem chemical blending facility in Carlyle, Saskatchewan. For the year ended December 31, 2010, $11.3 million was spent on property and equipment (net of $2.3 million in vehicle financing and leases). Notable additions during the year ended December 31, 2010 include the total capital investment in the PureChem blending facility of $3.7 million, $2.1 million of new vehicles, $1.0 million of new tanks, and $2.3 million of new warehouse and buildings for AES operations.

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

| | Three Months Ended December 31, | | Year Ended December 31, | |
|---|---|---|---|---|
| *$000's* | **2010** | 2009 | **2010** | 2009 |
| Expansion capital | **6,352** | 1,430 | **11,301** | 4,306 |
| Maintenance capital | **860** | 568 | **2,346** | 612 |
| Total investment in property and equipment | **7,212** | 1,998 | **13,647** | 4,918 |
| Vehicle financing and leases | **(1,281)** | (349) | **(2,317)** | (451) |
| Capital expenditures | **5,931** | 1,649 | **11,330** | 4,467 |
| Change in non-cash investing working capital | **256** | (334) | **393** | (478) |
| Cash used for investment in property and equipment | **6,187** | 1,315 | **11,723** | 3,989 |

In general, the long-term capital investments required for CES to execute its business plan are not significant, 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 year ended December 31, 2010, cash flow from financing activities was a cash inflow of $71.1 million compared to a cash outflow of $6.8 million during 2009. For the year ended December 31, 2010, CES completed the private placement of Subscription Receipts for net proceeds of $42.4 million, paid dividends to shareholders totalling $13.2 million, and drew $35 million, net of foreign exchange, in bank indebtedness. During the three months ended December 31, 2010, cash flow from financing activities totalled a cash inflow of $1.1 million compared to $12.4 million during the comparative prior year period. For the three month period ended December 31, 2010, CES repaid $0.9 million of its long-term debt balances, paid dividends to shareholders totalling $4.6 million, and drew $3.3 million in bank indebtedness.

*Dividend Policy*

During the fourth quarter, CES declared monthly dividends of $0.10 per share for a total of $0.30 per share for the quarter. This compares to monthly distributions of $0.0792 per unit made for a total of $0.2376 per unit during the comparable quarter in 2009 under the pre-Conversion distribution policy.

| *$000's except per share amounts* | **Dividend Record Date** | **Dividend Payment Date** | **Per Common Share** | **Total** |
|---|---|---|---|---|
| January | Jan 31 | Feb 15 | 0.06 | **802** |
| February | Feb 28 | Mar 15 | 0.06 | **804** |
| March | Mar 31 | Apr 15 | 0.06 | **808** |
| April | Apr 30 | May 15 | 0.06 | **808** |
| May | May 31 | Jun 15 | 0.06 | **808** |
| June | Jun 30 | Jul 15 | 0.08 | **1,181** |
| July | Jul 31 | Aug 15 | 0.08 | **1,184** |
| August | Aug 31 | Sep 15 | 0.08 | **1,184** |
| September | Sep 30 | Oct 15 | 0.08 | **1,419** |
| October | Oct 31 | Nov 15 | 0.10 | **1,420** |
| November | Nov 30 | Dec 15 | 0.10 | **1,809** |
| December | Dec 31 | Jan 15 | 0.10 | **1,813** |
| Total dividends declared during the year | | | 0.92 | **14,040** |

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 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. 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 or distribution as the long-term capital investments required and maintenance capital expenditures required for CES to execute its business plan are not significant.

Subsequent to December 31, 2010, CES declared and paid a monthly dividend of $0.10 per common share to shareholders of record at January 31, 2011, and February 28, 2011, for the months of January and February 2011. CES also declared a revised monthly dividend of $0.12 per common share to shareholders of record at March 31, 2011.

***Shareholders' Equity***
On January 1, 2010, pursuant to the Conversion, all outstanding Class A Units of Canadian Energy Services LP were converted to common shares of Canadian Energy Services & Technology Corp. During Q1 2010, 791,776 common shares were issued pursuant to the forced conversion of the Debenture. Additionally, as part of the Fluids Management Acquisition, a total of 1,289,370 common shares of the Company were issued.

On July 13, 2010, in conjunction with the Fluids Management Acquisition, the Company, through a syndicate of underwriters, completed a bought deal private placement financing. Pursuant to the Offering, the Company issued a total of 2,905,000 Subscription Receipts at $15.50 per Subscription Receipt for gross proceeds of $45.0 million. Net proceeds after offering expenses and underwriter's commission were $42.4 million. On September 7, 2010, the Subscription Receipts were converted to common shares of the Company.

For the year ended December 31, 2010, an aggregate of 598,483 common shares were issued pursuant to the exercise of employee stock options, and upon the termination of the Distribution Rights Plan. As of December 31, 2010, CES had a total of 18,131,829 common shares outstanding. As of the date of this MD&A, CES had a total of 18,141,329 common shares outstanding.

***Stock-based Compensation***
As at December 31, 2010, a total of 1,813,183 common shares were reserved for issuance under the Company's Option Plan and Share Rights Incentive Plan of which 566,333 remained available for grant.

*a) Option Plan, formerly referred to as the Partnership Unit Option Plan*
At December 31, 2010, a total of 76,350 (December 31, 2009 - 682,500) Options were outstanding at a weighted average exercise price of $7.42. As at December 31, 2010, a total of 9,433 Options were exercisable at a weighted average price of $9.27. As of the date of this MD&A, there were a remaining 66,850 Options outstanding. As a result of the Conversion, 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") – established January 1, 2010*
In connection with the Conversion, CES has adopted a new SRIP. The SRIP provides incentives to the employees, officers, and directors of CES or its subsidiaries, and certain service providers by issuing rights to acquire common shares ("Share Rights"). Share Rights granted under the SRIP generally vest as to one-third on each of the first, third, and third anniversary dates of the grant, or such other vesting schedule as determined by the Board of Directors, and expire no later than five years after the grant. Under the SRIP, employees may elect to exercise the Share Rights at an adjusted exercise price in which the option exercise price will be adjusted downwards by the cumulative dividends paid by the Company. At December 31, 2010, a total of 1,170,500 Share Rights were outstanding (December 31, 2009 – Nil) at a weighted average exercise price of $16.94 (assuming

all SRIP's are exercised at their respective original exercise price) of which Nil were exercisable. As of the date of this MD&A, an aggregate of 1,170,500 Share Rights remaining outstanding, of which 17,667 have vested.

*c) Partnership Distribution Rights Plan – terminated January 1, 2010*
In conjunction with the Conversion effective January 1, 2010, the Company's Distribution Rights Plan was terminated and the outstanding Distribution Rights were redeemed for an aggregate of 122,536 CES common shares on January 15, 2010.

*d) Partnership Unit Bonus Plan – terminated January 1, 2010*
In conjunction with the Conversion, the Company's Unit Bonus Plan was terminated effective January 1, 2010.

***Commitments / Contractual Obligations***
At December 31, 2010, CES had the following additional commitments not included as liabilities on its balance sheet:

| *$000's* | **2011** | **2012** | **2013** | **2014** | **2015** | **Total** |
|---|---|---|---|---|---|---|
| Office and facility rent | 1,161 | 1,029 | 604 | 336 | 336 | **3,466** |
| Vehicle operating leases | 43 | 23 | - | - | - | **66** |
| Total | 1,204 | 1,052 | 604 | 336 | 336 | **3,532** |

Payments denominated in foreign currencies have been translated at the respective December 31, 2010 exchange rate

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

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.

In connection with the acquisition of the business assets of Clear Environmental Solutions Inc. on June 12, 2008, the Company was required to pay consideration pursuant to the earn-out payment of $2.0 million of which $0.2 million remained outstanding as at December 31, 2009 and was paid out in cash during 2010.

In conjunction with the Champion Drilling Fluids Inc. acquisition, the Company had US$2 million of deferred acquisition consideration payable in cash upon the earlier of the second anniversary of the acquisition or the successful business expansion of the Champion Drilling Fluids business operations into the Marcellus shale region of the United States. The Company paid the outstanding balance of US$2.0 million on May 3, 2010.

In conjunction with the Fluids Management acquisition, the Company has $4.9 million (US$5.0 million) in additional deferred acquisition consideration payable in cash upon the Fluids Management division achieving an EBITDA target of US$9.5 million for the twelve month period post close. As of the date of this MD&A the target threshold has been exceeded and the US$5.0 million will be paid out in July 2011.

## CRITICAL ACCOUNTING POLICIES AND ESTIMATES

CES prepares its consolidated financial statements in accordance with Canadian GAAP. Except as noted below, the policies used by CES for the year ended December 31, 2010 remain consistent with those used for the year ended December 31, 2009. Details of CES' significant accounting policies are found in note three of CES' audited financial statements for the year ended December 31, 2010.

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 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' consolidated financial statements are the impairment of goodwill, the amortization of property, equipment and intangible assets, future income taxes, and stock-based compensation.

## CHANGES IN ACCOUNTING POLICIES

*Leases*
The Company's leases are classified as either capital or operating. Leases which effectively transfer substantially all of the risks and rewards of ownership to the Company are classified as capital leases and are accounted for as an acquisition of an asset and an assumption of an obligation at the inception of the lease, measured as the present value of the future minimum lease payments. The asset is amortized in accordance with the Company's depreciation policy. The obligations recorded under capital leases are reduced by the lease payments made. All other leases are accounted for as operating leases and payments are expensed over the term of the lease.

*Foreign Currency Translation*
Effective January 1, 2010, the Company changed the classification of its US foreign subsidiary operations, AES, from integrated to self-sustaining and, as a result, the operations of AES included in the consolidated financial statements subsequent to that date have been translated using the current rate method as opposed to the previously used temporal method. Under the current rate method of translation, revenues and expenses of the subsidiary are translated at the rate in effect at the time of the transactions while assets and liabilities are translated at the current exchange rate in effect at the balance sheet date. Upon consolidation of the US operations, translation gains and losses due to fluctuations in the foreign currency exchange rates are deferred on the consolidated balance sheet as a separate component of Accumulated Other Comprehensive Income (AOCI). Accumulated other comprehensive income (loss) forms part of Shareholders' Equity. This change in translation method has been applied prospectively effective January 1, 2010 and resulted in a foreign exchange loss of $0.2 million being deferred and recorded as AOCI as at January 1, 2010.

*Stock-Based Compensation*
The Company uses the fair value method to account for stock options granted to employees, officers, directors, and certain service providers of the Company for grants under the Company's Option Plan and Share Rights Incentive Plan. CES has adopted a Share Rights Incentive Plan for any new issuances effective January 1, 2010. All prior grants under the Unit Option Plan will continue based on the terms and conditions as of the original grant. Under the fair value method, the fair value of the share options is estimated at the grant date using a Black-Scholes option pricing model, and such fair value is expensed over the vesting period, with a corresponding increase in contributed surplus. Any consideration received upon the exercise of the stock-based compensation together with the amount of non-cash compensation expense recognized in contributed surplus is recorded as an increase in Shareholders' Equity. For any new grants under the Share Rights Incentive Plan, the Company has incorporated an estimated forfeiture rate for Share Rights that will not vest in the computation of the fair value of the Share Rights on the date of the grant.

