# Condensed Consolidated Financial Statements

**For the Three and Nine Months Ended September 30, 2011**

## Canadian Energy Services & Technology Corp.

Condensed Consolidated Statements of Financial Position (unaudited)
(stated in thousands of dollars, except per share amounts)

| | As at | |
|---|---|---|
| | **September 30, 2011** | December 31, 2010 |
| ASSETS | | |
| Current assets | | |
| Accounts receivable | **140,502** | 100,733 |
| Financial derivative asset (note 19) | **-** | 25 |
| Inventory (note 5) | **50,913** | 31,303 |
| Prepaid expenses | **4,396** | 2,513 |
| | **195,811** | 134,574 |
| Property and equipment (note 6) | **39,869** | 30,553 |
| Intangible assets (note 7) | **15,531** | 17,083 |
| Deferred income tax asset | **3,394** | 10,212 |
| Goodwill | **97,649** | 95,448 |
| | **352,254** | 287,870 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current liabilities | | |
| Bank indebtedness (note 8) | **68,664** | 44,172 |
| Accounts payable and accrued liabilities | **68,598** | 46,714 |
| Financial derivative liability (note 19) | **404** | - |
| Deferred acquisition consideration (note 18) | **-** | 4,990 |
| Dividends payable (note 17) | **2,194** | 1,813 |
| Current portion of finance lease obligation (note 10) | **1,864** | 1,184 |
| Current portion of long-term debt (note 9) | **1,555** | 1,584 |
| | **143,279** | 100,457 |
| Finance lease obligation (note 10) | **3,076** | 1,722 |
| Long-term debt (note 9) | **2,827** | 3,556 |
| Deferred income tax liability | **5,855** | 3,118 |
| | **155,037** | 108,853 |
| Commitments (note 18) | | |
| Shareholders' equity | | |
| Common shares (note 14) | **198,314** | 195,755 |
| Contributed surplus (note 16) | **3,611** | 1,900 |
| Deficit | **(5,395)** | (13,255) |
| Accumulated other comprehensive income (loss) | **687** | (5,383) |
| | **197,217** | 179,017 |
| | **352,254** | 287,870 |

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

**Canadian Energy Services & Technology Corp.**
Condensed Consolidated Statements of Comprehensive Income (unaudited)
(stated in thousands of dollars, except per share amounts)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | **2011** | 2010 | **2011** | 2010 |
| Revenue | **121,958** | 78,398 | **320,464** | 154,648 |
| Cost of sales (notes 5 and 11) | **91,438** | 56,703 | **234,349** | 112,523 |
| Gross margin | **30,520** | 21,695 | **86,115** | 42,125 |
| General and administrative expenses (note 12) | **14,810** | 11,251 | **42,683** | 23,593 |
| Operating profit | **15,710** | 10,444 | **43,432** | 18,532 |
| Finance costs (income) (note 13) | **1,460** | (119) | **2,852** | 368 |
| Income before taxes | **14,250** | 10,563 | **40,580** | 18,164 |
| Current income tax expense | **631** | 153 | **4,420** | 196 |
| Deferred income tax expense (recovery) | **4,118** | 3,226 | **9,338** | (6,914) |
| Net income | **9,501** | 7,184 | **26,822** | 24,882 |
| Other comprehensive income (loss): | | | | |
| Unrealized foreign exchange gain (loss) on translation of foreign operations | **10,068** | (1,834) | **6,070** | (1,870) |
| Comprehensive income | **19,569** | 5,350 | **32,892** | 23,012 |
| Net income per share (note 14) | | | | |
| Basic | **0.17** | 0.15 | **0.49** | 0.59 |
| Diluted | **0.17** | 0.14 | **0.48** | 0.56 |

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

## Canadian Energy Services & Technology Corp.

Condensed Consolidated Statements of Changes in Equity (unaudited)
(stated in thousands of dollars, except per share amounts)

| | Nine Months Ended September 30, | |
|---|---|---|
| | **2011** | 2010 |
| **Common shares** | | |
| Balance, beginning of period | **195,755** | 117,448 |
| Stock options exercised | **2,559** | 2,199 |
| Consideration for acquired business | **-** | 21,468 |
| Equity issue, net of share issue costs and tax | **-** | 43,066 |
| Conversion of subordinate convertible debenture | **-** | 6,627 |
| Balance, end of period | **198,314** | 190,808 |
| **Subordinate convertible debenture** | | |
| Balance, beginning of period | **-** | 6,627 |
| Conversion of subordinate convertible debenture | **-** | (6,627) |
| Balance, end of period | **-** | - |
| **Contributed surplus (note 16)** | | |
| Balance, beginning of period | **1,900** | 1,983 |
| Stock options exercised | **(584)** | (561) |
| Stock-based compensation | **2,295** | 753 |
| Balance, end of period | **3,611** | 2,175 |
| **Accumulated other comprehensive income (loss)** | | |
| Balance, beginning of period | **(5,383)** | - |
| Foreign currency translation adjustment | **6,070** | (1,870) |
| Balance, end of period | **687** | (1,870) |
| **Deficit** | | |
| Balance, beginning of period | **(13,255)** | (33,525) |
| Total net income for the period | **26,822** | 24,882 |
| Dividends declared (note 17) | **(18,962)** | (8,998) |
| Balance, end of period | **(5,395)** | (17,640) |
| **Total shareholders' equity** | **197,217** | 173,473 |

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

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | **2011** | 2010 | **2011** | 2010 |
| CASH PROVIDED BY (USED IN): | | | | |
| OPERATING ACTIVITIES: | | | | |
| Net income for the period | **9,501** | 7,184 | **26,822** | 24,882 |
| Adjustments for: | | | | |
| Amortization | **2,375** | 2,126 | **6,905** | 4,462 |
| Stock-based compensation | **798** | 310 | **2,295** | 753 |
| Non-cash finance costs | **538** | (37) | **699** | (2) |
| Deferred income tax expense (recovery) | **4,118** | 3,226 | **9,338** | (6,914) |
| (Gain) loss on disposal of assets | **(15)** | (25) | **(101)** | (1) |
| Change in non-cash working capital (note 20) | **(18,117)** | (33,575) | **(35,228)** | (42,735) |
| | **(802)** | (20,791) | **10,730** | (19,555) |
| FINANCING ACTIVITIES: | | | | |
| Repayment of long-term debt and capital leases | **(945)** | (662) | **(2,649)** | (1,709) |
| Issuance of long-term debt and lease proceeds | **1,834** | - | **1,834** | 4,147 |
| Issuance of shares, net of issuance costs | **186** | 42,819 | **1,976** | 44,000 |
| Bridge Loan financing | **-** | (41,920) | **-** | - |
| Increase in bank indebtedness | **15,027** | 26,001 | **22,693** | 32,127 |
| Shareholder dividends | **(6,580)** | (3,549) | **(18,580)** | (8,563) |
| | **9,522** | 22,689 | **5,274** | 70,002 |
| INVESTING ACTIVITIES: | | | | |
| Investment in property and equipment | **(4,260)** | (2,022) | **(12,031)** | (5,300) |
| Investment in intangible assets | **(35)** | (9) | **(140)** | (53) |
| Deferred acquisition consideration | **(4,951)** | - | **(4,951)** | (2,245) |
| Conversion transaction | **-** | - | **-** | (2,800) |
| Acquisition of Fluids Management | **-** | - | **-** | (40,563) |
| Proceeds on disposal of fixed assets | **405** | 46 | **765** | 395 |
| | **(8,841)** | (1,985) | **(16,357)** | (50,566) |
| Effect of exchange rate on bank indebtedness | **121** | 87 | **353** | 119 |
| CHANGE IN CASH | **-** | - | **-** | - |
| Cash, beginning of period | **-** | - | **-** | - |
| Cash, end of period | **-** | - | **-** | - |
| SUPPLEMENTARY CASH FLOW DISCLOSURE | | | | |
| Interest paid | **479** | 460 | **1,982** | 972 |
| Taxes paid | **1,730** | 10 | **4,300** | 10 |

