# Western Energy Services Corp.

## Interim Consolidated Financial Statements

*September 30, 2010 and 2009*

*(Unaudited)*

# Western Energy Services Corp.

**Interim Consolidated Balance Sheets (Unaudited)**
**(thousands of Canadian dollars)**

| | September 30, 2010 | December 31, 2009 |
|---|---|---|
| **Assets** | | |
| Current assets | | |
| Cash | $ 105 | $ 2,386 |
| Accounts receivable | 15,961 | 1,022 |
| Inventory | 338 | 313 |
| Prepaid expenses | 511 | 175 |
| Future income taxes | 1,250 | - |
| Deferred charges | 142 | - |
| Assets of discontinued operations (Note 12) | 39 | 1,012 |
| | 18,346 | 4,908 |
| Property and equipment (Note 5) | 124,946 | 5,414 |
| Intangible assets (Note 4) | 375 | - |
| Assets of discontinued operations (Note 12) | 31 | 1,897 |
| | $ 143,698 | $ 12,219 |
| **Liabilities** | | |
| Current liabilities | | |
| Accounts payable and accrued liabilities | $ 7,208 | $ 2,552 |
| Current portion of long term debt (Note 6) | 3,796 | 5 |
| Liabilities of discontinued operations (Note 12) | 935 | 1,520 |
| | 11,939 | 4,077 |
| Deferred credits | 505 | - |
| Long term debt (Note 6) | 20,636 | 17 |
| Future income taxes | 3,974 | - |
| Liabilities of discontinued operations (Note 12) | - | 48 |
| | 37,054 | 4,142 |
| **Shareholders' Equity** | | |
| Common shares (Note 7) | 85,292 | 8,253 |
| Contributed surplus | 2,201 | 1,835 |
| Retained earnings (deficit) | 19,151 | (2,011) |
| | 106,644 | 8,077 |
| | $ 143,698 | $ 12,219 |

Commitments (Note 8)
Subsequent events (Note 13)
See accompanying notes to these unaudited consolidated financial statements

## Western Energy Services Corp.

**Interim Consolidated Statements of Operations, Comprehensive Income (Loss) and Retained Earnings (Deficit) (Unaudited)**
**(thousands of Canadian dollars, except share and per share amounts)**

| | After comprehensive revaluation | Before comprehensive revaluation | After comprehensive revaluation | Before comprehensive revaluation |
|---|---|---|---|---|
| | **Three months ended September 30, 2010** | **Three months ended September 30, 2009** | **Nine months ended September 30, 2010** | **Nine months ended September 30, 2009** |
| **Revenue** | $ 19,320 | $ 921 | $ 37,035 | $ 2,787 |
| **Expenses** | | | | |
| Operating | 11,805 | 682 | 22,794 | 2,455 |
| General and administrative | 2,086 | 465 | 5,065 | 890 |
| Depreciation | 2,086 | 427 | 4,024 | 1,304 |
| Amortization of intangibles | 95 | - | 190 | - |
| Stock-based compensation | 167 | - | 366 | - |
| Loss on sale of assets | - | - | 11 | 2 |
| Interest and finance costs | 163 | 90 | 521 | 237 |
| Foreign exchange (gain) loss | 110 | 165 | (128) | 233 |
| Acquisition costs | 188 | - | 445 | - |
| Gain on business acquisitions (Note 4) | (8,720) | - | (19,814) | - |
| Goodwill impairment | - | 599 | - | 599 |
| Income (loss) from continuing operations before taxes | 11,340 | (1,507) | 23,561 | (2,933) |
| **Income taxes** | | | | |
| Future income taxes | 817 | - | 1,421 | - |
| Net income (loss) from continuing operations | 10,523 | (1,507) | 22,140 | (2,933) |
| Net loss from discontinued operations (Note 12) | (369) | (143) | (978) | (715) |
| Net income (loss) and comprehensive income (loss) | 10,154 | (1,650) | 21,162 | (3,648) |
| Retained earnings (deficit), beginning of period | 8,997 | (11,084) | (2,011) | (9,086) |
| Retained earnings (deficit), end of period | $ 19,151 | $ (12,734) | $ 19,151 | $ (12,734) |
| Net income (loss) per share from continuing operations | | | | |
| Basic and diluted | $ 0.02 | $ (0.05) | $ 0.05 | $ (0.09) |
| Net income (loss) per share from discontinued operations | | | | |
| Basic and diluted | $ - | $ - | $ - | $ (0.02) |
| Net income (loss) per share | | | | |
| Basic and diluted | $ 0.02 | $ (0.05) | $ 0.05 | $ (0.11) |
| Weighted average number of shares | | | | |
| Basic | 527,549,161 | 32,246,405 | 417,441,772 | 32,246,405 |
| Diluted | 552,431,255 | 32,246,405 | 448,351,277 | 32,246,405 |