*Business Combinations*
In January 2009, the Canadian Institute of Chartered Accountant's Accounting Standards Board ("AcSB") issued Section 1582, Business Combinations, which replaces former guidance on business combinations. Section 1582 establishes principles and requirements of the acquisition method for business combinations and related disclosures. This standard applies prospectively to business combinations for which the acquisition date is after the beginning of the first annual reporting period on or after January 2011 with earlier application permitted. The Company adopted this standard effective January 1, 2010 and has had no effect except for that the Fluids Management Acquisition will be accounted for in accordance with new the new guidelines.

*Consolidated Financial Statements and Non-Controlling Interests*
In January 2009, the AcSB issued Sections 1601, Consolidated Financial Statements, and 1602, Non-controlling Interests, which replace existing guidance. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 provides guidance on accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. These standards are effective on or after the beginning of the first annual reporting period beginning after January 2011 with earlier application permitted. The Company adopted these standards effective January 1, 2010 and there was no effect to the Company's financial statements.

***Future Accounting Pronouncements***
*International Financial Reporting Standards (IFRS)*
On February 13, 2008, the AcSB confirmed that effective for interim and annual financial statements related to fiscal years beginning on or after January 1, 2011, International Financial Reporting Standards (IFRS) will replace Canada's current Generally Accepted Accounting Principles for all publicly accountable profit-oriented enterprises.

The IFRS transition project consists of three phases: initial assessment, detailed assessment, and design and implementation. The first phase involved the completion of an initial review of the major differences between current Canadian GAAP and IFRS and their impact to the existing account balances of CES, development of a project timeline, and a review of IFRS 1 transition exemptions. The detailed assessment and design phase involved completing a comprehensive analysis of the impact of the IFRS differences identified in the initial assessment. The implementation phase involves executing the required changes to business processes, financial systems, IT systems, accounting policies, disclosure controls, and internal controls over financial reporting. The Company's IFRS project is on schedule and progressing well. CES' IFRS project team and management continue to liaise with the external auditors and key stakeholders in the Company to enable the timely and smooth transition to IFRS in 2011. With respect to the key areas identified, the following is a summary of progress:

*IFRS 1 – First Time Adoption:*
In general, adopting companies are required to apply IFRS retrospectively, with prior period adjustments made against opening retained earnings on the opening balance sheet. However, IFRS 1 provides a number of exemptions from full retrospective application of IFRS. Based on management's analysis of the various accounting policy choices available, the IFRS 1 elections most relevant to CES' business are as follows:

- Business Combinations – Management has elected not to restate any business combinations that have occurred prior to January 1, 2010. CES has, however, aligned itself to comply with IFRS by early adopting Business Combinations effective January 1, 2010, which substantially converged with the equivalent IFRS standards for business combinations. CES has taken this step in order to minimize any differences between Canadian GAAP and IFRS for business combinations occurring in 2010.
- Deemed Cost – With respect to CES' Property and Equipment, management has elected not to use fair value but historic amortized cost at January 1, 2010 as the deemed cost.
- Share Based Payments – Management has elected not to restate the stock-based payment expense for share based payments granted and vested prior to January 1, 2010. Further, CES changed its accounting policy with respect to stock-based compensation, effective January 1, 2010, for new issuances under the Share Rights Incentive Plan to comply with the IFRS guidelines under IFRS 2. The resultant change required CES to account for an estimate of forfeitures at the time of grant and the associated compensation expense on a tranche by tranche basis.

While the final quantitative impact of converting to IFRS is still to be determined, the section below illustrates management's preliminary estimate of the quantitative impact of adopting IFRS on the Company's balance sheet as at January 1, 2010 ("the Company's date of transition to IFRS") and highlights those areas that CES believes may be the most significant. An explanation of how the transition from Canadian GAAP to IFRS is expected to affect the Company's financial position is set out below, and is based on the standards as published on the Company's date of transition. Any revisions or changes to the standards issued by the International Accounting Standards Board ("IASB") after this date may also contribute to additional changes some of which may be material changes to the results and the impact discussed below. Consequently, the estimated quantitative differences identified below should be regarded as preliminary, have not been audited and are subject to change.

*Impairment of Assets:*
Under Canadian GAAP, goodwill is tested for impairment by comparing the carrying value of goodwill at the operating segment level compared to its fair value. If the carrying value of goodwill is greater than its corresponding fair value, an impairment loss is recognized to the extent that the carrying amount of goodwill exceeds its implied fair value. Under IFRS, goodwill is tested for impairment at the cash generating unit ("CGU") level. If the carrying value of each CGU exceeds the greater of fair value less cost to sell or value in use, an impairment loss is recognized in the CGU. Based on management's initial estimates, using the IFRS impairment methodology is not expected to result in any changes to the transition date balance sheet.

*Property and Equipment:*
In contrast to Canadian GAAP, IFRS permits items of property and equipment to be measured either at fair value or amortized cost. In this regard, CES expects to continue to reflect property and equipment at its historic amortized cost. Further, IFRS requires that significant asset parts (i.e. components) are recognized and depreciated separately. CES has assessed componentization under IFRS to be very similar to how the assets have been componentized by the Company under Canadian GAAP and the impact on CES' financial statements of the IFRS adoption is not expected to be material.

*Leases:*
In contrast to Canadian GAAP, IAS 17 does not contain numerical thresholds to determine the nature of any particular lease. As a result, certain leases currently classified as operating leases will be classified as finance leases under IFRS. The impact on the transition date balance sheet is an increase in property and equipment of approximately $0.2 million, an increase to debt of

approximately $0.2 million, and a slight decrease to equity. The reclassification of leases will result in a slight increase to cost of sales and interest expense in future periods, offset by a reduction in administrative expenses.

*Stock-Based Compensation:*
When recognizing share based payment expenses, Canadian GAAP and IFRS differ in the timing and, potentially, the amount of expense recognition. IFRS requires that an estimate of forfeitures and a graded valuation of each tranche be factored into the calculation of periodic compensation expense. This option is available, but not required, under Canadian GAAP. The impact on the transition date balance sheet is a decrease to contributed surplus of approximately $0.15 million with an equal and offsetting increase to retained earnings.

*Future Income Taxes & Deferred Tax Credit:*
The accounting treatment under IFRS of the deferred tax credit is the most significant change from Canadian GAAP anticipated by management at this time. In 2010, as a result of the Conversion, under Canadian GAAP, the Company recognized a future income tax asset of $15.5 million and a deferred tax credit in the amount of $12.7 million with the difference of $2.8 million representing the consideration paid to New Nevaro. During 2010, the deferred tax credit was amortized in proportion to the corresponding future income tax asset as the tax pools were utilized. For the year ended December 31, 2010, $5.8 million of this future income tax asset and $4.8 million of this deferred tax credit have been amortized relating to the estimated usage with the difference of $1.1 million representing future income tax expense.

As the Conversion transaction was completed January 1, 2010, there will be no impact to the opening balance sheet at the date of transition to IFRS. However, under IFRS the deferred tax asset in Q1 2010 would have been initially measured at an amount equal to the consideration paid of $2.8 million. Immediately following the transaction, CES would have re-measured the deferred tax asset to the extent that it is probable that tax losses will be utilized. This would result in an increase to the deferred tax asset of approximately $12.7 million with an equal and offsetting increase to future income tax recovery in the period. There would be no deferred tax credit recorded on acquisition of the deferred tax losses or subsequent to the completion of the transaction. Under IFRS, during 2010, the Company would have recorded future income tax expense of approximately $5.8 million, representing the amortized balance of the future income tax asset during the year.

The recognition of the future tax asset in the 2010 first quarter comparatives under IFRS will result in an increase to net income compared to what was recorded in Q1 2010 under GAAP, of approximately $12 to $13 million offset by the future income tax expense recorded relating to the utilization of the pools. Accordingly, under IFRS, the Company expects that the value of the deferred tax credit will be $nil, with the offset being recorded as a future income tax recovery during Q1 2010. Subsequent to 2010, because the full benefit of the tax losses acquired under IFRS will have been recognized in Q1 2010, the Company anticipates future period net income amounts to be correspondingly lower.

*Financial Statement Presentation & Disclosure:*
Under IFRS, the Company plans to present its statement of operations under a functional disclosure approach which will result in certain expense classifications, namely amortization expenses and stock-based compensation expense, being presented as part of cost of sales and administrative expenses on the statement of operations. In addition, the form of presentation of financial statements is more prescribed under IFRS and there will be an increase in note disclosure. This is primarily because there is more judgement required under IFRS so additional disclosure is considered necessary to help readers understand how an entity accounts for its transactions. Draft IFRS financial statements were prepared and reviewed by management in the fourth quarter of 2010 and subsequently reviewed by the Audit Committee in the first quarter of 2011. In the first quarter of 2011, CES will further refine the financial statements to ensure efficient and timely preparation of the first set of IFRS statements in compliance with IAS 34 for the first quarter of 2011. At this time, the Company does not expect to utilize the 30 day extension available to it with respect to the release of Q1 2011 financial statements.

*Internal Controls*
The conversion to IFRS is not expected to have a significant impact on the current control environment, business processes, financial systems, or IT systems. During the final implementation phase in Q1 2011, we plan on executing any required changes to internal controls over financial reporting, business processes, financial systems, accounting policies, and IT systems.

## RISKS AND UNCERTAINITIES 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 America and in turn demand for CES' products and services. There was a dramatic reduction in crude oil and natural gas prices during the last half of 2008. While crude oil prices have since recovered and appear to have stabilized, natural gas prices remain relatively weak compared to recent historical standards and continue to experience significant volatility. This, along with reduced access to capital, especially for junior and intermediate producers, resulted in a decline in industry drilling activity levels in the WCSB and the United States in 2009 compared to the previous year. Q4 2009 saw a rebound in activity and this has continued throughout 2010 and CES has experienced an increase in the demand for its services over the previous year.

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 and third quarter until equipment is moved for winter drilling programs in the fourth 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 performance of the Company. If the business continues to expand in the US, it is expected that the overall seasonality of the Company's operations will be less pronounced in future periods.

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 of all of 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 and the Mid-continent 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 commodity prices and tight 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.

As a result of the US Acquisitions, CES' US footprint and size of operations has been significantly increased. 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 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 twenty-four months has impacted the general availability of both credit and equity financing in the marketplace. In the face of this uncertainty, in December 2009, CES raised $10 million in the equity markets through the completion of a bought deal private placement financing, and in July 2010 raised an additional $45 million in the equity markets through the completion of another bought deal private placement financing. However, past success is not a guarantee of future success. 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 demand Operating Facility is critical to the effective execution of the business. CES has not experienced any funding issues under its debt facilities to date.

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 proposed 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 do not apply to the Conversion.

Reference should be made to CES' Annual Information Form dated March 17, 2011 for the period ended December 31, 2010, 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.