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

**1. The Company**

Canadian Energy Services & Technology Corp. ("CES") is a company domiciled in Canada and was incorporated under the Canada Business Corporations Act on November 13, 1986. CES was formerly Canadian Energy Services L.P. (the "Partnership"). Effective January 1, 2010, the Partnership completed a Plan of Arrangement ("Arrangement") with Nevaro Capital Corporation ("Nevaro") which resulted in the Company converting from a limited partnership to a corporation (the "Conversion"). The condensed consolidated financial statements of the Company as at and for the three and nine months ended September 30, 2011, comprise the Company and its subsidiaries (together referred to as the "Company" or "CES").

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 drilling fluid and production chemical blending 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 second quarter. These seasonal trends typically lead to quarterly fluctuations in Canadian operating results and working capital requirements which should be considered in any quarter over quarter analysis of the Company. As the business expands in the US, it is expected that the overall seasonality of the Company's operations will be less pronounced.

**2. Basis of Presentation**

**a) Statement of compliance**

In 2010, the Handbook of the Canadian Institute of Chartered Accountants ("CICA Handbook") was revised to incorporate International Financial Reporting Standards ("IFRS") and requires publicly accountable enterprises to apply such standards effective for years beginning on or after January 1, 2011. Accordingly, the Company commenced reporting on this basis in the March 31, 2011, interim condensed consolidated financial statements. In these financial statements, the term "Canadian GAAP" refers to Canadian generally accepted accounting principles before the adoption of IFRS.

These financial statements have been prepared in accordance with International Accounting Standard 34 ("IAS 34"), "Interim Financial Reporting" as issued by the International Accounting Standards Board and using the accounting policies the Company expects to adopt in its consolidated financial statements for the year ending December 31, 2011, which will be the Company's first consolidated annual financial statements prepared in accordance with IFRS. IFRS requires an entity to adopt IFRS in its first annual financial statements under IFRS by making an explicit and unreserved statement in those financial statements of compliance with IFRS. The Company will make this statement when it issues its 2011 annual financial statements. IFRS 1, "*First-time Adoption of International Financial Reporting Standards"*, has been applied with a transition date of January 1, 2010. An explanation of how the transition to IFRS has affected the reported financial position, financial performance, and cash flows of the Company, including the nature and effect of significant changes in accounting policies from those used in the Company's consolidated financial statements for the year ended December 31, 2010, is provided in note 4. These unaudited interim condensed consolidated financial statements were authorized for issue by the Board of Directors on November 7, 2011.

**b) Basis of measurement**

The consolidated financial statements have been prepared on a going concern basis using the historical cost convention except for the following items in the statement of financial position:

(i) derivative financial instruments are measured at fair value; and
(ii) financial instruments at fair value through profit or loss are measured at fair value.

**3. Significant Accounting Policies**

These unaudited interim condensed consolidated financial statements have been prepared by management of the Company in accordance with IAS 34 following the same accounting principles and methods of computation as outlined in the Company's unaudited interim condensed consolidated financial statements for the three months ended March 31, 2011, except as noted below. These unaudited interim condensed consolidated financial statements include all necessary disclosures required for interim financial statements but do not include all disclosures required for annual financial statements. Therefore, these interim condensed consolidated financial statements should be read in conjunction with the most recent audited annual consolidated financial statements and the notes thereto for the year ended December 31, 2010, and the disclosures and accounting policies included in the unaudited condensed consolidated financial statements as at and for the three months ended March 31, 2011.

**a) Restricted share units**
CES adopted a Restricted Share Unit plan ("RSU") effective June 30, 2011. RSUs are intended to be awarded to employees and officers of the Company and entitle the holder to a number of common shares plus reinvested notional dividends. The RSUs shall vest and be redeemed on the first anniversary from the date of grant, subject to the absolute discretion of the Board of Directors. Compensation expense is based on the estimated fair value of the share-based compensation award at the date of grant. Compensation expense associated with the share-based compensation plans are recognized in income over the vesting period of the plan with a corresponding increase to contributed surplus. CES estimates the forfeiture rate for RSUs at the date of grant, based on the number of awards expected to vest.

**b) Recent Accounting Pronouncements**
In May 2011, the IASB issued the following new and amended standards:

- IFRS 9, "*Financial Instruments*" is intended to replace IAS 39 "*Financial Instruments: Recognition and Measurement*". For financial assets, IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, and replaces the multiple rules in IAS 39. The new standard also requires a single impairment method to be used, replacing the multiple impairment methods in IAS 39. For financial liabilities, although the classification criteria for financial liabilities will not change under IFRS 9, the approach to the fair value option for financial liabilities may require different accounting for changes to the fair value of a financial liability as a result of changes to an entity's own credit risk;
- IFRS 10, "*Consolidated Financial Statements*" ("IFRS 10") replaces IAS 27, "*Consolidated and Separate Financial Statements*" ("IAS 27") and Standing Interpretations Committee ("SIC") 12, "*Consolidation – Special Purpose Entities*". IFRS 10 revises the definition of control and focuses on the need to have power and variable returns for control to be present. IFRS 10 provides guidance on participating and protective rights and also addresses the notion of "de facto" control. It also includes guidance related to an investor with decision making rights to determine if it is acting as a principal or agent;
- IFRS 11, "*Joint Arrangements*" ("IFRS 11") replaces IAS 31, "*Interest in Joint Ventures*" ("IAS 31") and SIC 13, "*Jointly Controlled Entities – Non-Monetary Contributions by Venturers*". This standard requires a party to assess its rights and obligations from the arrangement in order to determine the type of joint arrangement. The choice of proportionate consolidation accounting is removed for joint ventures (formerly jointly controlled entities) as equity accounting is required;
- IFRS 12, "*Disclosure of Interest in Other Entities*" ("IFRS 12") replaces the disclosure requirements previously included in IAS 27, IAS 31, and IAS 28, "*Investments in Associates*". It sets out the extensive disclosure requirements relating to an entity's interests in subsidiaries, joint arrangements, associates, and unconsolidated structured entities;
- IFRS 13, "*Fair Value Measurement*" ("IFRS 13") provides a consistent and less complex definition of fair value, establishes a single source for determining fair value, and introduces consistent requirements for disclosures related to fair value measurement;
- IAS 1, "*Presentation of Financial Statements*" ("IAS 1") requires companies to group items presented within Other Comprehensive Income based on whether they may be subsequently reclassified to profit or loss. This amendment to IAS 1 is effective for annual periods beginning on or after July 1, 2012 with full retrospective application;
- IAS 19, "*Employee Benefits*" ("IAS 19") improves the accounting for employee benefits by eliminating the 'corridor method' to defer recognition of gains and losses, presentation changes for assets and liabilities arising from defined benefit plan, and introducing enhanced disclosure requirements for defined benefit plans;
- IAS 27, "*Separate Financial Statements*" has been amended to conform to the changes made in IFRS 10 but retains the current guidance for separate financial statements; and
- IAS 28, "*Investments in Associates and Joint Ventures*" has been amended to conform to the changes made in IFRS 10 and IFRS 11.