See accompanying notes to these unaudited consolidated financial statements

## Western Energy Services Corp.

**Interim Consolidated Statements of Cash Flows (Unaudited)**
**(thousands of Canadian dollars)**

| | After comprehensive revaluation | Before comprehensive revaluation | After comprehensive revaluation | Before comprehensive revaluation |
|---|---|---|---|---|
| | **Three months ended September 30, 2010** | **Three months ended September 30, 2009** | **Nine months ended September 30, 2010** | **Nine months ended September 30, 2009** |
| **Operating Activities** | | | | |
| Net income (loss) from continuing operations | $ 10,523 | $ (1,507) | $ 22,140 | $ (2,933) |
| Items not affecting cash: | | | | |
| Depreciation | 2,086 | 427 | 4,024 | 1,304 |
| Amortization of intangibles | 95 | - | 190 | - |
| Stock-based compensation | 167 | - | 366 | - |
| Loss on sale of assets | - | - | 11 | 2 |
| Future income taxes | 817 | - | 1,421 | - |
| Goodwill impairment | - | 599 | - | 599 |
| Amortization of deferred charges and credits | 97 | - | 167 | - |
| Gain on business acquisitions | (8,720) | - | (19,814) | - |
| Unrealized foreign exchange loss (gain) | 131 | (208) | (88) | (1,622) |
| Change in non-cash working capital | (1,955) | (6) | (1,459) | (4) |
| Continuing operations | 3,241 | (695) | 6,958 | (2,654) |
| Discontinued operations | (112) | 511 | (174) | 2,262 |
| | 3,129 | (184) | 6,784 | (392) |
| **Investing activities** | | | | |
| Proceeds on sale of property and equipment | 18 | - | 1,579 | 506 |
| Business acquisitions (Note 4) | (195) | - | (35,985) | - |
| Additions to property and equipment | (6,480) | (4) | (10,409) | (41) |
| Changes in non-cash working capital | 405 | - | 1,351 | - |
| Continuing operations | (6,252) | (4) | (43,464) | 465 |
| Discontinued operations | 384 | 103 | 1,694 | 181 |
| | (5,868) | 99 | (41,770) | 646 |
| **Financing activities** | | | | |
| Issue of common shares, net of costs | - | - | 70,883 | - |
| Payment of long term debt | 558 | 854 | (37,728) | 1,458 |
| Debt issue costs | - | - | (260) | - |
| Change in non-cash working capital | (39) | - | 102 | - |
| Continuing operations | 519 | 854 | 32,997 | 1,458 |
| Discontinued operations | - | (616) | (292) | (1,589) |
| | 519 | 238 | 32,705 | (131) |
| Increase (decrease) in cash | $ (2,220) | $ 153 | $ (2,281) | $ 123 |
| Cash, beginning of period | $ 2,325 | $ 41 | $ 2,386 | $ 71 |
| Cash, end of period | $ 105 | $ 194 | $ 105 | $ 194 |
| **Supplemental cash flow information** | | | | |
| Interest paid | $ 233 | $ 110 | $ 634 | $ 367 |
| Taxes paid | $ 180 | $ - | $ 243 | $ - |

See accompanying notes to these unaudited consolidated financial statements

## 1. Description of business and basis of presentation

Western Energy Services Corp. ("Western" or the "Company") is an oilfield service company with operations in two industry segments: contract drilling and production services. Operations in the contract drilling segment are conducted through Western's wholly owned subsidiary Horizon Drilling Inc. ("Horizon"), which was acquired on March 18, 2010. Operations in the production services segment are conducted through Western's wholly owned subsidiary Stimsol Canada Inc. ("Stimsol").

These unaudited interim consolidated financial statements for Western Energy Services Corp. were prepared using accounting policies and methods of their application consistent with those used in the preparation of the Company's audited consolidated financial statements for the year ended December 31, 2009 except as noted below. These interim consolidated financial statements conform in all material respects to the requirements of Canadian generally accepted accounting principles for annual financial statements with the exception of certain note disclosures. As a result, these interim consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements as at and for the year ended December 31, 2009. All significant transactions and balances between Western and its subsidiaries have been eliminated on consolidation.