# OUTLOOK

Crude oil prices have rebounded off their lows of 2009 and appear to have stabilized in a profitable band for operators. Natural gas prices continue to remain relatively weak in context to oil prices and recent history, making the economics of drilling for dry natural gas challenging. In the WCSB, operators have diverted capital to drilling for oil or liquids rich gas. In the US, this same trend is emerging but areas such as the Marcellus shale continue to attract capital to dry gas drilling.

Beginning in the fourth quarter of 2009, drilling activity levels began to rebound in both the WCSB and the US and throughout 2010 drilling activity exceeded comparable periods in 2009. Both CES' Q4 2010 and 2010 annual results reflect the increase in activity with corresponding revenue gains across all of CES' business segments. CES' dominant business line, the drilling fluids segment, experienced the most material gains over 2009 as a result of the increased industry activity and a continuing trend by operators to drill more complex, horizontal wells. CES has capitalized on this trend in the WCSB through its leading market share position and in the US by completing two accretive acquisitions, the Champion acquisition on November 30, 2009 and the Fluids Management Acquisition completed at the end of Q2 2010. The US Acquisitions coupled with the immediate organic growth that the Company has been able to generate off of these acquired platforms, has established CES as a truly North American company with a wide footprint and a significant presence in the majority of the key basins of activity throughout North America.

CES' strategy is to utilize its patented and proprietary technologies and superior execution to increase market share in North America. CES' exposure to the key resource plays and the growth in the number of horizontal wells being drilled bodes well for future growth. A larger percentage of the wells being drilled require more complex drilling fluids to best manage down hole conditions, drilling times and costs and its unique products like Seal-AX™/PolarBond, ABS40™ and Liquidrill™/Tarbreak, combined with our concerted focus on providing superior service, positions CES well in this increasingly technically competitive environment. CES believes that its unique value propositions in the increasingly complex drilling environment makes it the premier independent drilling fluids provider in the North American market.

The EQUAL Transport division experienced significant growth, particularly in south-eastern Saskatchewan where the business hauls drilling fluids and products to drilling locations and also provides other oilfield hauling services to our customers including the hauling of produced fluids. It is expected this business will continue to be economically attractive and may expand further as viable opportunities emerge.

In Q2 2010, CES announced the establishment of the PureChem Services division. PureChem manufactures and sells both drilling fluid chemicals and production chemicals. The construction of the PureChem facility in Carlyle, Saskatchewan was completed in February 2011 and operations have commenced. PureChem is a complimentary business to both CES' drilling fluids business and EQUAL's production hauling businesses in Canada. In the US, the Fluids Management division also produces and blends its own set of proprietary drilling fluid products which provides synergies and experience to PureChem going forward.

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. Clear has experienced an increase in activity which began in the fourth quarter of 2009 and has continued throughout 2010. At this time, Clear's activity levels are expected to remain healthy throughout 2011.

As drilling has become more complex, applied 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 market. In addition, CES continues to assess integrated business opportunities that will keep CES competitive and enhance profitability, while at the same time closely manage its dividend levels and capital expenditures in order to preserve its balance sheet strength and liquidity position.

## CORPORATE GOVERNANCE

For information regarding the corporate governance policies and practices of CES, the reader should refer to CES' 2010 Annual Report, CES' Annual Information Form dated March 17, 2011 in respect of the year ended December 31, 2010, and CES' Information Circular in respect to the June 16, 2010 Annual General and Special Meeting of shareholders each of which are available on the CES' SEDAR profile at www.sedar.com.

## ADDITIONAL INFORMATION

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

# MANAGEMENT'S REPORT

Management is responsible for the preparation of the consolidated financial statements in accordance with generally accepted accounting principles and for the consistency therewith of all other financial and operating data presented in this annual report.

Management maintains a system of internal controls to provide reasonable assurance that all assets are safeguarded and to facilitate the preparation of relevant, reliable and timely financial and management information.

External auditors appointed by the shareholders have examined the consolidated financial statements. The Audit Committee, consisting of three independent, non-management directors, is responsible to review these statements with management and the auditors and to report to the Board of Directors. The Board of Directors is responsible to review and approve the consolidated financial statements.

*"Thomas J. Simons"*
Thomas J. Simons
President & Chief Executive Officer
March 17, 2011

*"Craig F. Nieboer"*
Craig F. Nieboer
Chief Financial Officer
March 17, 2011

# INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Canadian Energy Services & Technology Corp.:

We have audited the accompanying consolidated financial statements of Canadian Energy Services & Technology Corp., which comprise the consolidated balance sheets as at December 31, 2010 and 2009, and the consolidated statements of operations and deficit and comprehensive income and accumulated other comprehensive loss and cash flow for the years then ended, and the notes to the consolidated financial statements.

*Management's Responsibility for the Consolidated Financial Statements*
Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

*Auditor's Responsibility*
Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

*Opinion*
In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Canadian Energy Services & Technology Corp. as at December 31, 2010 and 2009, and its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

*"Deloitte & Touche LLP"*
Chartered Accountants
Calgary, Alberta
March 17, 2011

**Canadian Energy Services & Technology Corp.**
Consolidated Balance Sheets
(stated in thousands of dollars except per share amounts)

| | As at | |
|---|---|---|
| | **December 31, 2010** | December 31, 2009 |
| ASSETS | | |
| Current assets | | |
| Accounts receivable | **100,733** | 35,336 |
| Financial derivative asset (note 19) | **25** | - |
| Inventory (note 4) | **31,303** | 10,001 |
| Prepaid expenses | **2,513** | 389 |
| | **134,574** | 45,726 |
| Property and equipment (note 5) | **30,320** | 14,564 |
| Intangible assets (note 6) | **17,083** | 7,169 |
| Future income tax asset (note 13) | **10,212** | 1,949 |
| Goodwill (note 7) | **95,448** | 61,291 |
| | **287,637** | 130,699 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current liabilities | | |
| Bank indebtedness (note 8) | **44,172** | 8,762 |
| Accounts payable and accrued liabilities | **46,714** | 21,212 |
| Financial derivative liability (note 19) | **-** | 11 |
| Earn-out payable (note 18) | **-** | 207 |
| Deferred acquisition consideration (notes 3 and 18) | **4,990** | 2,098 |
| Dividends payable (note 17) | **1,813** | 983 |
| Current portion of capital lease obligation (note 11) | **1,072** | - |
| Current portion of long-term debt (note 10) | **1,584** | 1,106 |
| | **100,345** | 34,379 |
| Capital lease obligation (note 11) | **1,664** | - |
| Long-term debt (note 10) | **3,556** | 2,557 |
| Future income tax liability (note 13) | **3,118** | 1,229 |
| Deferred tax credit (note 13) | **7,906** | - |
| | **116,589** | 38,165 |
| Commitments (note 18) | | |
| Shareholders' equity | | |
| Common shares (note 14) | **195,755** | 117,448 |
| Subordinate convertible debenture (note 3 and 12) | **-** | 6,627 |
| Contributed surplus (note 16) | **2,120** | 2,122 |
| Deficit | **(21,444)** | (33,663) |
| Accumulated other comprehensive loss | **(5,383)** | - |
| | **171,048** | 92,534 |
| | **287,637** | 130,699 |

APPROVED ON BEHALF OF THE BOARD:

*"Thomas J. Simons"*
Thomas J. Simons
*President & Chief Executive Officer and Director*

*"D. Michael Stewart"*
D. Michael Stewart
*Director & Chairman, Audit Committee*

*The accompanying notes are an integral part of these consolidated financial statements.*

**Canadian Energy Services & Technology Corp.**
Consolidated Statements of Operations and Deficit and Comprehensive Income and Accumulated Other Comprehensive Loss
(stated in thousands of dollars except per share amounts)

| | Year Ended December 31, 2010 | 2009 |
|---|---|---|
| Revenue | **249,116** | 89,454 |
| Cost of sales (note 4) | **176,943** | 62,742 |
| Gross margin | **72,173** | 26,712 |
| Expenses | | |
| Selling, general, and administrative expenses | **31,578** | 16,754 |
| Amortization | **6,439** | 3,526 |
| Stock-based compensation (note 15) | **1,791** | 827 |
| Interest expense (note 8, 9, and 10) | **1,663** | 478 |
| Foreign exchange gain | **(894)** | (13) |
| Financial derivative loss (gain) (note 19) | **(1)** | 55 |
| Loss (gain) on disposal of assets | **(13)** | 110 |
| | **40,563** | 21,737 |
| Income before taxes | **31,610** | 4,975 |
| Current income tax expense (note 13) | **315** | - |
| Future income tax expense (recovery) (note 13) | **5,036** | (2,540) |
| Net income | **26,259** | 7,515 |
| Deficit, beginning of year | **(33,663)** | (30,419) |
| Dividends declared (note 17) | **(14,040)** | (10,759) |
| Deficit, end of year | **(21,444)** | (33,663) |
| Net income per share (note 14) | | |
| Basic | **1.74** | 0.67 |
| Diluted | **1.69** | 0.66 |
| Net income | **26,259** | 7,515 |
| Other comprehensive loss: | | |
| Unrealized foreign exchange loss on translation of self-sustaining foreign operations | **(5,174)** | - |
| Comprehensive income | **21,085** | 7,515 |
| Accumulated other comprehensive loss, beginning of year | **-** | - |
| Adjustment for change in foreign currency translation method (note 2) | **(209)** | - |
| Other comprehensive loss | **(5,174)** | **-** |
| Accumulated other comprehensive loss, end of year | **(5,383)** | - |

*The accompanying notes are an integral part of these consolidated financial statements.*

**Canadian Energy Services & Technology Corp.**
Consolidated Statements of Cash Flow
(stated in thousands of dollars except per share amounts)

| | Year Ended December 31, 2010 | 2009 |
|---|---|---|
| CASH PROVIDED BY (USED IN): | | |
| OPERATING ACTIVITIES: | | |
| Net income for the period | **26,259** | 7,515 |
| Items not involving cash: | | |
| Amortization | **6,439** | 3,526 |
| Stock-based compensation | **1,791** | 827 |
| Future income tax expense (recovery) | **5,036** | (2,540) |
| (Gain) loss on disposal of assets | **(13)** | 110 |
| Unrealized foreign exchange loss | **10** | 13 |
| Unrealized financial derivative (gain) loss | **(24)** | 11 |
| Change in non-cash operating working capital (note 21) | **(55,092)** | 9,883 |
| | **(15,594)** | 19,345 |
| FINANCING ACTIVITIES: | | |
| Repayment of long-term debt and capital leases | **(2,615)** | (1,562) |
| Issuance of long-term debt and lease proceeds | **4,147** | - |
| Issuance of shares, net of issuance costs | **47,715** | 9,719 |
| Bridge Loan financing (note 9) | **-** | - |
| Increase (decrease) in bank indebtedness | **35,026** | (3,940) |
| Shareholder dividends | **(13,210)** | (11,002) |
| | **71,063** | (6,785) |
| INVESTING ACTIVITIES: | | |
| Investment in property and equipment | **(11,330)** | (4,467) |
| Investment in intangible assets | **(58)** | (46) |
| Deferred acquisition consideration | **(2,245)** | - |
| Conversion transaction (note 1 and 13) | **(2,800)** | - |
| Acquisition of Fluids Management (note 3) | **(40,563)** | - |
| Acquisition of Champion Drilling Fluids (note 3) | **-** | (8,943) |
| Proceeds on disposal of fixed assets | **750** | 473 |
| Change in non-cash investing working capital (note 21) | **393** | 478 |
| | **(55,853)** | (12,505) |
| Effect of exchange rate on cash balances | **384** | (55) |
| CHANGE IN CASH | **-** | - |
| Cash, beginning of year | **-** | - |
| Cash, end of year | **-** | - |
| SUPPLEMENTARY CASH FLOW DISCLOSURE | | |
| Interest paid | **1,684** | 495 |
| Taxes paid | **12** | - |

*The accompanying notes are an integral part of these consolidated financial statements.*

### 1. The Company

Canadian Energy Services & Technology Corp. (the "Company" or "CES") was incorporated under the Canada Business Corporations Act by registration of Articles of Incorporation on November 13, 1986. CES was formerly Canadian Energy Services L.P. (the "Partnership"), a limited partnership formed on January 13, 2006, pursuant to the Limited Partnerships Act (Ontario). Effective January 1, 2010, the Partnership and Canadian Energy Services Inc., the general partner of the Partnership (the "General Partner") completed a Plan of Arrangement ("Arrangement") with Nevaro Capital Corporation ("Nevaro") which resulted in the Partnership converting from a publicly-traded Canadian limited partnership to a publicly-traded corporation (the "Conversion").