Except as noted above, all of the above pronouncements are effective for annual periods beginning on or after January 1, 2013, with early adoption permitted. The Company is currently evaluating the impact of adopting these standards.

**4. Explanation of Transition to IFRS**
The Company has adopted IFRS effective January 1, 2010, ("the Transition Date") and has prepared its opening IFRS statement of financial position as at that date. Prior to the adoption of IFRS, the Company prepared its financial statements in accordance with Canadian GAAP. The Company's consolidated financial statements for the year ending December 31, 2011, will be the

first annual financial statements that comply with IFRS. The Company will ultimately prepare its opening IFRS statement of financial position by applying existing IFRS with an effective date of December 31, 2011. Accordingly, the opening IFRS statement of financial position and the December 31, 2010, comparative statement of financial position presented in the consolidated financial statements for the year ending December 31, 2011, may differ from those presented at this time.

**a) Mandatory exceptions to retrospective application**

In preparing these consolidated financial statements in accordance with IFRS 1, "First-time Adoption of International Financial Reporting Standards" ("IFRS 1"), the Company has applied certain mandatory exceptions from full retrospective application of IFRS. The mandatory exceptions applied from full retrospective application of IFRS are described below:

(i) Hedge accounting
Only hedging relationships that satisfied the hedge accounting criteria as of the transition date are reflected as hedges in the Company's results under IFRS. Any derivatives not meeting the IAS 39 criteria for hedge accounting were recorded as non-hedging derivative financial instruments.

(ii) Estimates
Hindsight was not used to create or revise estimates and accordingly the estimates previously made by the Company under Canadian GAAP are consistent with their application under IFRS.

**b) Elected exemptions from full retrospective application**

In preparing these consolidated financial statements in accordance with IFRS 1, the Company has applied certain of the optional exemptions from full retrospective application of IFRS. The optional exemptions applied are described below:

(i) Business combinations
The Company has applied the business combinations exemption under IFRS 1 to not apply IFRS 3, "Business Combinations", retrospectively to past business combinations. Accordingly, the Company has not restated business combinations that took place prior to the Transition Date.

(ii) Stock-based payment transactions
The Company has elected to apply IFRS 2, *"Share-based Payments"* ("IFRS 2"), to equity instruments granted after November 7, 2002, which have not vested by the Transition Date. Accordingly, the Company has not restated stock compensation expense on options vested prior to the Transition Date.

(iii) Borrowing costs
IAS 23, *"Borrowing Costs"*, has not been applied to borrowing costs relating to qualifying assets for which the commencement date for capitalization is before January 1, 2010. Accordingly, the Company has not capitalized borrowing costs relating to qualifying assets for which the commencement date for capitalization was before January 1, 2010.

(iv) Fair value or revaluation as deemed cost
IAS 16, *"Property, plant, and equipment"*, allows for property and equipment to continue to be carried at cost less depreciation, as determined under Canadian GAAP. Accordingly, the Company has elected to carry its property and equipment at historical cost less accumulated amortization.

**c) Reconciliation of equity and comprehensive income as reported under Canadian GAAP and IFRS**

In preparing its opening IFRS consolidated statement of financial position, the Company has adjusted amounts reported previously in the financial statements prepared in accordance with Canadian GAAP. An explanation of how the transition from Canadian GAAP to IFRS has affected the Company's consolidated statements of financial position, comprehensive income, and cash flows is set out in the following tables and the notes that accompany the tables.

(stated in thousands of dollars, except per share amounts)

**Reconciliation of financial position:**

| | | As at | | | | | |
|---|---|---|---|---|---|---|---|
| | | September 30, 2010 | | | January 1, 2010 | | |
| | Note | Canadian GAAP | Effect of transition IFRSs | **IFRS** | Canadian GAAP | Effect of transition IFRSs | **IFRS** |
| ASSETS | | | | | | | |
| Current assets | | | | | | | |
| Accounts receivable | | 91,944 | - | **91,944** | 35,336 | - | **35,336** |
| Financial derivative asset | | 10 | - | **10** | - | - | **-** |
| Inventory | | 25,787 | - | **25,787** | 10,001 | - | **10,001** |
| Prepaid expenses | | 1,047 | - | **1,047** | 389 | - | **389** |
| | | 118,788 | - | **118,788** | 45,726 | - | **45,726** |
| Property and equipment | **c, e** | 25,593 | 277 | **25,870** | 14,564 | 170 | **14,734** |
| Intangible assets | | 17,658 | - | **17,658** | 7,169 | - | **7,169** |
| Deferred income tax asset | | 13,063 | - | **13,063** | 1,949 | - | **1,949** |
| Goodwill | | 96,769 | - | **96,769** | 61,291 | - | **61,291** |
| | | 271,871 | 277 | **272,148** | 130,699 | 170 | **130,869** |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | | | | | |
| Current liabilities | | | | | | | |
| Bank indebtedness | | 40,889 | - | **40,889** | 8,762 | - | **8,762** |
| Accounts payable and accrued liabilities | | 41,536 | - | **41,536** | 21,212 | - | **21,212** |
| Financial derivative liability | | - | - | **-** | 11 | - | **11** |
| Earn-out payable | | - | - | **-** | 207 | - | **207** |
| Deferred acquisition consideration | | 5,145 | - | **5,145** | 2,098 | - | **2,098** |
| Distributions payable | | 1,419 | - | **1,419** | 983 | - | **983** |
| Current portion of capital lease obligation | **c** | 918 | 182 | **1,100** | - | 89 | **89** |
| Current portion of long-term debt | | 1,653 | - | **1,653** | 1,106 | - | **1,106** |
| | | 91,560 | 182 | **91,742** | 34,379 | 89 | **34,468** |
| Capital lease obligation | **c** | 1,293 | 65 | **1,358** | - | 82 | **82** |
| Long-term debt | | 3,635 | - | **3,635** | 2,557 | - | **2,557** |
| Deferred income tax liability | | 1,940 | - | **1,940** | 1,229 | - | **1,229** |
| Deferred tax credit | **d** | 10,217 | (10,217) | **-** | - | - | **-** |
| | | 108,645 | (9,970) | **98,675** | 38,165 | 171 | **38,336** |
| SHAREHOLDERS' EQUITY | | | | | | | |
| Common shares | | 190,808 | - | **190,808** | 117,448 | - | **117,448** |
| Subordinate convertible debt | | - | - | **-** | 6,627 | - | **6,627** |
| Contributed surplus | **b** | 2,354 | (179) | **2,175** | 2,122 | (139) | **1,983** |
| Deficit | **f** | (28,066) | 10,426 | **(17,640)** | (33,663) | 138 | **(33,525)** |
| Accumulated other comprehensive loss | | (1,870) | - | **(1,870)** | - | - | **-** |
| Total shareholders' equity | | 163,226 | 10,247 | **173,473** | 92,534 | (1) | **92,533** |
| Total liabilities and equity | | 271,871 | 277 | **272,148** | 130,699 | 170 | **130,869** |