The comparative results from discontinued operations have been reclassified to conform to the current period's financial statement presentation.

### Comprehensive revaluation

On December 22, 2009, the Company completed a recapitalization and reorganization, which had the following key elements:

- An entirely new management team and board of directors were appointed.
- Pursuant to a private placement agreement, net proceeds of $6.7 million were raised of which approximately $3.7 million was applied against debt.
- As a condition of the completion of the private placement, the holders of Western's existing bridge lending facility, subordinated convertible debentures, subscriptions received and other specified obligations, converted existing debt of approximately $6.1 million in exchange for 12,285,425 common shares of Western at a price of $0.50 per share.
- As part of the reorganization, Western also completed approximately $1.7 million in asset sales with the proceeds applied against debt.

The Company's consolidated balance sheet as at December 22, 2009 was prepared under the provisions of the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 1625, Comprehensive Revaluation of Assets and Liabilities. As a result of the comprehensive revaluation, all assets and liabilities were revalued at estimated fair values and Western's deficit was eliminated.

The Company's financial information before the comprehensive revaluation has been presented to provide additional information to the reader. In reviewing the financial information for the three and nine months ended September 30, 2009, readers are reminded that they do not reflect the effects of the financial reorganization or the application of its accounting. Detailed information on the recapitalization and reorganization and the impact of adjustments made in the comprehensive revaluation is available in the Company's audited financial statements for the year ended December 31, 2009 as filed on SEDAR at www.sedar.com.

## 2. Significant accounting policies

### Deferred charges

Costs associated with the increase of the credit facility are deferred and amortized by the straight-line method over the term of the facility. The amortization is included in interest and finance costs.

### Deferred credits

The Company has received certain lease inducements related to the lease of its head office. These inducements are being amortized into income on a straight-line basis over the term of the lease. Deferred credits also include acquired out of the money contracts and are recorded at fair value and amortized by the straight-line method over the life of the contract.

### Intangible assets

Intangible assets, which are comprised of acquired in the money contracts, are recorded at fair value and amortized using a straight-line method over the life of the contract.

### Changes in accounting policies

On January 1, 2010, the Company adopted the following CICA Handbook sections:

- "Business Combinations", Section 1582, which replaced the previous business combinations standard. Under the new section, the term "business" is more broadly defined than in the previous standard, most assets acquired and liabilities assumed are measured at fair value, any interest in an acquiree owned prior to obtaining control is remeasured at fair value at the acquisition date (eliminating the need for guidance on step acquisitions), a bargain purchase results in recognition of a gain, and acquisition costs are expensed. The adoption of this standard impacts the accounting treatment of business combinations entered into after January 1, 2010 (see Note 4).
- "Consolidated Financial Statements", Section 1601, which, together with Section 1602 below, replace the former consolidated financial statements standard. Section 1601 establishes the requirements for the preparation of consolidated financial statements. The adoption of this standard had no material impact on Western's consolidated financial statements.
- "Non-controlling Interests", Section 1602, which establishes the accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. The standard requires a non-controlling interest in a subsidiary to be classified as a separate component of equity. In addition, net earnings and components of other comprehensive income are attributed to both the parent and non-controlling interest. The adoption of this standard had no material impact on Western's consolidated financial statements.

## 3. Seasonality

The Company's operations are often weather dependent, which has a seasonal impact, particularly in Canada. During the first quarter, the frozen conditions allow oil and gas companies to move heavy equipment to otherwise inaccessible areas and the resulting demand for services, such as those provided by the Company, is high. The second quarter is normally a slower period due to wet conditions creating weight restrictions on roads and reducing the mobility of heavy equipment, which slows activity levels in the industry. The third and fourth quarters are usually representative of average activity levels. Therefore, interim periods many not be representative of the results expected for the full year of operation due to seasonality.