The Company specializes in the design and implementation of drilling fluid solutions for the North American oil and gas industry, and in particular for horizontal and directional resource play drilling. In Canada, it operates as Canadian Energy Services and Moose Mountain Mud. In the United States ("US"), it operates through its indirect wholly-owned subsidiary, AES Drilling Fluids, LLC ("AES"), and through AES' operating divisions Champion Drilling Fluids, and Fluids Management. In Canada, in addition to drilling fluids, the Company operates a transportation division, Equal Transport; an environmental services division, Clear Environmental Solutions; and has established a chemical blending and production chemical division, Purechem Services.

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 third quarter until equipment is moved for winter drilling programs in the fourth 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 performance of the Company. If the business continues to expand in the US, it is expected that the overall seasonality of the Company's operations will be less pronounced in future periods.

### 2. Basis of Presentation and Significant Accounting Policies

The consolidated financial statements have been prepared by management of the Company in accordance with Canadian generally accepted accounting principles ("GAAP").

The preparation of consolidated financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the period. Such estimates include providing for amortization of property and equipment and intangible assets, impairment of goodwill and intangibles, future income taxes, and stock-based compensation. The impairment calculations for goodwill, intangibles, and other fixed assets are based upon estimated future cash flows and as such are dependent upon future drilling activity within the oil and natural gas industry. Future activity cannot be predicted with certainty and as such actual results will differ from these estimates.

#### a) Consolidation

These consolidated financial statements include the accounts of the Company and its subsidiaries all of which are wholly-owned. All inter-company balances and transactions are eliminated on consolidation.

#### b) Inventory

Inventory is stated at the lower of cost, as determined on an average cost basis, and net realizable value.

#### c) Property and equipment

Property and equipment are recorded at cost less accumulated amortization. Property and equipment are amortized using the straight-line method over their estimated useful lives at the following rates:

| | |
|---|---|
| Computer equipment and software | 3 years |
| Vehicles | 3 years |
| Trucks and trailers | 3-5 years |
| Field equipment | 5 years |
| Leasehold improvements | up to 3 years |
| Furniture and fixtures | 5 years |
| Buildings | 10-20 years |
| Processing equipment | 15 years |
| Tanks | 15 years |

The Company regularly reviews its property and equipment to assess for impairment.

**d) Leases**

The Company's leases are classified as either capital or operating. Leases which effectively transfer substantially all of the risks and rewards of ownership to the Company are classified as capital leases and are accounted for as an acquisition of an asset and an assumption of an obligation at the inception of the lease, measured as the present value of the future minimum lease payments. The asset is amortized in accordance with the Company's property and equipment depreciation policies. The obligations recorded under capital leases are reduced by the lease payments made. All other leases are accounted for as operating leases and payments are expensed over the term of the lease.

**e) Intangible assets**

Costs attributable to intangible assets are capitalized if future economic benefits are reasonably assured. Intangible assets are initially recorded at cost and are amortized over their estimated useful lives when the realization of economic benefits begin. Intangible assets are tested for recoverability at least annually and whenever events or changes in circumstances indicate that carrying amounts may not be recoverable. The impairment test is based on estimated future cash flows associated with the intangible asset.

**f) Goodwill**

Goodwill is the residual amount that results when the purchase price of an acquired business exceeds the sum of the amounts allocated to the assets acquired, less liabilities assumed, based on their fair values.

Goodwill is not amortized and is tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. The impairment test is carried out in two steps. In the first step, the carrying amount of the reporting unit is compared with its fair value. When the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not to be impaired and the second step of the impairment test is unnecessary.

The second step is necessary when the carrying amount of a reporting unit exceeds its fair value, in which case, the implied fair value of the reporting unit's goodwill is compared with its carrying amount to measure the amount of the impairment loss, if any. The implied fair value of goodwill is determined in the same manner as the value of goodwill is determined in a business combination, using the fair value of the reporting unit as if it were the purchase price. When the carrying amount of goodwill exceeds the implied fair value of the goodwill, an impairment loss is recognized in an amount equal to the excess. Impairment provisions are not reversed if there is a subsequent increase in the fair value of goodwill.

**g) Revenue recognition**

The Company's revenue is primarily comprised of the sale of products and the provision of services. Revenue on sales of product is recognized based on fixed or determinable prices when the product has been delivered to the well site and the product has been mixed into the mud system. As applicable, for sales that are invoiced upon shipment of the product, deferred revenue is recorded for the portion of the product that has not been mixed. Revenue from field service and trucking charges is recognized based upon agreed daily, hourly, or job rates when the service is performed. Revenue is only recognized when collection is reasonably assured. The Company considers persuasive evidence to exist when a formal contract is signed or customer acceptance is obtained. Contract terms do not include a provision for significant post-service delivery obligations.

**h) Stock-based compensation**

The Company uses the fair value method to account for stock options granted to employees, officers, directors, and certain service providers of the Company for grants under the Company's Option Plan and Share Rights Incentive Plan. CES has adopted a Share Rights Incentive Plan for any new issuances effective January 1, 2010. All prior grants under the Unit Option Plan will continue based on the terms and conditions as of the original grant. Under the fair value method, the fair value of the share options is estimated at the grant date using a Black-Scholes option pricing model, and such fair value is expensed over the vesting period, with a corresponding increase in contributed surplus. Any consideration received upon the exercise of the stock-based compensation together with the amount of non-cash compensation expense recognized in contributed surplus is recorded as an increase in Shareholders' Equity. For any new grants under the Share Rights Incentive Plan, the Company has incorporated an estimated forfeiture rate for Share Rights that will not vest in the computation of the fair value of the Share Rights on the date of the grant.

**i) Income taxes**

Effective January 1, 2010, as a result of the Conversion, the Company converted from a limited partnership structure to a corporate structure. As a result, CES is subject to federal and provincial income taxes in Canada and to federal and state income taxes in the United States to the extent that they are not sheltered by existing tax pools. Previously, the income earned directly by the Partnership in Canada was taxed at the Partnership unitholder level and as such provisions for current income tax were not made by CES. Effective January 1, 2010, the income of CES will be subject to tax and accordingly future income taxes have been recorded relating to temporary differences expected to reverse after this date.

CES and its subsidiaries follow the liability method of recording future income taxes. Under this method, future tax assets and liabilities are recognized for the estimated future tax consequences attributable to temporary differences between the financial statement carrying values of existing assets and liabilities and their respective tax basis. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates that are expected to apply to taxable income in the period in which those temporary differences are expected to reverse. Future income tax inflows and outflows are subject to estimation in terms of both timing and the amount of future taxable earnings. Should these estimates change, the carrying value of income tax assets or liabilities will change. The effect of a change in tax rates on future tax assets and liabilities is recognized in income in the period that the legislation is enacted or substantively enacted.

**j) Foreign currency translation**
Transactions in foreign currencies are translated at rates in effect at the time of the transaction. Monetary assets and liabilities are translated at the exchange rate in effect at the balance sheet date with the corresponding gains and losses included in net earnings.

Effective January 1, 2010, the Company changed the classification of its U.S. foreign subsidiary operations, AES from integrated to self-sustaining and as a result, the operations of AES are included in the consolidated financial statements subsequent to that date have been translated using the current rate method as opposed to the previously used temporal method. Under the current rate method of translation, revenues and expenses of the subsidiary are translated at the rate in effect at the time of the transactions while assets and liabilities are translated at the current exchange rate in effect at the balance sheet date. Upon consolidation of the U.S. operations, translation gains and losses due to fluctuations in the foreign currency exchange rates are deferred on the consolidated balance sheet as a separate component of Accumulated Other Comprehensive Income (“AOCI”). Accumulated other comprehensive income (loss) forms part of Shareholders’ Equity. This change in translation method has been applied prospectively effective January 1, 2010 and resulted in a foreign exchange loss of $209 being deferred and recorded as AOCI as at January 1, 2010.

**k) Derivative financial instruments**
Derivative financial instruments are used by the Company to manage its exposure to market risk associated with currency fluctuations. The Company’s policy is not to utilize derivative financial instruments for speculative or trading purposes. These derivative instruments are classified as held for trading. These derivative instruments are recorded at fair values on the consolidated balance sheet as either an asset or liability with changes in fair value recognized in the consolidated statement of operations. Realized gains and losses from financial derivatives are recognized as they occur. Unrealized gains and losses are recognized in the consolidated statement of operations at each respective reporting period. The fair value of these transactions is based upon the estimated amounts that would have been paid to or received from counterparties to settle the outstanding transactions with reference to the estimated forward prices as of the date of the consolidated balance sheet.

**l) Financial instruments**
The Company has classified all financial instruments into one of the following five categories: 1) loans and receivables; 2) assets held to maturity; 3) assets available for sale; 4) other financial liabilities; and 5) held for trading. Financial instruments classified as held for trading are measured at fair value and any gains or losses resulting from a change in the fair value during the period are recognized in net income. Financial instruments classified as available for sale are measured at fair value and any gains or losses resulting from a change in the fair value during the period are recognized in other comprehensive income, until realized through disposal or impairment. All other financial instruments are accounted for initially at fair value and then at amortized cost with foreign exchange gains and losses recognized immediately in net income. Transaction costs relating to financial instruments are expensed as incurred and included in net income.

The Company has classified its financial instruments as follows: cash and financial derivatives – held for trading; accounts receivable – loans and receivables; and bank indebtedness, accounts payable and accrued liabilities, earn-out payable, deferred acquisition consideration, dividends payable and long-term debt – other financial liabilities.