(stated in thousands of dollars, except per share amounts)

**Reconciliation of comprehensive income:**

| | | Three months ended September 30, 2010 | | | Nine months ended September 30, 2010 | | |
|---|---|---|---|---|---|---|---|
| | Note | Canadian GAAP | Effect of transition IFRSs | IFRS | Canadian GAAP | Effect of transition IFRSs | IFRS |
| Revenue | | 78,398 | - | **78,398** | 154,648 | - | **154,648** |
| Cost of sales | a, b, c | 56,703 | - | **56,703** | 112,520 | 3 | **112,523** |
| Gross margin | | 21,695 | - | **21,695** | 42,128 | (3) | **42,125** |
| General and administrative expenses | a, b | 11,264 | (13) | **11,251** | 23,633 | (40) | **23,593** |
| Operating profit | | 10,431 | 13 | **10,444** | 18,495 | 37 | **18,532** |
| Finance costs | a, e | (98) | (21) | **(119)** | 401 | (33) | **368** |
| Income before taxes | | 10,529 | 34 | **10,563** | 18,094 | 70 | **18,164** |
| Current income tax expense | | 153 | - | **153** | 196 | - | **196** |
| Deferred income tax expense (recovery) | d | 2,286 | 940 | **3,226** | 3,303 | (10,217) | **(6,914)** |
| Net income (loss) | | 8,090 | (906) | **7,184** | 14,595 | 10,287 | **24,882** |
| Other comprehensive income: | | | | | | | |
| Unrealized loss on translation of foreign operations | | (1,834) | - | **(1,834)** | (1,870) | - | **(1,870)** |
| Comprehensive income (loss) | | 6,256 | - | **5,350** | 12,725 | - | **23,012** |

**Notes to the Reconciliations**

**a) Presentation differences**

Certain presentation differences between Canadian GAAP and IFRS have no impact on reported income or total equity. Some line items are described differently under IFRS as compared to Canadian GAAP and certain line items have been added or removed in accordance with IAS 1, Presentation of Financial Statements. These line items are as follows (with Canadian GAAP descriptions in brackets):

- General and administrative expenses (Selling, general, and administrative expenses); and
- Finance costs (consists of 'Financial derivative (gain)/loss' and 'Foreign exchange (gain)/loss', and 'Interest expense').

Certain items of expense have been reclassified into other line items under IFRS at the Transition Date. Reclassifications have been recorded for the following line items:

- Stock-based compensation and Amortization have been proportionately allocated by the function of the expense to the accounts of 'Cost of sales' and 'General and administrative expenses';
- Loss on disposal of assets has been reclassified based on the function of the expense to 'Cost of sales'; and
- Foreign exchange (gain)/loss, Financial derivative (gain)/loss, and Interest expense have been reclassified to 'Finance Costs'.

**b) Stock-based compensation**

Under Canadian GAAP, the Company recognized compensation expense associated with stock-based compensation plans with graded vesting features on a straight line basis over the vesting period. Under IFRS, the Company is required to treat each "tranche" of a stock-based compensation arrangement as a separate grant which results in the recognition of compensation expense on an accelerated basis as compared to Canadian GAAP. Further, IFRS requires that an estimate of the number of awards expected to vest be accounted for at the date of the grant. As a result, this decreased contributed surplus and decreased deficit by $139 at the Transition Date and decreased general and administration expenses by $13 and $40 for the three and nine months ended September 30, 2010, respectively, with a corresponding decrease to contributed surplus for each of the respective periods.

(stated in thousands of dollars, except per share amounts)

**c) Leases**

Under Canadian GAAP, certain leases of vehicles and trucks were classified as operating leases. Under IFRS, the vehicles and trucks are classified as finance leases because the gains and losses from the fluctuation in the fair value of the residual accrue to the Company. The effect of this change in classification at the Transition Date is to increase property and equipment by $170 (September 30, 2010 – $244) net of the related accumulated depreciation of $55 (September 30, 2010 – $76) on the finance leases, and increase total finance lease obligations by $171 (September 30, 2010 – $247). Additional lease expense of $1 at the Transition date, and $0.2 and $3, for the three and nine months ended September 30, 2010, respectively, has been recorded.

**d) Deferred tax credit**

Under Canadian GAAP, a future income tax asset and deferred tax credit were recognized upon the Conversion. Under IFRS, a deferred tax asset is recognized for the carry-forward of unused tax losses and unused tax credits to the extent that it is probable that future taxable profit will be able to utilize unused tax losses and unused tax credits. As such, the deferred tax asset recognized in the three months ended March 31, 2010, would have been initially measured at an amount equal to the consideration paid of $2,800 and 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 with an equal and offsetting increase to deferred 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. As a result, upon transition to IFRS, the Company has made an adjustment to reverse any previously recognized deferred tax credit and to recognize any previously unrecognized deferred tax assets to the extent that it is probable that future taxable profit will allow the deferred tax asset to be recovered. Any re-measurement has been recognized in income for the period. Accordingly, deferred income tax recovery has decreased by $940 and increased by $10,217 for the three and nine month periods ended September 30, 2010, respectively, with a corresponding elimination of the deferred tax credit.

**e) Borrowing costs**

Under Canadian GAAP, the Company expensed borrowing costs as incurred. At the Transition Date, the Company elected to capitalize borrowing costs only in respect of qualifying assets for which the commencement date for capitalization was on or after the Transition Date. Accordingly, finance costs have decreased by $21 and $33, respectively, for the three and nine month periods ended September 30, 2010, with a corresponding increase in property and equipment.

**f) Summary of adjustments to deficit**

The following is a summary of transition adjustments to the Company's deficit from Canadian GAAP to IFRS:

| | As at | |
|---|---|---|
| | September 30, 2010 | January 1, 2010 |
| Deficit as reported under Canadian GAAP | (28,066) | (33,663) |
| IFRS adjustments increase (decrease): | | |
| Stock-based compensation | 179 | 139 |
| Leases | (3) | (1) |
| Deferred tax | 10,217 | - |
| Borrowing costs | 33 | - |
| | 10,426 | 138 |
| Deficit as reported under IFRS | (17,640) | (33,525) |

**g) Material adjustments to the consolidated statement of cash flows for 2010**

Consistent with the Company's accounting policy choice under IAS 7, the Statement of Cash Flows has no material differences between the statement of cash flows presented under IFRS and the statement of cash flows presented under previous Canadian GAAP.