## 4. Acquisitions

### i. Impact Drilling Ltd. ("Impact")

On August 25, 2010, Western acquired all of the issued and outstanding common shares of Impact Drilling Ltd. for cash consideration of approximately $247,000. The aggregate consideration for the Impact acquisition consists of the following:

| As at August 25, 2010 | | Amount |
|---|---|---|
| Cash paid | $ | 247 |
| Assumption of bank debt (net of $52,000 cash acquired) | | 19,554 |
| | $ | 19,801 |

This acquisition has been accounted for using the acquisition method with an acquisition date of August 25, 2010, whereby the assets acquired and the liabilities assumed are recorded at their fair values with the shortage of the aggregate consideration relative to the fair value of the identifiable net assets recorded as a gain on business acquisition. As of the acquisition date, Impact's operating results have been included in Western's revenues, expenses and capital spending.

The following summarizes the allocation of the aggregate consideration for the Impact acquisition:

| As at August 25, 2010 | | Amount |
|---|---|---|
| Net working capital (excluding cash) | $ | 76 |
| Property and equipment | | 24,413 |
| Deferred credit | | (101) |
| Future income tax asset | | 4,106 |
| Gain on business acquisition | | (8,693) |
| | $ | 19,801 |

The Company assessed the acquisition for intangible assets and concluded that none exist. The allocations described above are preliminary and subject to changes upon final purchase price adjustments. These adjustments may include, but are not limited to, future income tax balance adjustments on the filing of respective returns for each corporate acquisition, final working capital adjustments on respective balances acquired, and transaction cost adjustments for actual cost incurred.

### ii. Horizon Drilling Inc. ("Horizon")

In March, through a series of transactions, Western acquired control of all of the issued and outstanding common shares of Horizon for cash consideration of approximately $41.4 million. The aggregate consideration for the Horizon acquisition consists of the following:

| As at March 18, 2010 | | Amount |
|---|---|---|
| Cash paid | $ | 41,430 |
| Assumption of bank debt (net of $5.6 million in cash acquired) | | 24,289 |
| | $ | 65,719 |

This acquisition has been accounted for using the acquisition method with an acquisition date of March 18, 2010, whereby the assets acquired and the liabilities assumed are recorded at their fair values with the shortage of the aggregate consideration relative to the fair value of the identifiable net assets recorded as a gain on business acquisition. As of the acquisition date, Horizon's operating results have been included in Western's revenues, expenses and capital spending.

The following summarizes the allocation of the aggregate consideration for the Horizon acquisition:

| As at March 18, 2010 | | Amount |
|---|---|---|
| Net working capital (excluding cash) | $ | 8,510 |
| Property and equipment | | 71,175 |
| Intangible assets | | 343 |
| Future income tax asset | | 1,241 |
| Deferred credit | | (355) |
| Future income tax liability | | (6,082) |
| Gain on business acquisition | | (9,113) |
| | $ | 65,719 |

The allocations described above are preliminary and subject to changes upon final purchase price adjustments. These adjustments may include, but are not limited to, future income tax balance adjustments on the filing of respective returns for each corporate acquisition, final working capital adjustments on respective balances acquired, and transaction cost adjustments for actual cost incurred. In the three month period ended September 30, 2010, an adjustment was made to the purchase price allocation of approximately $78,000, resulting in a decrease in net working capital and a decrease to the gain on business acquisition.

**iii. Cedar Creek Drilling Ltd. ("Cedar Creek")**

On March 18, 2010, Western acquired all of the issued and outstanding common shares of Cedar Creek in exchange for 2.66 Western common shares for each Cedar Creek common share. An aggregate of 20,517,331 common shares of Western were issued at an ascribed price of $0.30 per share, based on the closing trading price on March 17, 2010. The aggregate consideration for the Cedar Creek acquisition consists of the following:

| As at March 18, 2010 | | Amount |
|---|---|---|
| Common shares issued | $ | 6,155 |
| Assumption of bank debt | | 12,603 |
| | $ | 18,758 |

This acquisition has been accounted for using the acquisition method, whereby the assets acquired and the liabilities assumed are recorded at their fair values with the shortage of the aggregate consideration relative to the fair value of the identifiable net assets recorded as a gain on business acquisition. As of the acquisition date, Cedar Creek's operating results have been included in Western's revenues, expenses and capital spending.