**m) Net income per share**
Basic earnings per share are based on the income attributable to shareholders for the period divided by the weighted average number of common shares outstanding during the period. The diluted earnings per share are based on the weighted average number of common shares outstanding during the period plus the effects of dilutive share equivalents. This method requires that the dilutive effect of outstanding stock options, share rights, bonus units, and distribution rights issued should be calculated using

the treasury stock method. The treasury stock method assumes that all in the money share equivalents have been exercised and that the funds obtained thereby were used to purchase shares of the Company at the average trading price of the common shares during the period.

**n) Subordinated convertible debentures**

The Company's subordinated convertible debenture (the "Debenture") was classified as an equity instrument. The Debenture was not bifurcated into debt and equity components and no portion of the Debenture was classified as debt instrument. The terms and provisions of the Debenture were such that the Debenture automatically converted under a forced conversion provision effective January 1, 2010 to a fixed number of common shares of the Company following the Conversion.

**o) Accounting changes**

*Business Combinations*

In January 2009, the Canadian Institute of Chartered Accountant's Accounting Standards Board ("AcSB") issued Section 1582, Business Combinations, which replaces former guidance on business combinations. Section 1582 establishes principles and requirements of the acquisition method for business combinations and related disclosures. This standard applies prospectively to business combinations for which the acquisition date is after the beginning of the first annual reporting period on or after January 2011 with earlier application permitted. The Company adopted this standard effective January 1, 2010 for all acquisitions occurring on or after that date.

*Consolidated Financial Statements and Non-Controlling Interests*

In January 2009, the AcSB issued Sections 1601, Consolidated Financial Statements, and 1602, Non-controlling Interests, which replace existing guidance. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 provides guidance on accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. These standards are effective on or after the beginning of the first annual reporting period beginning after January 2011 with earlier application permitted. The Company adopted these standards effective January 1, 2010 and there was no effect on the Company's consolidated financial statements.

*International Financial Reporting Standards ("IFRS")*

On February 13, 2008 the CICA Accounting Standards Board announced that Canadian public reporting issuers will be required to report under International Financial Reporting Standards ("IFRS"), which will replace Canadian generally accepted accounting principles for years beginning on or after January 1, 2011. The Company will adopt IFRS for interim and annual periods commencing January 1, 2011, including the preparation and reporting of one year of comparative figures.

## 3. Business Acquisition

On June 30, 2010, the Company closed its acquisition of selected drilling fluids business assets of Fluids Management II, Ltd., Brookshire Investment Trust, and Stikley Enterprises, Inc. (collectively "Fluids Management"), a privately-held drilling fluids services company which designs and implements drilling fluid systems for oil and gas operators in the United States. The effective date of the acquisition was June 21, 2010. The aggregate purchase price was $67,271 consisting of $40,563 (US$38,705) in cash, $21,468 in share consideration through the issuance of 1,289,370 common shares of the Company, and $5,240 (US$5,000) in additional deferred acquisition consideration. The US$5,000 is contingent based as an earn-out and is payable upon the Fluids Management division achieving an EBITDA target of US$9,500 for the twelve month period post close. In addition, as of June 30, 2010, the Company had entered into an agreement to purchase selected real estate assets for total consideration of US$1,795 subject to the completion of satisfactory environmental assessments. As of December 31, 2010, the Company completed the purchase of these selected real estate assets.

The acquisition was accounted for using the purchase method. The purchase price allocation is based upon the respective closing date values as of June 30, 2010. The Company's purchase price allocation is as follows:

| *Allocation of purchase price $000's* | |
|---|---|
| Current assets | 13,686 |
| Property and equipment | 7,814 |
| Intangible assets (note 6) | 12,692 |
| Goodwill (note 7) | 36,388 |
| **Total assets** | **70,580** |
| Current liabilities | (2,888) |
| Current portion of capital lease obligation | (352) |
| Long-term portion of capital lease obligation | (69) |
| **Total liabilities** | **(3,309)** |
| **Net assets acquired** | **67,271** |

| *Consideration given $000's* | |
|---|---|
| Cash | 40,563 |
| Share consideration | 21,468 |
| Deferred acquisition consideration | 5,240 |
| **Total consideration** | **67,271** |

On November 30, 2009, the Company completed its acquisition of selected business assets of Champion Drilling Fluids Inc. ("Champion"), a privately-held Oklahoma based drilling fluids services company which designs and implements drilling fluid systems for oil and gas operators in the US midcontinent region. The aggregate purchase price, including transaction costs, was $18,001 (US$17,086) consisting of $8,212 (US$7,824) in net cash consideration after a working capital adjustment, $2,431 (US$2,300) in additional deferred acquisition consideration, and a $6,627 (US$6,271) Debenture. US$2,000 of the additional deferred acquisition consideration was payable in cash upon the earlier of the second anniversary of the acquisition or the successful business expansion of the Champion Drilling Fluids business operations into the Marcellus shale region of the United States. This was paid on May 3, 2010 (note 18). The acquisition was accounted for using the purchase method with the purchase price allocation as follows:

| *Allocation of purchase price $000's* | |
|---|---|
| Current assets | 2,182 |
| Property and equipment | 423 |
| Intangible assets | 4,018 |
| Goodwill | 11,378 |
| **Net assets acquired** | **18,001** |

| *Consideration given $000's* | |
|---|---|
| Cash | 8,867 |
| Working capital adjustment | (655) |
| Net cash consideration | 8,212 |
| Subordinate convertible debenture (note 12) | 6,627 |
| Deferred consideration (note 18) | 2,431 |
| Transaction costs | 731 |
| **Total consideration** | **18,001** |

## 4. Inventory

The cost of inventory expensed in cost of sales for the year ended December 31, 2010 was $123,570 (2009 - $40,692).

## 5. Property and Equipment

Property and equipment are comprised of the following balances:

| | **As at December 31, 2010** | | | As at December 31, 2009 | | |
|---|---|---|---|---|---|---|
| *$000's* | **Cost** | **Accumulated Amortization** | **Net Book Value** | Cost | Accumulated Amortization | Net Book Value |
| Trucks and trailers | **6,914** | **(2,271)** | **4,643** | 5,680 | (1,242) | 4,438 |
| Buildings | **9,660** | **(651)** | **9,009** | 4,117 | (355) | 3,762 |
| Tanks | **5,466** | **(271)** | **5,195** | 902 | (99) | 803 |
| Vehicles | **5,972** | **(1,820)** | **4,152** | 3,725 | (1,342) | 2,383 |
| Field equipment | **4,236** | **(1,452)** | **2,784** | 2,182 | (865) | 1,317 |
| Computer equipment and software | **1,070** | **(608)** | **462** | 1,177 | (580) | 597 |
| Processing equipment | **1,811** | **(74)** | **1,737** | - | - | - |
| Land | **1,616** | **-** | **1,616** | 989 | - | 989 |
| Furniture and fixtures | **503** | **(211)** | **292** | 301 | (133) | 168 |
| Leasehold improvements | **582** | **(152)** | **430** | 136 | (29) | 107 |
| | **37,830** | **(7,510)** | **30,320** | 19,209 | (4,645) | 14,564 |

## 6. Intangible Assets

Intangible assets are comprised of the following balances:

| | **As at December 31, 2010** | | | As at December 31, 2009 | | |
|---|---|---|---|---|---|---|
| *$000's* | **Cost** | **Accumulated Amortization** | **Net Book Value** | Cost | Accumulated Amortization | Net Book Value |
| Customer relationships | **18,599** | **(3,123)** | **15,476** | 8,118 | (1,130) | 6,988 |
| Software | **774** | **(326)** | **448** | - | - | - |
| Patents | **227** | **(64)** | **163** | 218 | (37) | 181 |
| Other intangibles | **1,048** | **(52)** | **996** | - | - | - |
| | **20,648** | **(3,565)** | **17,083** | 8,336 | (1,167) | 7,169 |

As part of the acquisition of Fluids Management (note 3), the Company recognized $12,692 of intangible assets relating to software, customer relationships, and other intangibles acquired. The value will be amortized over its expected life of three, seven, and ten years, respectively.

## 7. Goodwill

Details of the change in the Company's goodwill balance are as follows:

| *$000's* | |
|---|---|
| Balance, December 31, 2009 | **61,291** |
| Fluids Management acquisition (note 3) | **36,388** |
| Foreign exchange | **(2,231)** |
| Balance, December 31, 2010 | **95,448** |

At December 31, 2010, the Company completed its annual goodwill impairment test. Management estimated the fair value of the Company's business using a number of industry accepted valuation methodologies including comparable industry valuation multiples, recent trading activity, and capital market pricing of the Company's common shares. Management concluded that there was no impairment to goodwill.

## 8. Bank Indebtedness

The Company has a revolving demand loan with a commercial bank permitting it to borrow up to $80,000, subject to the value of certain accounts receivable and inventory. As of December 31, 2010, based on eligible accounts receivable and inventory balances, the maximum available draw on the facility was $72,093 (December 31, 2009 - $20,901). Amounts drawn on the facility incur interest at the bank's prime rate plus 1.25%. The weighted average interest rate incurred for the year ended December 31, 2010, was 4.25%.

The Company's debt and bank lease facilities, including the operating line are secured by general security agreements creating a first priority security interest in all present and after-acquired personal property of Canadian Energy Services & Technology Corp., Canadian Energy Services Inc., the Partnership and each of its subsidiaries, an unlimited corporate guarantee of the indebtedness, obligations and liabilities of the Partnership to the bank given by each of the General Partner, Canadian Energy Services & Technology Corp., and each of the Partnership's subsidiaries, together with demand collateral mortgages on the Partnership's Edson, Alberta and Carlyle, Saskatchewan properties.

## 9. Bridge Loan

In conjunction with the Fluids Management acquisition (note 3), the Company arranged for bank financing (the "Bridge Loan") of US $40,000 to initially finance the cash portion of the purchase price of the Fluids Management acquisition on June 30, 2010. Following the close of the bought deal financing (note 14) on July 13, 2010, the Bridge Loan was repaid in full. The Company paid total interest on the Bridge Loan of $98.

## 10. Long-Term Debt

The Company has long-term debt as follows:

| *$000's* | **December 31, 2010** | December 31, 2009 |
|---|---|---|
| Vehicle financing loans | **1,633** | 1,464 |
| Committed loan facilities | **3,507** | 2,199 |
| | **5,140** | 3,663 |
| Less current portion of long-term debt | **(1,584)** | (1,106) |
| Long-term debt | **3,556** | 2,557 |

Details of the Company's outstanding committed loan facilities as of December 31, 2010 are as follows:

| **Facility** | **Balance Outstanding $000's** | **Interest Rate** | **Monthly Payments $000's** | **Term** |
|---|---|---|---|---|
| 1 | 1,419 | Prime + 1.40% | 10 | April 2013 (1) |
| 2 | 463 | Prime + 1.40% | 17 | April 2013 |
| 3 | 1,625 | Prime + 1.40% | 42 | March 2014 |
| | **3,507** | | **69** | |

(1) The bank reserves the right to extend the term of the loan by two additional five year periods at its discretion.

Vehicle financing loans are secured by each related vehicle and incur interest at rates up to 8.78%, with a weighted average rate of approximately 6.08%, and have termination dates ranging from February 2011 to August 2013.