**5. Inventory**

The cost of inventory expensed in cost of sales for the three and nine months ended September 30, 2011 was $65,022 and $160,999, respectively (2010 – $39,611 and $76,183, respectively).

## 6. Property and Equipment

Property and equipment are comprised of the following balances:

| | **As at September 30, 2011** | | | As at December 31, 2010 | | |
|---|---|---|---|---|---|---|
| *$000's* | **Cost** | **Accumulated Amortization** | **Carrying Value** | Cost | Accumulated Amortization | Carrying Value |
| Trucks and trailers | **9,729** | **(3,341)** | **6,388** | 6,914 | (2,271) | 4,643 |
| Buildings | **12,070** | **(1,047)** | **11,023** | 9,726 | (651) | 9,075 |
| Tanks | **8,217** | **(568)** | **7,649** | 5,466 | (271) | 5,195 |
| Vehicles | **8,164** | **(2,432)** | **5,732** | 6,209 | (1,890) | 4,319 |
| Field equipment | **5,984** | **(2,178)** | **3,806** | 4,236 | (1,452) | 2,784 |
| Computer equipment | **1,106** | **(799)** | **307** | 1,070 | (608) | 462 |
| Processing equipment | **2,805** | **(243)** | **2,562** | 1,811 | (74) | 1,737 |
| Land | **1,692** | **-** | **1,692** | 1,616 | - | 1,616 |
| Furniture and fixtures | **631** | **(291)** | **340** | 503 | (211) | 292 |
| Leasehold improvements | **738** | **(369)** | **369** | 582 | (152) | 430 |
| | **51,136** | **(11,268)** | **39,868** | 38,133 | (7,580) | 30,553 |

*Borrowing costs*

For the three and nine months ended September 30, 2011, the Company capitalized borrowing costs attributable to the construction of qualifying assets in the amount of $nil and $40 respectively (2010 – $21 and $33 respectively).

## 7. Intangible Assets

Intangible assets are comprised of the following balances:

| | **As at September 30, 2011** | | | As at December 31, 2010 | | |
|---|---|---|---|---|---|---|
| *$000's* | **Cost** | **Accumulated Amortization** | **Net Book Value** | Cost | Accumulated Amortization | Net Book Value |
| Customer relationships | **19,299** | **(5,324)** | **13,975** | 18,599 | (3,123) | 15,476 |
| Software | **912** | **(485)** | **427** | 774 | (326) | 448 |
| Patents | **301** | **(90)** | **211** | 227 | (64) | 163 |
| Other intangibles | **1,049** | **(131)** | **918** | 1,048 | (52) | 996 |
| | **21,561** | **(6,030)** | **15,531** | 20,648 | (3,565) | 17,083 |

## 8. Bank Indebtedness

On March 22, 2011, the Company entered into a new credit agreement with a commercial bank providing for the New Senior Credit Facility (the "Facility"), permitting it to borrow up to $80,000, subject to the value of certain accounts receivable and inventory.

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

As of September 30, 2011, based on eligible accounts receivable and inventory balances, the maximum available draw on the Facility was $80,000 (December 31, 2010 - $72,093). Amounts drawn on the facility incur interest at approximately the bank's prime rate plus 1.25%.

## 9. Long-Term Debt

The Company has long-term debt as follows:

| | As at | |
|---|---|---|
| *$000's* | **September 30, 2011** | December 31, 2010 |
| Vehicle financing loans | **1,487** | 1,633 |
| Committed loan facilities | **2,895** | 3,507 |
| | **4,382** | 5,140 |
| Less current portion of long-term debt | **(1,555)** | (1,584) |
| Long-term debt | **2,827** | 3,556 |

Details of the Company's outstanding committed loan facilities as of September 30, 2011, are as follows:

| Facility | Outstanding | Interest Rate | Payments | Term |
|---|---|---|---|---|
| 1 | 1,332 | Prime + 1.40% | 10 | April 2013 [1] |
| 2 | 313 | Prime + 1.40% | 17 | April 2013 |
| 3 | 1,250 | Prime + 1.40% | 42 | March 2014 |
| | **2,895** | | **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 8.75%, with a weighted average rate of 6.16%, and have termination dates ranging from October 2011 to September 2015.

For the three and nine months ended September 30, 2011, the Company paid $85 and $304, respectively (2010 – $120 and $247), in interest expense related to its long-term debt and lease balances.

Scheduled principal payments at September 30, 2011, are as follows:

| *$000's* | |
|---|---|
| 2011 - 3 months | **393** |
| 2012 | **1,545** |
| 2013 | **2,211** |
| 2014 | **217** |
| 2015 | **16** |
| Total | **4,382** |

## 10. Finance Leases

On September 30, 2011, the Company completed a sale and leaseback transaction on specified assets for proceeds equal to the net book value of the respective assets in the amount of $1,834. The leases are for a period of 48 months and have a fixed interest rate of 4.94%.

The Company leases equipment and vehicles under a number of finance lease agreements for which the underlying leased assets secure the lease obligations. 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 March 2012 through June 2014 with interest rates of up to 9.68% and a weighted average interest rate of approximately 6.42%. Assets under finance leases at September 30, 2011 totaled $6,848 (December 31, 2010 – $3,647) with accumulated amortization of $1,441 (December 31, 2010 – $824). Amortization expense relating to assets under finance leases for the nine months ended September 30, 2011, totaled $721 (2010 – $690).

## 11. Cost of Sales

Included in cost of sales for the three and nine months ended September 30, 2011 is amortization charged on property and equipment of $1,500 and $4,288, respectively (2010 – $1,071 and $2,581, respectively), and employee compensation of $8,288 and $22,552, respectively (2010 – $5,933 and $13,603, respectively).

### 12. General and Administrative Expenses

Included in general and administrative expense for the three and nine months ended September 30, 2011 is amortization charged on property and equipment of $875 and $2,617, respectively (2010 – $1,055 and $1,881), stock-based compensation of $798 and $2,295, respectively (2010 – $310 and $753), and employee compensation of $7,478 and $21,617, respectively (2010 – $5,751 and $12,732).

### 13. Finance Costs

The Company recognized the following finance income and expenses in profit or loss:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| *$000's* | **2011** | 2010 | **2011** | 2010 |
| Foreign exchange (gain) loss | **458** | (623) | **589** | (617) |
| Financial derivative (gain) loss | **468** | (12) | **303** | 9 |
| Interest on debt | **534** | 537 | **2,000** | 1,009 |
| Less: capitalized interest | **-** | (21) | **(40)** | (33) |
| Finance costs (income) | **1,460** | (119) | **2,852** | 368 |

### 14. Share Capital

*a) Authorized*

The Company is authorized to issue an unlimited number of common shares.