The following summarizes the allocation of the aggregate consideration for the Cedar Creek acquisition:

| As at March 18, 2010 | | Amount |
|---|---|---|
| Net working capital | $ | 1,990 |
| Property and equipment | | 19,146 |
| Intangible assets | | 222 |
| Future income tax liability | | (592) |
| Gain on business acquisition | | (2,008) |
| | $ | 18,758 |

The allocations described above are preliminary and subject to changes upon final purchase price adjustments. These adjustments may include, but are not limited to, future income tax balance adjustments on the filing of respective returns for each corporate acquisition, final working capital adjustments on respective balances acquired, and transaction cost adjustments for actual cost incurred. In the three month period ended September 30, 2010, an adjustment was made to the purchase price allocation of approximately $105,000, resulting in an increase in net working capital and an increase to the gain on business acquisition.

## 5. Property and equipment

| | September 30, 2010 | | |
|---|---|---|---|
| | Cost | Accumulated depreciation | Net book value |
| Land | $ 951 | $ - | $ 951 |
| Buildings | 1,366 | 38 | 1,328 |
| Drilling rigs and related equipment | 116,110 | 3,341 | 112,769 |
| Oilfield service equipment | 6,147 | 537 | 5,610 |
| Shop and office equipment | 589 | 112 | 477 |
| Vehicles under capital lease | 502 | 35 | 467 |
| Assets under construction | 3,344 | - | 3,344 |
| | $ 129,009 | $ 4,063 | $ 124,946 |

Assets under construction of $3.3 million relate to the construction of a top drive telescopic efficient long-reach double drilling rig with hoisting and pumping capabilities, which is expected to be commissioned in the first quarter of 2011.

| | December 31, 2009 | | |
|---|---|---|---|
| | Cost | Accumulated depreciation | Net book value |
| Oilfield service | $ 5,380 | $ 37 | $ 5,343 |
| Shop and office equipment | 61 | 2 | 59 |
| Vehicles under capital lease | 12 | - | 12 |
| | $ 5,453 | $ 39 | $ 5,414 |

## 6. Long-term debt

| | September 30, 2010 | December 31, 2009 |
|---|---|---|
| Revolving credit facility | $ 23,000 | $ - |
| Bank loans - mortgages | 1,127 | - |
| Capital lease obligations | 305 | 22 |
| | 24,432 | 22 |
| Less current portion | (3,796) | (5) |
| Total | $ 20,636 | $ 17 |

On April 15, 2010, Western announced the increase of its credit facility with its existing lender. The credit facility consists of a $5 million operating demand revolving loan (the “Operating Facility”), and a $45 million 364-day committed extendible revolving credit facility (the “Revolving Facility”). The purpose of the Revolving Facility is to assist the Company in completing corporate acquisitions and financing the construction of additional equipment. In addition, the Revolving Facility was initially used to consolidate certain indebtedness acquired from Horizon and Cedar Creek. As at September 30, 2010, the Company had approximately $22 million in available credit under the Revolving Facility and $5.0 million under the Operating Facility. These loans require interest to be paid monthly with no scheduled principal repayment unless the Revolving Facility is not extended. If not extended, the Revolving Facility is capped and repayable over the ensuing two year period commencing in July 2011 by monthly principal and interest payments. The credit facility is secured by the assets of the company. Amounts borrowed under the credit facility will bear interest at the bank’s prime rate plus 1.5% to 2.0% or the banker’s acceptance rate plus 3.0% to 3.5% depending, in each case, on the ratio of funded debt to EBITDA.

Western's increased credit facility is subject to the following financial covenants:

| | Covenant | September 30, 2010 |
|---|---|---|
| Current assets to current liabilities | 1.25 to 1.00 or more | 2.25 |
| Funded debt to EBITDA | 2.5 to 1.0 or less | 1.33 |
| Funded debt to capitalization | 0.60 to 1.0 or less | 0.19 |
| Revolving facility balance to net book value of fixed assets | Less than 45% | 18% |

As at September 30, 2010, the Company is in compliance with all covenants related to its credit facilities.

During the three and nine months ended September 30, 2010, the Company incurred interest and financing costs of approximately $163,000 (2009 - $90,000) and $521,000 (2009 - $237,000), respectively, on its long term debt. The Company paid an average of 4.37% (2009 – 5.67%) and 4.18% (2009 – 5.29%) on its borrowings for the three and nine months ended September 30, 2010, respectively.

**7. Common shares**

**a. Authorized**

Unlimited number of common shares.