For the year ended December 31, 2010, the Company paid $385 (2009 - $197) in interest expense related to its long-term debt and leasing facilities.

Scheduled principal payments at December 31, 2010 are as follows:

| *$000's* | |
|---|---|
| 2011 | **1,584** |
| 2012 | **1,438** |
| 2013 | **1,993** |
| 2014 | **125** |
| 2015 | **-** |
| Total | **5,140** |

### 11. Leases

On March 31, 2010, the Company completed a sale and lease back transaction on specified assets for proceeds of $2,147. The Company recognized a gain of $174 on the sale and lease back transaction which has been deferred and will be recognized over the remaining life of the assets. The Company's equipment leases are for terms ranging from March 2013 to March 2014 with interest on the Company's lease facilities at the bank's prime rate of interest plus 1.75%. The Company's vehicle leases are for terms ranging from July 2011 through December 2013 with interest rates of up to 9.96% and a weighted average interest rate of approximately 6.71%. Assets under capital leases at December 31, 2010 totaled $3,647 with accumulated amortization of $753. Amortization expense relating to assets under capital lease for the year ended December 31, 2010 totaled $753 (2009 - $nil).

### 12. Subordinate Convertible Debenture

In conjunction with the acquisition of Champion Drilling Fluids Inc. (note 3), a $6,627 subordinate convertible debenture (the "Debenture") was issued by the Company. The Debenture paid interest at 12% per annum and provided for a forced conversion of the Debenture into 791,776 common shares of CES, at a fixed conversion price of $8.37 per common share, upon completion of the Conversion. The Conversion was completed January 1, 2010, and the Debenture was converted to 791,776 common shares of CES on January 4, 2010. The common shares issued are subject to escrow provisions, with one-third of the escrowed shares being released, subject to industry standard exceptions including a change of control of CES, on each of the first, second, and third anniversaries after closing of the acquisition.

### 13. Income Taxes

As outlined in note 1, effective January 1, 2010, as a result of the Conversion, the Company converted from a limited partnership structure to a corporate structure. As a result, CES is subject to federal and provincial/state income taxes in Canada and the United States to the extent that they are not sheltered by existing tax pools.

Under the Arrangement, Nevaro transferred certain assets and all of its liabilities to a new corporation ("New Nevaro"), leaving certain tax attributes related to Nevaro's previous operations. Nevaro then acquired all of the Class A Units of the Partnership and all of the shares of Canadian Energy Services Inc., and, in exchange, the previous holders of Class A Units of the Partnership received one common share of Nevaro for each Class A Unit of the Partnership they held. Nevaro then changed its name to "Canadian Energy Services & Technology Corp." which became the parent entity of CES on a go forward basis with no changes to the underlying business operations of CES. Under the Arrangement, New Nevaro received consideration from the Company in the aggregate amount of $2,800. CES incurred $586 in costs related to the Arrangement which were expensed during the year ended December 31, 2009.

As a result of the Arrangement, a future income tax asset of $15,482 and a deferred tax credit in the amount of $12,682 were recognized with the difference of $2,800 representing the consideration paid to New Nevaro under the arrangement. The deferred tax credit is amortized in proportion to the corresponding future income tax asset as the tax pools are utilized. For the year ended December 31, 2010, $5,827 of this future income tax asset and $4,776 of this deferred tax credit has been amortized relating to the estimated usage.

For the year ended December 31, 2009, the income earned directly by the Partnership was taxed in the hands of the partners. Effective January 1, 2010, as a result of the Conversion, the Partnership converted from a limited partnership structure to a corporate structure. As a result, for the year ended December 31, 2010, the Canadian operations are subject to federal and provincial income taxes in Canada to the extent they are not sheltered by existing tax pools and accordingly future income taxes have been recorded relating to temporary differences. AES, as it has been since its establishment, will continue to be subject to federal and state income taxes in the United States to the extent its income is not sheltered by existing tax pools.

The provision for income taxes differs from the result that would have been obtained by applying the combined Canadian statutory federal and provisional income tax rates for the following reasons:

| | Year Ended December 31, | |
|---|---|---|
| *$000's* | **2010** | **2009** |
| Income before taxes | **31,610** | 4,975 |
| Income tax rate | **28.53%** | 29.65% |
| Expected income tax expense | **9,018** | 1,475 |
| | | |
| Effects on taxes resulting from | | |
| Utilization of deferred tax credit | **(4,774)** | - |
| Non-deductible expenses | **732** | (293) |
| Change in unrecognized temporary differences | **165** | 347 |
| Unrealized foreign exchange | **42** | - |
| Reduction of future income tax due to rate changes | **160** | (73) |
| Other | **8** | (217) |
| Income distributed to partners | **-** | (1,856) |
| Adjustment to future income tax liability for accelerated recognition | **-** | (816) |
| Income tax in jurisdictions with different tax rates | **-** | (256) |
| Valuation allowance | **-** | (851) |
| Income tax expense | **5,351** | (2,540) |

The components of future income tax assets and liabilities are as follows:

| | As at | |
|---|---|---|
| *$000's* | **December 31, 2010** | December 31, 2009 |
| Property and equipment | **1,409** | 542 |
| Goodwill and other intangible assets | **2,442** | 1,465 |
| Financing costs and other tax credits | **(800)** | (588) |
| Non-capital losses | **(10,145)** | (2,192) |
| Capital losses | **(4,943)** | - |
| Other | **-** | 53 |
| Valuation allowance, net | **4,943** | - |
| Total, net future income tax (asset) liability | **(7,094)** | (720) |
| Future income tax asset | **10,212** | 1,949 |
| Future income tax liability | **3,118** | 1,229 |

The federal non-capital losses expire in 2026 and beyond.

| | As at | |
|---|---|---|
| *$000's* | **December 31, 2010** | December 31, 2009 |
| 2026 and beyond | **37,148** | 5,870 |
| Total non-capital tax loss pools | **37,148** | 5,870 |

Non-capital tax losses denominated in foreign currencies have been translated at the respective exchange rate.

As at December 31, 2010, the Company had capital loss carry forward pools of $18,636 (2009 - $nil). Due to uncertainty over realization of the respective pools, no future income tax asset has been recognized in relation to the capital loss carry forward pools and a provision has been taken in full.

### 14. Shareholders' Equity

*a) Issued and outstanding*

A summary of the changes to shareholders' equity for the period is presented below:

| | **Year Ended December 31, 2010** | | Year Ended December 31, 2009 | |
|---|---|---|---|---|
| ***Common Shares*** *($000's except shares)* | **Number of Shares** | **Amount** | Number of Units (1) | Amount |
| Balance, beginning of the year | **12,417,573** | **117,448** | 9,018,315 | 84,352 |
| Equity issue, net of share issue costs and tax | **2,905,000** | **43,066** | 1,000,000 | 9,550 |
| Consideration for acquired business (note 3) | **1,289,370** | **21,468** | 223,054 | 1,793 |
| Issued on conversion of Debenture | **791,776** | **6,627** | - | - |
| Issued pursuant to Unit Bonus Plan | **-** | **-** | 20,500 | 224 |
| Issued pursuant to Option Plan | **598,483** | **5,353** | 45,500 | 353 |
| Contributed surplus related to Option Plan exercise | **-** | **1,793** | - | 129 |
| Issued pursuant to Distribution Rights Plan | **129,627** | **-** | 8,718 | - |
| Units repurchased | **-** | **-** | (50,000) | (467) |
| Conversion of Subordinated Class B Units | **-** | **-** | 2,151,486 | 21,514 |
| Balance, end of the year | **18,131,829** | **195,755** | 12,417,573 | 117,448 |

(1) The term "shares" refers to commons shares of the Company post January 1, 2010, and Class A Units of the Partnership prior to January 1, 2010.

The Debenture issued in conjunction with the acquisition of Champion Drilling Fluids Inc. (note 3) for $6,627 was converted into 791,776 common shares of CES, at a fixed conversion price of $8.37 per common share on January 4, 2010 after completion of the Conversion. The common shares issued are subject to escrow provisions, with one-third of the escrowed shares being released, subject to industry standard conditions including a change of control of CES, on each of the first, second, and third anniversaries after closing of the acquisition.

On July 13, 2010, in conjunction with the Fluids Management acquisition (note 3), the Company, through a syndicate of underwriters, completed a bought deal private placement financing (the "Offering"). Pursuant to the Offering, the Company issued a total of 2,905,000 Subscription Receipts at $15.50 per Subscription Receipt for gross proceeds of $45,028. Net proceeds after offering expenses and underwriter's commission of $2,665, net of tax of $703, were $43,066. On September 7, 2010, the 2,905,000 Subscription Receipts were converted to 2,905,000 common shares of the Company.

*b) Net income per share*

In calculating the basic and diluted net income per share for the year ended December 31, 2010 and 2009, the weighted average number of shares used in the calculation is shown in the table below. Dilutive securities relate to shares issuable under the Company's Option Plan and Share Rights Incentive Plan. For the year ended December 31, 2010, dilutive securities includes the dilutive impact of the Subscription Receipts for the period of July 13, 2010 through September 7, 2010.

| | Year Ended December 31, | |
|---|---|---|
| *$000's, except share and per share amounts* | **2010** | 2009 |
| Net income | **26,259** | 7,515 |
| Weighted average number of shares outstanding: | | |
| Basic shares outstanding | **15,096,650** | 11,267,540 |
| Effect of dilutive securities | **445,699** | 46,535 |
| Diluted shares outstanding | **15,542,349** | 11,314,075 |
| Net income per share - basic | **$1.74** | $0.67 |
| Net income per share - diluted | **$1.69** | $0.66 |

(stated in thousands of dollars except per share amounts)

## 15. Stock-Based Compensation

As at December 31, 2010, a total of 1,813,183 common shares were reserved for issuance under the Company's Option Plan and Share Rights Incentive Plan of which 566,333 remained available for grant.