*b) Issued and outstanding*

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

| | **Nine Months Ended September 30, 2011** | | Year Ended December 31, 2010 | |
|---|---|---|---|---|
| ***Common Shares*** *($000's except shares)* | **Number of Shares [(1)]** | **Amount** | Number of Shares [(1)] | Amount |
| Balance, beginning of period | **54,395,487** | **195,755** | 37,252,719 | 117,448 |
| Equity issue, net of share issue costs and tax | **-** | **-** | 8,715,000 | 43,066 |
| Consideration for acquired business | **-** | **-** | 3,868,110 | 21,468 |
| Issued on conversion of Debenture | **-** | **-** | 2,375,328 | 6,627 |
| Issued pursuant to Option Plan & SRIP | **446,548** | **1,975** | 1,795,449 | 5,353 |
| Contributed surplus related to Option Plan & SRIP exercise | **-** | **584** | - | 1,793 |
| Issued pursuant to Distribution Rights Plan | **-** | **-** | 388,881 | - |
| Balance, end of period | **54,842,035** | **198,314** | 54,395,487 | 195,755 |

(1) Pursuant to the three-for-one split of CES' outstanding common shares on July 13, 2011, all share data has been retroactively adjusted to reflect the stock split.

*c) Net income per share*
In calculating the basic and diluted net income per share for the three and nine months ended September 30, 2011 and 2010, the weighted average number of shares used in the calculation is shown in the table below:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| *$000's, except share and per share amounts* | **2011** | 2010 | **2011** | 2010 |
| Net income | **9,501** | 7,184 | **26,822** | 24,882 |
| Weighted average number of shares outstanding: | | | | |
| Basic shares outstanding (1) | **54,834,583** | 46,656,015 | **54,659,033** | 42,429,851 |
| Effect of dilutive securities (1) | **1,409,966** | 5,995,970 | **1,356,487** | 2,242,405 |
| Diluted shares outstanding | **56,244,549** | 52,651,985 | **56,015,520** | 44,672,256 |
| Net income per share - basic | **$0.17** | $0.15 | **$0.49** | $0.59 |
| Net income per share - diluted | **$0.17** | $0.14 | **$0.48** | $0.56 |

(1) Pursuant to the three-for-one split of CES' outstanding common shares on July 13, 2011, all share data has been retroactively adjusted to reflect the stock split.

Excluded from the calculation of dilutive securities for the three and nine months ended September 30, 2011, are 27,000 and 57,200 Share Rights, respectively (2010 – nil).

### 15. Stock-Based Compensation
Pursuant to the Stock Split, for each Option and Share Right outstanding, an additional two Options or Share Rights were issued at an exercise price reduced to one-third of the original exercise price. The stock-based compensation plans have been retroactively adjusted to give effect to the stock split as reflected in the information below.

As at September 30, 2011, a total of 5,484,204 common shares were reserved for issuance under the Company's Option Plan, Share Rights Incentive Plan, and Restricted Share Unit Plan, of which 2,056,702 common shares remained available for grant.

*a) Option Plan, formerly referred to as the Company Unit Option Plan*
CES has a Share Rights Incentive Plan for any new issuances effective 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:

| | **Nine Months Ended September 30, 2011** | | Year Ended December 31, 2010 | |
|---|---|---|---|---|
| | **Options (1)** | **Average Exercise Price (1)** | Options (1) | Average Exercise Price (1) |
| Balance, beginning of period | **229,050** | **$2.47** | 2,047,500 | $2.92 |
| Granted during the period | **-** | **-** | - | - |
| Exercised during the period | **(66,050)** | **2.46** | (1,795,449) | 2.98 |
| Forfeited during the period | **-** | **-** | (23,001) | 2.42 |
| Balance, end of period | **163,000** | **$2.48** | 229,050 | $2.47 |
| Exercisable options, end of period | **46,000** | **$2.33** | 28,299 | $3.09 |

(1) Pursuant to the three-for-one split of CES' outstanding common shares on July 13, 2011, the number of options outstanding and average exercise prices have been retroactively adjusted to effect the stock split.

*b) Share Rights Incentive Plan ("SRIP")*
CES' SRIP provides incentives to the employees, officers, and directors of the Company 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.

(stated in thousands of dollars, except per share amounts)

A summary of changes to the Share Rights is presented below:

| | Nine Months Ended September 30, 2011 | | Year Ended December 31, 2010 | |
|---|---|---|---|---|
| | **Share Rights [(1)]** | **Average Exercise Price [(1)]** | Share Rights [(1)] | Average Exercise Price [(1)] |
| Balance, beginning of period | **3,511,500** | **$5.65** | - | $ - |
| Granted during the period | **273,000** | **10.59** | 3,678,000 | 5.60 |
| Exercised during the period | **(380,498)** | **4.76** | - | - |
| Forfeited during the period | **(168,000)** | **5.16** | (166,500) | 4.72 |
| Balance, end of period | **3,236,002** | **$6.19** | 3,511,500 | $5.65 |
| Exercisable Share Rights, end of period | **47,500** | **$5.15** | - | $ - |

[(1)] Pursuant to the three-for-one split of CES' outstanding common shares on July 13, 2011, the number of share rights outstanding and average exercise prices have been retroactively adjusted to effect the stock split.

The fair value of the Share Rights granted, as of the date of grant, during the three and nine months ended September 30, 2011, was $80 and $732, respectively (2010 – $74 and $1,829, respectively). The compensation costs for Share Rights granted during the nine month period ended September 30, 2011, were calculated using a Black-Scholes option pricing model using the following assumptions:

| | **Nine Months Ended September 30, 2011** |
|---|---|
| Risk-free interest rate | **0.99% - 2.14%** |
| Expected average life of Share Rights | **3.25 years** |
| Share Right term | **5.0 years** |
| Annual forfeiture rate | **8.56 - 9.00%** |
| Dividend yield | **3.99% - 4.65%** |
| Expected volatility | **52.61% - 54.99%** |
| Weighted average fair value per Share Right | **$3.26** |

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

Effective June 30, 2011, the Company implemented the RSU Plan which provides incentives to eligible employees, officers, and directors of the Company through the issuance of RSU's. The RSU's shall vest and be redeemed on the first anniversary from the date of grant, subject to the absolute discretion of the Board of Directors. Throughout the vesting period, holders of Restricted Shares will be entitled to the dividend equivalents in the form of additional Restricted Shares on each dividend payment date, to be held in the RSU account until such time as the awards have vested. A summary of changes to the RSU plan is presented below:

| | Nine Months Ended September 30, 2011 | | Year Ended December 31, 2010 | |
|---|---|---|---|---|
| | **Restricted Share Units** | **Average Exercise Price** | Restricted Share Units | Average Exercise Price |
| Balance, beginning of period | **-** | **$ -** | - | $ - |
| Granted during the period | **28,500** | **11.09** | - | - |
| Exercised during the period | **-** | **-** | - | - |
| Forfeited during the period | **-** | **-** | - | - |
| Balance, end of period | **28,500** | **$11.09** | - | $ - |

The fair value of the Restricted Share Units granted, as of the date of grant, during the three and nine months ended September 30, 2011, was $283 and $283, respectively (2010 – $nil and $nil, respectively). The compensation costs for Restricted Shares granted during the nine month period ended September 30, 2011, is based on the fair value of the shares at the date of grant. The amount of compensation expense recorded is reduced by an estimated forfeiture rate of 9% per year at the date of grant. As at September 30, 2011, the Restricted Shares have a remaining weighted average term of 1.35 years (December 31, 2010 – nil).