**b. Issued**

| Common shares | Shares | | Amount |
|---|---|---|---|
| Balance, December 31, 2009 | 132,031,830 | $ | 8,253 |
| Issued for cash - March 18, 2010 | 375,000,000 | | 75,000 |
| Issued on acquisition of Cedar Creek | 20,517,331 | | 6,155 |
| Issue costs | - | | (4,116) |
| Balance, September 30, 2010 | 527,549,161 | $ | 85,292 |

**c. Share option plan**

The Company's share option plan provides for share options to assist directors, officers, employees and consultants of the Company and its affiliates to participate in the growth and development of the Company. Subject to the specific provisions of the share option plan, eligibility, grant, vesting and terms of options and the number of options are to be determined by the Board of Directors at the time of grant. The share option plan allows the Board of Directors to issue up to 10% of the Company's outstanding shares as stock options.

| | Share options outstanding | | Weighted average exercise price |
|---|---|---|---|
| Balance, December 31, 2009 | 170,003 | $ | 2.370 |
| Granted | 19,700,000 | | 0.285 |
| Forfeited | (1,666,669) | | 0.317 |
| Balance, September 30, 2010 (1) | 18,203,334 | $ | 0.285 |

(1) Diluted weighted average common shares outstanding for the three and nine months ended September 30, 2010 does not include the share impact of 18,203,334 share options, as the impact would be anti-dilutive.

| Exercise price ($/share) | Number of options outstanding | Weighted average contractual life (years) | Number of options exercisable |
|---|---|---|---|
| 0.285 | 18,200,000 | 4.50 | - |
| 1.32 | 3,334 | 1.49 | 3,334 |
| | 18,203,334 | 4.50 | 3,334 |

The average fair value of the share options granted in 2010 was $0.11 per share option. For the three and nine months ended September 30, 2010, the Company recorded approximately $167,000 and $366,000 respectively, in stock based compensation expense. The accounting fair value as at the date of grant is calculated in accordance with the Black-Scholes methodology used the following inputs:

| | |
|---|---|
| Risk-free interest rate | 2% |
| Average expected life | 3.0 years |
| Maximum life | 5.0 years |
| Average vesting period | 3.0 years |
| Expected dividend | nil |
| Expected share price volatility | 60% |

**d. Warrants**

| | Warrants outstanding | Weighted average exercise price |
|---|---|---|
| Balance, December 31, 2009 and September 30, 2010 | 50,500,000 | $ 0.105 |

Pursuant to the private placement completed on December 22, 2009, 50,500,000 warrants were issued to management and the Board of Directors entitling the holder to purchase one common share at a price of $0.105 for a period of five years.

**8. Commitments**

The Company has commitments for office and shop premises and various operating vehicles and equipment leases which require payments for the next five years as follows:

| | 2010 | 2011 | 2012 | 2013 | 2014 and beyond | Total |
|---|---|---|---|---|---|---|
| Operating leases | $ 341 | $ 1,352 | $ 946 | $ 840 | $ 575 | $ 4,054 |
| Capital commitments | 9,903 | 3,967 | - | - | - | 13,870 |
| Purchase commitments | 161 | - | - | - | - | 161 |
| Total | $ 10,405 | $ 5,319 | $ 946 | $ 840 | $ 575 | $ 18,085 |

**9. Financial Instruments**

The Company's financial instruments include cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, and long term debt. Cash and cash equivalents are carried at fair value. The carrying amount of accounts receivable, and accounts payable and accrued liabilities approximates their fair values due to their short-term nature. Long term debt instruments bear interest at rates that approximate market rates and therefore, their carrying values approximate fair values.

**a. Interest rate risk**

The Company is exposed to interest rate risk on certain debt instruments to the extent of changes in the prime interest rate. Currently the Company's revolving credit facilities are subject to interest rate changes. For the revolving credit facility, a one percent change in interest rates would have an approximately $29,000 and $57,000 impact on interest expense for the three and nine months ended September 30, 2010, respectively. Other long term debt, such as capital leases, is subject to fixed rates.

**b. Foreign exchange risk**

The Corporation is exposed to foreign currency fluctuations in relation to its USA and international operations. To date the Company has not hedged against these fluctuations. For the three and nine months ended September 30, 2010, the increase or decrease in net earnings before taxes for each one percent change in foreign exchange rates between the Canadian and US Dollars is estimated to be less than $0.1 million.

**c. Credit risk**

Credit risk arises from cash held with banks and financial institutions, as well as credit exposure to customers in the form of outstanding accounts receivable. The maximum exposure to credit risk is equal to the carrying value of the financial assets which reflects management's assessment of the credit risk. At September 30, 2010, approximately 97% of the Company's trade accounts receivable from continuing operations is less than 90 days overdue. During the three and nine months ended September 30, 2010, there have been no significant changes to the allowance for doubtful accounts provision from continuing operations.