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

In conjunction with the Conversion, CES has adopted a Share Rights Incentive Plan for any new issuances after January 1, 2010. All prior grants under the Unit Option Plan will continue based on the terms and conditions as of the original grant. A summary of changes to the Option Plan is presented below:

| | **Year Ended December 31, 2010** | | Year Ended December 31, 2009 | |
|---|---|---|---|---|
| | **Options** | **Average Exercise Price** | Options | Average Exercise Price |
| Balance, beginning of the year | **682,500** | **$8.75** | 725,500 | $9.08 |
| Granted during the year | **-** | **-** | 85,000 | 6.38 |
| Exercised during the year | **(598,483)** | **8.94** | (45,500) | 7.80 |
| Forfeited during the year | **(7,667)** | **7.26** | (82,500) | 9.70 |
| Balance, end of the year | **76,350** | **$7.42** | 682,500 | $8.75 |
| Exercisable options, end of the year | **9,433** | **$9.27** | 515,584 | $9.14 |

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

CES' SRIP provides incentives to the employees, officers, and directors of the Company or its subsidiaries, and certain service providers by issuing options to acquire common shares. Share Rights granted generally vest as to one-third on each of the first, second, and third anniversary dates of the grant, or such other vesting schedule as determined by the Board of Directors, and expire no later than five years after the grant. Under the SRIP, employees may elect to exercise the Share Rights at an adjusted exercise price in which the option exercise price will be adjusted downwards by the cumulative dividends paid by the Company. A summary of changes to the Share Rights is presented below:

| | **Year Ended December 31, 2010** | | Year Ended December 31, 2009 | |
|---|---|---|---|---|
| | **Share Rights** | **Average Exercise Price** | Share Rights | Average Exercise Price |
| Balance, beginning of the year | **-** | **$ -** | - | $ - |
| Granted during the year | **1,226,000** | **16.81** | - | - |
| Cancelled during the year | **(55,500)** | **14.15** | - | - |
| Balance, end of the year | **1,170,500** | **$16.94** | - | $ - |
| Exercisable Share Rights, end of the year | **-** | **$ -** | - | $ - |

The fair value of the Share Rights granted, as of the date of grant, during the year ended December 31, 2010 was $5,101 (2009 – $nil). The stock-based compensation costs for Share Rights granted during the year ended December 31, 2010 were calculated using a Black-Scholes option pricing model using the following assumptions:

| | **Year Ended December 31, 2010** |
|---|---|
| Risk-free interest rate | **1.65% - 2.65%** |
| Expected life of Share Rights | **3.5 years** |
| Share Right term | **5.0 years** |
| Annual forfeiture rate | **9.00%** |
| Dividend yield | **4.95% - 5.66%** |
| Expected volatility | **54.83% - 55.74%** |
| Weighted average fair value per Share Right | **$4.16** |

For the year ended December 31, 2010, stock-based compensation expense of $1,791 (2009 - $760) was recorded relating to the Company's Option and Share Rights stock-based compensation plans. The following table summarizes information about the outstanding grants under the Company's Option and Share Rights Plans as at December 31, 2010:

| | Options & Share Rights Outstanding | | | Options & Share Rights Exercisable | |
|---|---|---|---|---|---|
| Range of exercise prices | Options | Weighted average exercise price | Weighted average term remaining in years | Options | Weighted average exercise price |
| $5.53 - $8.00 | 51,850 | $6.40 | 2.96 | 3,100 | $7.72 |
| $8.01 - $11.31 | 24,500 | 9.57 | 2.82 | 6,333 | 10.03 |
| $11.32 - $14.54 | 431,000 | 14.32 | 4.26 | - | - |
| $14.55 - $18.50 | 739,500 | 18.46 | 4.76 | - | - |
| | 1,246,850 | $16.35 | 4.47 | 9,433 | $9.27 |

*c) Distribution Rights Plan*

The Distribution Rights Plan was terminated effective January 1, 2010 in conjunction with the Conversion. Effective January 15, 2010, all outstanding Distribution Rights were redeemed for common shares of the Company.

| ***Common Shares Accumulated From Distribution Rights*** | **Year Ended December 31, 2010** | Year Ended December 31, 2009 |
|---|---|---|
| Balance, beginning of the year | **129,627** | 46,812 |
| Granted during the year | **-** | 100,782 |
| Redeemed during the year pursuant to option exercise | **(7,091)** | (8,718) |
| Redeemed during the year upon termination of distribution rights plan | **(122,536)** | - |
| Forfeited during the year | **-** | (9,249) |
| Balance, end of the year | **-** | 129,627 |

*d) Partnership Unit Bonus Plan*

The Partnership Unit Bonus Plan was terminated effective January 1, 2010 in conjunction with the Conversion. During the year ended December 31, 2010, the Company recognized $nil of stock-based compensation expense (2009 - $67) relating to the Unit Bonus Plan.

## 16. Contributed Surplus

The following table reconciles the Company's contributed surplus:

| *$000's* | **Year Ended December 31, 2010** | Year Ended December 31, 2009 |
|---|---|---|
| Contributed surplus, beginning of the year | **2,122** | 1,531 |
| Stock-based compensation | **1,791** | 827 |
| Shares repurchased at less than carrying value | **-** | 117 |
| Shares issued pursuant to Unit Bonus Plan | **-** | (224) |
| Exercise of share options | **(1,793)** | (129) |
| Contributed surplus, end of the year | **2,120** | 2,122 |

## 17. Cash Dividends

The Company has declared dividends to holders of common shares for the year ended December 31, 2010, as follows:

| *$000's except per share amounts* | Dividend Record Date | Dividend Payment Date | Per Common Share | Total |
|---|---|---|---|---|
| January | Jan 31 | Feb 15 | 0.06 | **802** |
| February | Feb 28 | Mar 15 | 0.06 | **804** |
| March | Mar 31 | Apr 15 | 0.06 | **808** |
| April | Apr 30 | May 15 | 0.06 | **808** |
| May | May 31 | Jun 15 | 0.06 | **808** |
| June | Jun 30 | Jul 15 | 0.08 | **1,181** |
| July | Jul 31 | Aug 15 | 0.08 | **1,184** |
| August | Aug 31 | Sep 15 | 0.08 | **1,184** |
| September | Sep 30 | Oct 15 | 0.08 | **1,419** |
| October | Oct 31 | Nov 15 | 0.10 | **1,420** |
| November | Nov 30 | Dec 15 | 0.10 | **1,809** |
| December | Dec 31 | Jan 15 | 0.10 | **1,813** |
| Total dividends declared during the year | | | 0.92 | **14,040** |

## 18. Commitments, Earn-Out Payable, and Deferred Acquisition Consideration

The Company has commitments, which are not recorded in the consolidated financial statements, with payments due as follows:

| *$000's* | 2011 | 2012 | 2013 | 2014 | 2015 | Total |
|---|---|---|---|---|---|---|
| Office and facility rent | 1,161 | 1,029 | 604 | 336 | 336 | **3,466** |
| Vehicle operating leases | 43 | 23 | - | - | - | **66** |
| Total | 1,204 | 1,052 | 604 | 336 | 336 | **3,532** |

Payments denominated in foreign currencies have been translated at the respective December 31, 2010 exchange rate

The Company is involved in litigation and disputes arising in the normal course of operations. Management is of the opinion that any potential litigation 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.

In connection with the acquisition of the business assets of Clear Environmental Solutions Inc. on June 12, 2008, the Company was required to pay consideration pursuant to the earn-out payment of $2,000 of which $207 remained outstanding as at December 31, 2009 and was paid out in cash during 2010.

In conjunction with the Champion acquisition (note 3), the Company had US$2,000 of deferred acquisition consideration payable in cash upon the earlier of the second anniversary of the acquisition or the successful business expansion of the Champion Drilling Fluids business operations into the Marcellus shale region of the United States. The Company paid the outstanding balance of US$2,000 on May 3, 2010.

In conjunction with the Fluids Management acquisition (note 3), the Company has $4,990 (US$5,000) in additional deferred acquisition consideration payable in cash upon the Fluids Management division achieving an EBITDA target of US$9,500 for the twelve month period post close.

## 19. Financial Instruments and Risk Management

*a) Financial instrument measurement and classification*

The classification of financial instruments remains consistent at December 31, 2010 with that as at December 31, 2009.

The following tables provide fair value measurement information for financial assets and liabilities as of December 31, 2010 and 2009. The carrying value of accounts receivable, accounts payable and accrued liabilities, bank indebtedness, earn-out payable, deferred acquisition consideration, and dividends payable approximate fair value due to the short-term nature of those instruments. The carrying values of financial liabilities where interest is charged based on a variable rate approximate fair value.

The carrying value of long-term debt and capital lease obligations where interest is charged at a fixed rate is not significantly different than fair value. These assets and liabilities are not included in the following tables:

| | As At December 31, 2010 | | | | |
|---|---|---|---|---|---|
| *$000's* | Carrying Value | Fair Value | Quoted Prices In Active Markets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Financial Assets | | | | | |
| Financial derivative asset | 25 | 25 | - | 25 | - |
| Total | 25 | 25 | - | 25 | - |

| | As At December 31, 2009 | | | | |
|---|---|---|---|---|---|
| *$000's* | Carrying Value | Fair Value | Quoted Prices In Active Markets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Financial Liabilities | | | | | |
| Financial derivative liability | 11 | 11 | - | 11 | - |
| Total | 11 | 11 | - | 11 | - |

Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2 – Pricing inputs are other than quoted prices in active markets included in Level 1. Prices in Level 2 are either directly or indirectly observable as of the reporting date. Level 2 valuations are based on inputs, including quoted forward prices for commodities, time value and volatility factors, which can be substantially observed or corroborated in the marketplace. The fair value of the risk management contracts are estimated based on the mark-to-market method of accounting, using publicly quoted market prices or, in their absence, third-party market indications and forecasts priced on the last trading day of the applicable period.

Level 3 – Valuations in this level are those with inputs for the asset or liability that are not based on observable market data.

*b) Credit risk*

Credit risk reflects the risk of loss if counterparties do not fulfill their contractual obligations to the Company. The Company manages credit risk by assessing the creditworthiness of its customers on an ongoing basis as well as monitoring the amount and age of balances outstanding. Accounts receivable primarily includes balances from customers operating primarily in the oil and natural gas industry. Accordingly, the Company views the credit risks on these amounts as normal for the industry. An analysis of accounts receivable, net of impairment provisions, which are past due but not impaired is as follows:

| | As at | |
|---|---|---|
| *$000's* | **December 31, 2010** | December 31, 2009 |
| Past due 61-90 days | **8,400** | 2,516 |
| Past due 91-120 days | **4,200** | 4 |
| Past 120 days | **663** | 224 |
| Total past due | **13,263** | 2,744 |

The Company reduces an account receivable to its estimated recoverable amount. At December 31, 2010, the Company had recorded a provision of $162 (December 31, 2009 - $284) relating to accounts receivable which may not be collectible.

*c) Interest rate risk*

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in prevailing market interest rates. The Company is exposed to interest rate risk as result of funds borrowed at floating interest rates. The Company manages this risk by monitoring interest rate trends and forecasted economic conditions. As of December 31, 2010, the Company had not entered into any interest rate derivatives to manage its exposure to fluctuations in interest rates.

A 50 basis point increase or decrease is used when reporting interest rate risk internally and represents management's assessment of the reasonably possible change in interest rates. If interest rates had been 50 basis points higher/lower, and all other variables were held constant, the Company's net income would be approximately $154 lower/higher for the year ended December 31, 2010 (2009 - $36).

*d) Foreign currency risk*

Foreign currency risk is the risk that the value of future cash flows will fluctuate as a result of changes in foreign currency exchange rates. The Company's foreign currency risk arises from its working capital balances denominated in foreign currencies and on the translation of its foreign operations, as well as its U.S. dollar denominated dividend payments. The Company uses the U.S. dollar as its functional currency for the operations of AES. The Company manages foreign currency risk by monitoring exchange rate trends and forecasted economic conditions and, as appropriate, through the use of financial derivatives. A 1% increase or decrease is used when reporting foreign currency risk internally and represents management's assessment of the reasonable change in foreign exchange rates. Excluding financial currency derivatives, for the year ended December 31, 2010, a 1% increase/decrease in the Canadian dollar vis-à-vis the U.S. dollar is estimated to decrease/increase net income of the Company by $1 (2009 - $7).