For the three and nine months ended September 30, 2011, stock compensation expense of $798 and $2,295, respectively (2010 – $310 and $753, respectively) was recorded relating to the Company's Option, Share Rights, and Restricted Share Unit stock-based compensation plans. The following table summarizes information about the outstanding grants under the Company's Share Rights Incentive Plan and Option Plan as at September 30, 2011:

| | Options and Share Rights Outstanding | | | Options and Share Rights Exercisable | |
|---|---|---|---|---|---|
| Range of exercise prices | Options and Share Rights [(1)] | Weighted average exercise price [(1)] | Weighted average term remaining in years | Options and Share Rights [(1)] | Weighted average exercise price [(1)] |
| $1.84 - $3.10 | 98,500 | $2.02 | 2.44 | 31,000 | $1.84 |
| $3.11 - $4.23 | 64,500 | 3.17 | 2.09 | 15,000 | 3.34 |
| $4.24 - $5.25 | 789,502 | 4.77 | 3.51 | 29,500 | 4.85 |
| $5.26 - $5.91 | 54,000 | 5.66 | 3.79 | 18,000 | 5.66 |
| $5.92 - $8.25 | 2,119,500 | 6.17 | 4.01 | - | - |
| $8.26 - $10.74 | 216,000 | 10.33 | 4.71 | - | - |
| $10.75 - $12.03 | 57,000 | 11.57 | 4.79 | - | - |
| | 3,399,002 | $6.01 | 3.87 | 93,500 | $3.77 |

(1) Pursuant to the three-for-one split of CES' outstanding common shares on July 13, 2011, the number of options and share rights outstanding, as well as the weighted average exercise prices, have been retroactively adjusted to effect the stock split.

## 16. Contributed Surplus

The following table reconciles the Company's contributed surplus:

| *$000's* | **Nine Months Ended September 30, 2011** | Year Ended December 31, 2010 |
|---|---|---|
| Contributed surplus, beginning of period | **1,900** | 1,983 |
| Stock-based compensation | **2,295** | 1,710 |
| Exercise of share options | **(584)** | (1,793) |
| Contributed surplus, end of period | **3,611** | 1,900 |

## 17. Dividends

The Company has declared dividends to holders of common shares for the nine months ended September 30, 2011, as follows:

| *$000's except per share amounts* | **Dividend Record Date** | **Dividend Payment Date** | **Per Common Share [(1)]** | **Total** |
|---|---|---|---|---|
| January | Jan 31 | Feb 15 | $0.033 | **1,814** |
| February | Feb 28 | Mar 15 | 0.033 | **1,814** |
| March | Mar 31 | Apr 15 | 0.040 | **2,179** |
| April | Apr 30 | May 13 | 0.040 | **2,189** |
| May | May 31 | Jun 15 | 0.040 | **2,192** |
| June | Jun 30 | Jul 15 | 0.040 | **2,192** |
| July | Jul 31 | Aug 15 | 0.040 | **2,194** |
| August | Aug 31 | Sep 15 | 0.040 | **2,194** |
| September | Sep 30 | Oct 14 | 0.040 | **2,194** |
| Total dividends declared during the period | | | $0.346 | **18,962** |

(1) Pursuant to the three-for-one split of CES' outstanding common shares, dividend payments per common share have been retroactively adjusted to reflect the stock split.

Subsequent to September 30, 2011, the Company declared dividends to holders of common shares in the amount of $0.04 per common share payable on November 15, 2011, for shareholders of record on October 31, 2011.

### 18. Commitments and Deferred Acquisition Consideration

The Company has commitments with payments due as follows:

| *$000's* | **3 months - 2011** | **2012** | **2013** | **2014** | **2015** | **Total** |
|---|---|---|---|---|---|---|
| Office and facility rent | 385 | 1,451 | 959 | 480 | 477 | **3,752** |

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

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 outstanding litigation and potential claims.

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. In conjunction with the Fluids Management acquisition, the Company had US$5.0 million of 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. The Company paid the deferred acquisition consideration of US$5.0 million on August 22, 2011.

### 19. Financial Instruments and Risk Management

*a) Financial instrument measurement and classification*

The classification of financial instruments remains consistent at September 30, 2011 with that as at December 31, 2010.

*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* | **September 30, 2011** | December 31, 2010 |
| Past due 61-90 days | **10,356** | 8,400 |
| Past due 91-120 days | **1,893** | 4,200 |
| Past 120 days | **1,271** | 663 |
| Total past due | **13,520** | 13,263 |

The Company reduces an account receivable to its estimated recoverable amount. At September 30, 2011, the Company had recorded a provision of $144 (December 31, 2010 – $162) relating to accounts receivable which may not be collectible and recorded bad debt expense of $24 (September 30, 2010 – $nil) on accounts deemed uncollectible.

*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 September 30, 2011, 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 $103 and $256 lower/higher for the respective three and nine months ended September 30, 2011 (2010 – $42 and $94 lower/higher).

*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. The Company uses the US dollar as its functional currency for the operations of AES Drillings Fluids, LLC. 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 three and nine months ended September 30, 2011, a 1% increase/decrease in the Canadian dollar vis-à-vis the US dollar is estimated to decrease/increase net income of the Company by approximately $45 and $211, respectively (2010 – decrease/increase of $4 and increase/decrease of $8, respectively).

At September 30, 2011, 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 |
|---|---|---|---|---|
| October 2011 | US$371 | Deliverable Forward | Physical Purchase | $0.9484 |
| Total | US$371 | | | $0.9484 |

At September 30, 2011, 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 a portion of any future monthly shareholder dividends:

| Period | Notional Balance $000's | Contract Type | Settlement | Average C$/US$ Exchange Rate |
|---|---|---|---|---|
| October 2011 | US$686 | Deliverable Forward | Physical Sale | $0.9969 |
| November 2011 | US$686 | Deliverable Forward | Physical Sale | $0.9979 |
| December 2011 | US$686 | Deliverable Forward | Physical Sale | $0.9944 |
| January 2012 | US$686 | Deliverable Forward | Physical Sale | $0.9947 |
| February 2012 | US$686 | Deliverable Forward | Physical Sale | $0.9858 |
| March 2012 | US$686 | Deliverable Forward | Physical Sale | $0.9866 |
| April 2012 | US$686 | Deliverable Forward | Physical Sale | $0.9711 |
| May 2012 | US$686 | Deliverable Forward | Physical Sale | $0.9853 |
| June 2012 | US$686 | Deliverable Forward | Physical Sale | $0.9892 |
| July 2012 | US$686 | Deliverable Forward | Physical Sale | $0.9625 |
| August 2012 | US$686 | Deliverable Forward | Physical Sale | $0.9936 |
| September 2012 | US$686 | Deliverable Forward | Physical Sale | $1.0004 |
| Total | US$8,232 | | | $0.9882 |

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 statement of financial position. 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 statement of financial position as assets or liabilities with changes in their fair value recorded in net income for the period.