The table below provides an analysis of our accounts receivable aging:

| | | September 30, 2010 |
|---|---|---|
| Trade accounts receivable | | |
| Current | $ | 8,713 |
| Outstanding for 31 to 60 days | | 3,990 |
| Outstanding for 61 to 90 days | | 2,247 |
| Outstanding for over 90 days | | 462 |
| Less: allowance for doubtful accounts | | (95) |
| Other accounts receivable | | 644 |
| Total | $ | 15,961 |

For the three months ended September 30, 2010, the Company had three significant customers comprising 18.0%, 13.0% and 11.0%, respectively of total revenue. The combined total of the three significant customers represented 42.0% of total revenue in the three month period. No other single customer represents greater than 10% of the Company's total revenue in the three month period.

For the nine months ended September 30, 2010, the Company had two significant customers comprising 16.5% and 12.5%, respectively of total revenue. The combined total of the two significant customers represented 29.0% of total revenue in the nine month period. No other single customer represents greater than 10% of the Company's total revenue in the nine month period.

**d. Liquidity risk**

Liquidity risk is the exposure of the Company to the risk of not being able to meet its financial obligations as they become due. The Company manages liquidity risk through management of its capital structure, monitoring and reviewing actual and forecasted cash flows and the effect on bank covenants, and maintaining unused credit facilities where possible to ensure there is available cash resources to meet the Company's liquidity needs. The Company's existing credit facilities and cash flow from operating activities are expected to be greater than anticipated capital expenditures and the contractual maturities of the Company's financial liabilities. This expectation could be adversely affected by a material negative change in the oilfield service industry in Canada.

**e. Fair Value**

Financial assets and liabilities recorded at fair value in the consolidated balance sheet are categorized based upon the level of judgment associated with the inputs used to measure their fair value. Hierarchical levels based on the amount of subjectivity associated with the inputs in the fair determination of these assets and liabilities are as follows:

Level I – Inputs are unadjusted, quoted prices in active markets for identical assets or liabilities at the measurement date.

Level II – Inputs (other than quoted prices included in Level I) are either directly or indirectly observable for the asset or liability through correlation with market data at the measurement date and for the duration of the instrument's anticipated life.

Level III – Inputs reflect management's best estimate of what market participants would use in pricing the asset or liability at the measurement date. Consideration is given to the risk inherent in the valuation technique and the risk inherent in the inputs to the model.

The Company's cash and cash equivalents is the only financial asset or liability measured using fair value and is a level 1 measurement.

**10. Capital management**

The capital structure of the Company consists of cash, revolving credit facilities, other current debt instruments, long-term debt, and share capital. The overall capitalization of the Company is outlined below:

| | September 30, 2010 | December 31, 2009 |
|---|---|---|
| Revolving credit facilities | $ 23,000 | $ - |
| Bank loans - mortgages | 1,127 | - |
| Capital lease obligations | 305 | 22 |
| Total debt | 24,432 | 22 |
| Share capital | 85,292 | 8,253 |
| Less: cash | (105) | (2,386) |
| Total capitalization | $ 109,619 | $ 5,889 |

Management is focused on several objectives while managing the capital structure of the Company. Specifically:

**a.** Ensuring Western has the financing capacity to continue to execute on opportunities to increase overall market share through strategic acquisitions that add value for our shareholders;
**b.** Maintaining a strong capital base to ensure that investor, creditor and market confidence is secured;
**c.** Maintaining balance sheet strength, ensuring Western's strategic objectives are met, while retaining an appropriate amount of leverage; and
**d.** Safeguarding the entity's ability to continue as a going concern, such that it continues to provide returns for shareholders and benefits for other stakeholders.

Western manages its capital structure based on current economic conditions, the risk characteristics of the underlying assets, and planned capital requirements, within guidelines approved by its Board of Directors. Total capitalization is maintained or adjusted by drawing on existing debt facilities, issuing new debt or equity securities when opportunities are identified and through the disposition of underperforming assets to reduce debt when required. As at September 30, 2010, the Company had $27.0 million in available credit under its credit facilities and is in compliance with all debt covenants (see Note 6).