At December 31, 2010, the Company had entered into the following foreign exchange U.S. dollar forward purchase contracts to manage its exposure to upcoming U.S. dollar denominated purchases pursuant to its Canadian operations:

| Period | Notional Balance $000's | Contract Type | Settlement | Average C$/US$ Exchange Rate |
|---|---|---|---|---|
| January 2011 | US$215 | Deliverable Forward | Physical Purchase | $1.0259 |
| February 2011 | US$589 | Deliverable Forward | Physical Purchase | $1.0118 |
| Total | US$804 | | | $1.0156 |

At December 31, 2010, the Company had entered into the following foreign exchange U.S. dollar forward sale contracts to manage its exposure to upcoming U.S. dollar denominated cash flows expected to, in part, fund the Company's anticipated future monthly shareholder dividends:

| Period | Notional Balance $000's | Contract Type | Settlement | Average C$/US$ Exchange Rate |
|---|---|---|---|---|
| January 2011 | US$360 | Deliverable Forward | Physical Sale | $1.0088 |
| February 2011 | US$360 | Deliverable Forward | Physical Sale | $1.0094 |
| March 2011 | US$360 | Deliverable Forward | Physical Sale | $1.0100 |
| April 2011 | US$360 | Deliverable Forward | Physical Sale | $1.0107 |
| May 2011 | US$360 | Deliverable Forward | Physical Sale | $1.0116 |
| June 2011 | US$360 | Deliverable Forward | Physical Sale | $1.0122 |
| July 2011 | US$360 | Deliverable Forward | Physical Sale | $1.0129 |
| August 2011 | US$360 | Deliverable Forward | Physical Sale | $1.0138 |
| September 2011 | US$360 | Deliverable Forward | Physical Sale | $1.0146 |
| October 2011 | US$360 | Deliverable Forward | Physical Sale | $1.0153 |
| November 2011 | US$360 | Deliverable Forward | Physical Sale | $1.0163 |
| December 2011 | US$260 | Deliverable Forward | Physical Sale | $1.0102 |
| Total | US$4,220 | | | $1.0122 |

The fair value of these transactions is based upon the estimated amounts that would have been paid to or received from counterparties in order to settle the outstanding transactions with reference to the estimated forward prices as of the date of the consolidated balance sheet. The contracts are transacted with counterparties with whom management has assessed credit risk and due to their relative short-term nature, management has determined that no adjustment for credit risk or liquidity risk is required in determining the estimated settlement price. The actual amounts realized will be based on the settlement prices at the time of settlement and will differ from these estimates. The Company has not designated any of these financial contracts as hedges and has therefore recorded the unrealized gains and losses on these contracts in the consolidated balance sheet as assets or liabilities with changes in their fair value recorded in net income for the period. For the year ended December 31, 2010, the Company recorded a realized loss of $22 (2009 - $44) relating to its foreign currency derivative contracts. For the year ended December 31, 2010, the Company recorded an unrealized gain of $24 (2009 – unrealized loss of $11) relating to its foreign currency derivative contracts. The fair value of these outstanding risk management assets at December 31, 2010 was $25 (December 31, 2009 – liability of $11). At December 31, 2010, a 1% increase / decrease in the Canadian dollar vis-à-vis the US dollar is estimated to increase / decrease in net income of the Company by $34 (2009 – decrease / increase by $15) as a result of the change in fair value of these outstanding contracts.

*e) Commodity price risk*

Commodity price risk is the risk that the value of future cash flows will fluctuate as a result of changes in commodity prices. The Company is exposed both directly and indirectly to changes in underlying commodity prices, namely crude oil and natural gas. The prices of these commodities are significantly impacted by world economic events which impact the supply and demand of crude oil and natural gas. The Company is primarily impacted by the effects of changes in the prices of crude oil and natural gas which impact overall drilling activity and the demand for the Company's products and services. In addition, through its operations, the Company purchases various chemicals and oil-based products and is directly exposed to changes in the prices of these items. As of December 31, 2010, the Company had not entered into any commodity derivatives to manage its exposure to fluctuations in commodity prices.

*f) Liquidity risk*

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due and describes the Company's ability to access cash. The Company requires sufficient cash resources to finance operations, fund capital expenditures, repay debt, fund shareholder dividends, and settle other liabilities of the Company as they come due. The Company manages liquidity risk by maintaining a revolving demand loan facility and through management of its operational cash flows. The following table details the remaining contractual maturities of the Company's financial liabilities as of December 31, 2010:

| | Payments Due By Period (1) | | | | | |
|---|---|---|---|---|---|---|
| *$000's* | Less than 3 months | 3 months to 1 year | 1-2 years | 2-5 years | 5+ years | **Total** |
| Bank indebtedness (3) | 44,172 | - | - | - | - | **44,172** |
| Accounts payable and accrued liabilities | 46,714 | - | - | - | - | **46,714** |
| Deferred acquisition consideration | - | 4,990 | - | - | - | **4,990** |
| Dividends payable (2) | 1,813 | - | - | - | - | **1,813** |
| Long-term debt at fixed interest rates (3) | 192 | 575 | 632 | 234 | - | **1,633** |
| Long-term debt at floating interest rates (3) | 204 | 613 | 817 | 1,873 | - | **3,507** |
| Capital lease obligations (3) | 268 | 804 | 1,190 | 419 | 55 | **2,736** |
| Office and vehicle operating leases | 301 | 902 | 1,052 | 604 | 673 | **3,532** |
| Total | 93,664 | 7,884 | 3,691 | 3,130 | 728 | **109,097** |

(1) Payments denominated in foreign currencies have been translated at the respective December 31, 2010 exchange rate

(2) Dividends declared as of December 31, 2010

(3) Bank indebtedness, long-term debt, and capital lease obligations reflect principal payments and excludes any associated interest portion

## 20. Capital Management

For the year ended December 31, 2010, the Company considers capital to include shareholders' equity, long-term debt (including current portion), and bank indebtedness. This remains consistent with the year ended December 31, 2009. The Company's objectives when managing capital are to safeguard its ability to continue as a going concern and to maintain and grow the business while incurring an acceptable level of risk and providing shareholders with sustainable prudent dividends.

Management of the Company sets the amount of capital in proportion to risk, and manages the capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust the capital structure, CES may adjust the level of dividends paid to shareholders, issue new shares, dispose of assets, repay debt, or issue new debt.

In addition to monitoring the externally imposed capital requirements, as detailed below, the Company manages capital by analyzing working capital levels, forecasted cash flows, planned investments in property and equipment, and general economic conditions. The Company has the following externally imposed capital requirements pursuant to the revolving demand facility agreement:

- 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 excluding the Bridge Loan divided by the total of stated capital, contributed surplus, deficit, and any indebtedness that has been subordinated and postponed to the bank less any intangible asset 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.
- 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 December 31, 2010, the Company has met all of the financial requirements under this agreement.

**21. Supplemental Information**

The changes in non-cash working capital were as follows:

| | Year Ended December 31, | |
|---|---|---|
| *$000's* | **2010** | 2009 |
| *Operating activities* | | |
| Decrease (increase) in current assets | | |
| Accounts receivable | **(63,759)** | 13,765 |
| Inventory | **(12,608)** | 1,902 |
| Prepaid expenses | **(2,159)** | 52 |
| Increase (decrease) in current liabilities | | |
| Accounts payable and accrued liabilities | **23,434** | (5,836) |
| | **(55,092)** | 9,883 |
| *Investing activities* | | |
| Decrease (increase) in current assets | | |
| Accounts receivable | **650** | (650) |
| Increase (decrease) in current liabilities | | |
| Accounts payable and accrued liabilities | **(257)** | 1,128 |
| | **393** | 478 |

**22. Segmented Information**

For the year ended December 31, 2010, the Company has three reportable operating segments as determined by management, which are the Drilling Fluids segment, the Trucking segment, and the Environmental Services segment. The Drilling Fluids segment designs and implements drilling fluid systems for the North American oil and natural gas industry. The Trucking segment is comprised of heavy duty trucks, trailers, and tanker trailers used in hauling drilling fluids to locations and hauling produced fluids for operators in Canada. The Environmental Services segment is comprised of the Company's environmental division, Clear Environmental Services which provides environmental and drilling fluids waste disposal services in Canada to oil and gas producers. Selected summary financial information relating to the operational segments is as follows:

| | **Year Ended December 31, 2010** | | | | |
|---|---|---|---|---|---|
| *$000's* | Drilling Fluids | Trucking | Environmental Services | Intercompany Eliminations | **Total** |
| Revenue | 220,991 | 15,297 | 13,960 | (1,131) | **249,116** |
| Gross margin | 61,810 | 5,484 | 4,879 | - | **72,173** |
| Amortization | 4,048 | 1,664 | 727 | - | **6,439** |
| Interest expense | 1,490 | 124 | 49 | - | **1,663** |
| Income before taxes | 27,293 | 2,704 | 1,613 | - | **31,610** |
| Total assets | 259,439 | 12,821 | 15,377 | - | **287,637** |
| Capital expenditures | 9,044 | 2,257 | 29 | - | **11,330** |

| | Year Ended December 31, 2009 | | | | |
|---|---|---|---|---|---|
| *$000's* | Drilling Fluids | Trucking | Environmental Services | Intercompany Eliminations | Total |
| Revenue | 73,148 | 8,117 | 9,004 | (815) | 89,454 |
| Gross margin | 20,786 | 2,602 | 3,324 | - | 26,712 |
| Amortization | 1,756 | 1,046 | 724 | - | 3,526 |
| Interest expense | 421 | 48 | 9 | - | 478 |
| Income before taxes | 3,499 | 835 | 641 | - | 4,975 |
| Total assets | 105,387 | 12,015 | 13,297 | - | 130,699 |
| Capital expenditures | 439 | 4,015 | 13 | - | 4,467 |

Geographical information relating to the Company's activities is shown in the tables below.

| | Revenue | |
|---|---|---|
| | Year Ended December 31, | |
| *$000's* | **2010** | 2009 |
| Canada | **139,461** | 83,197 |
| United States | **109,655** | 6,257 |
| Total | **249,116** | 89,454 |

| | Long-Term Assets (1) | |
|---|---|---|
| *$000's* | **December 31, 2010** | December 31, 2009 |
| Canada | **70,342** | 66,044 |
| United States | **72,509** | 16,980 |
| Total | **142,851** | 83,024 |

(1) Includes: Property and equipment, goodwill, and intangible assets

## 23. Economic Dependence

For the year ended December 31, 2010, one customer accounted for 10.6% (2009 - 11.8%) of the Company's total revenue.

**BOARD OF DIRECTORS**
Kyle D. Kitagawa[1]
Chairman

Colin D. Boyer[1,2]

John M. Hooks[2]

D. Michael G. Stewart[1]

Thomas J. Simons

Rodney L. Carpenter

James (Jim) G. Sherman

*[1] Member of the Audit Committee*
*[2] 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
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

**www.canadianenergyservices.com**

**STOCK EXCHANGE LISTING**
The Toronto Stock Exchange
Trading Symbol: CEU

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