For the three and nine months ended September 30, 2011, the Company recorded a realized gain of $109 and $147, respectively (2010 – gain of $2 and loss of $18, respectively) relating to all of its foreign currency derivative contracts. For the three and nine months ended September 30, 2011, the Company recorded an unrealized loss of $577 and $450, respectively (2010 – unrealized gain of $10 and $10, respectively) relating to its foreign currency derivative contracts. The combined fair value of these outstanding risk management liabilities at September 30, 2011, was $404 (December 31, 2010 – asset of $25). At September 30, 2011, 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 $83 (2010 – 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 September 30, 2011, 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 September 30, 2011:

| | 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] | 68,664 | - | - | - | - | **68,664** |
| Accounts payable and accrued liabilities | 68,598 | - | - | - | - | **68,598** |
| Dividends payable [2] | 2,194 | - | - | - | - | **2,194** |
| Long-term debt at fixed interest rates [3] | 123 | 615 | 569 | 159 | 21 | **1,487** |
| Long-term debt at floating interest rates [3] | 136 | 681 | 817 | 1,261 | - | **2,895** |
| Finance lease obligations at fixed interest rates [3] | 69 | 354 | 445 | 915 | - | **1,783** |
| Finance lease obligations at floating interest rates [3] | 232 | 1,209 | 1,450 | 266 | - | **3,157** |
| Office operating leases | 256 | 1,287 | 1,057 | 1,033 | 119 | **3,752** |
| Total | 140,272 | 4,146 | 4,338 | 3,634 | 140 | **152,530** |

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

[2] Dividends declared as of September 30, 2011

[3] Bank indebtedness, long-term debt, and finance lease obligations reflect principal payments and excludes any associated interest portion

## 20. Supplemental Information

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| *$000's* | **2011** | 2010 | **2011** | 2010 |
| Decrease (increase) in current assets | | | | |
| Accounts receivable | **(31,884)** | (47,383) | **(36,525)** | (52,990) |
| Inventory | **(12,203)** | (5,448) | **(17,673)** | (6,572) |
| Prepaid expenses | **1,665** | (490) | **(1,773)** | (660) |
| Increase (decrease) in current liabilities | | | | |
| Accounts payable and accrued liabilities | **24,637** | 20,280 | **20,535** | 17,624 |
| | **(17,785)** | (33,041) | **(35,435)** | (42,598) |
| *Relating to:* | | | | |
| Operating activities | **(18,117)** | (33,575) | **(35,228)** | (42,735) |
| Investing activities | **332** | 534 | **(207)** | 137 |

## 21. Segmented Information

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 oil and natural gas industry in the Western Canadian Sedimentary Basin and in the United States through its subsidiary, AES Drilling Fluids, LLC. 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. The Environmental Services segment is comprised of the Company’s environmental division, Clear Environmental Services, which provides environmental and drilling fluids waste disposal services largely to oil and gas producers.

Selected summary financial information relating to the operational segments is as follows:

| | **Three Months Ended September 30, 2011** | | | | |
|---|---|---|---|---|---|
| *$000's* | Drilling Fluids [(1)] | Trucking | Environmental Services | Intercompany Eliminations | **Total** |
| Revenue | 111,957 | 5,500 | 4,706 | (205) | **121,958** |
| Gross margin | 27,752 | 962 | 1,806 | - | **30,520** |
| Amortization | 1,636 | 558 | 181 | - | **2,375** |
| Interest expense | 486 | 35 | 13 | - | **534** |
| Income before taxes | 13,061 | 774 | 415 | - | **14,250** |
| Total assets | 321,689 | 15,434 | 15,131 | - | **352,254** |
| Capital expenditures | 1,236 | 3,020 | 4 | - | **4,260** |

| | **Nine Months Ended September 30, 2011** | | | | |
|---|---|---|---|---|---|
| *$000's* | Drilling Fluids [(1)] | Trucking | Environmental Services | Intercompany Eliminations | **Total** |
| Revenue | 294,951 | 13,828 | 12,288 | (603) | **320,464** |
| Gross margin | 79,105 | 2,406 | 4,604 | - | **86,115** |
| Amortization | 4,770 | 1,589 | 546 | - | **6,905** |
| Interest expense | 1,781 | 128 | 49 | - | **1,958** |
| Income before taxes | 37,939 | 1,023 | 1,618 | - | **40,580** |
| Total assets | 321,689 | 15,434 | 15,131 | - | **352,254** |
| Capital expenditures | 7,299 | 4,719 | 13 | - | **12,031** |

[(1)] Results from PureChem operations for the three and nine months ended September 30, 2011, have been included in the Drilling Fluids segment.

| | Three Months Ended September 30, 2010 | | | | |
|---|---|---|---|---|---|
| *$000's* | Drilling Fluids | Trucking | Environmental Services | Intercompany Eliminations | Total |
| Revenue | 71,959 | 4,003 | 2,814 | (378) | 78,398 |
| Gross margin | 19,416 | 1,272 | 1,007 | - | 21,695 |
| Amortization | 1,047 | 897 | 182 | - | 2,126 |
| Interest expense | 470 | 38 | 8 | - | 516 |
| Income before taxes | 9,080 | 1,037 | 446 | - | 10,563 |
| Total assets | 246,529 | 12,567 | 13,052 | - | 272,148 |
| Capital expenditures | 1,806 | 206 | 10 | - | 2,022 |

| | Nine Months Ended September 30, 2010 | | | | |
|---|---|---|---|---|---|
| *$000's* | Drilling Fluids | Trucking | Environmental Services | Intercompany Eliminations | Total |
| Revenue | 136,712 | 10,554 | 8,268 | (886) | 154,648 |
| Gross margin | 36,364 | 2,736 | 3,025 | - | 42,125 |
| Amortization | 2,703 | 1,213 | 546 | - | 4,462 |
| Interest expense | 938 | 34 | 4 | - | 976 |
| Income before taxes | 16,713 | 822 | 629 | - | 18,164 |
| Total assets | 246,529 | 12,567 | 13,052 | - | 272,148 |
| Capital expenditures | 4,283 | 999 | 18 | - | 5,300 |

Geographical information relating to the Company's activities is as follows:

| | Revenue | | | |
|---|---|---|---|---|
| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
| *$000's* | **2011** | 2010 | **2011** | 2010 |
| Canada | **60,201** | 34,054 | **144,754** | 94,272 |
| United States | **61,757** | 44,344 | **175,710** | 60,376 |
| Total | **121,958** | 78,398 | **320,464** | 154,648 |

| | Long-Term Assets [(1)] | |
|---|---|---|
| *$000's* | **September 30, 2011** | December 31, 2010 |
| Canada | **74,690** | 70,575 |
| United States | **78,359** | 72,509 |
| Total | **153,049** | 143,084 |

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

### 22. Economic Dependence

For the three and nine months ended September 30, 2011, one customer accounted for 13% and 14%, respectively (2010 – one customer accounted for 15%), of the Company's total revenue.

## Canadian Energy Services & Technology Corp.

Information

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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EQUAL Transport
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Fax: 780-728-0068

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**US OPERATIONS**

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