**11. Segmented information**

As at September 30, 2010, Western operates in two main industry segments, Contract Drilling and Production Services. Subsequent to the discontinuation of the United States and International geographic operations (Note 12), the Company operates in one geographic region. Contract drilling includes drilling rigs along with related equipment. Production services include various oilfield services relating to stimulation and fluid pumping, nitrogen services, specialty solvents and laboratory services.

| Three months ended September 30, 2010 | | Contract Drilling [1] | | Production Services | | Corporate | | Total |
|---|---|---|---|---|---|---|---|---|
| Continuing Operations: | | | | | | | | |
| Revenue | $ | 16,485 | $ | 2,835 | $ | - | $ | 19,320 |
| Segment profit (loss) | | 3,751 | | 616 | | (1,024) | | 3,343 |
| Depreciation | | 1,859 | | 195 | | 32 | | 2,086 |
| Total assets | | 136,498 | | 8,975 | | (1,845) [2] | | 143,628 |
| Expenditures on capital items | $ | 5,116 | $ | 1,361 | $ | 3 | $ | 6,480 |

[1] Contract drilling segment acquired on March 18, 2010 (Note 4).
[2] Includes bank indebtedness of $2.6 million.

| Three months ended September 30, 2009 | | Contract Drilling [1] | | Production Services | | Corporate | | Total |
|---|---|---|---|---|---|---|---|---|
| Continuing Operations: | | | | | | | | |
| Revenue | $ | - | $ | 921 | $ | - | $ | 921 |
| Segment profit (loss) | | - | | (346) | | (307) | | (653) |
| Depreciation | | - | | 427 | | - | | 427 |
| Total assets | | - | | 11,489 | | 104 | | 11,593 |
| Expenditures on capital items | $ | - | $ | 4 | $ | - | $ | 4 |

[1] Contract drilling segment acquired on March 18, 2010 (Note 4).

| Nine months ended September 30, 2010 | | Contract Drilling [1] | | Production Services | | Corporate | | Total |
|---|---|---|---|---|---|---|---|---|
| Continuing Operations: | | | | | | | | |
| Revenue | $ | 29,427 | $ | 7,608 | $ | - | $ | 37,035 |
| Segment profit (loss) | | 6,217 | | 1,417 | | (2,482) | | 5,152 |
| Depreciation | | 3,421 | | 548 | | 55 | | 4,024 |
| Total assets | | 136,498 | | 8,975 | | (1,845) [2] | | 143,628 |
| Expenditures on capital items | $ | 7,181 | $ | 2,954 | $ | 274 | $ | 10,409 |

[1] Contract drilling segment acquired on March 18, 2010 (Note 4).
[2] Includes bank indebtedness of $2.6 million.

| Nine months ended September 30, 2009 | | Contract Drilling [1] | | Production Services | | Corporate | | Total |
|---|---|---|---|---|---|---|---|---|
| Continuing Operations: | | | | | | | | |
| Revenue | $ | - | $ | 2,787 | $ | - | $ | 2,787 |
| Segment profit (loss) | | - | | (1,166) | | (696) | | (1,862) |
| Depreciation | | - | | 1,303 | | 1 | | 1,304 |
| Total assets | | - | | 11,489 | | 104 | | 11,593 |
| Expenditures on capital items | $ | - | $ | 41 | $ | - | $ | 41 |

[1] Contract drilling segment acquired on March 18, 2010 (Note 4).

A reconciliation of segment profit to income (loss) before taxes is as follows:

| | Three months ended September 30 | | Nine months ended September 30 | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Continuing operations: | | | | |
| Total segment profit (loss) | $ 3,343 | $ (653) | $ 5,152 | $ (1,862) |
| Add (deduct) | | | | |
| Amortization of intangibles | (95) | - | (190) | - |
| Stock-based compensation | (167) | - | (366) | - |
| Gain on sale of assets | - | - | (11) | (2) |
| Interest and finance costs | (163) | (90) | (521) | (237) |
| Foreign exchange gain (loss) | (110) | (165) | 128 | (233) |
| Goodwill impairment | | (599) | | (599) |
| Acquisition costs | (188) | - | (445) | - |
| Gain on business acquisitions | 8,720 | - | 19,814 | - |
| Income (loss) before taxes | $ 11,340 | $ (1,507) | $ 23,561 | $ (2,933) |

## 12. Discontinued operations

During the second quarter of 2010, management determined its United States and International production services divisions, included in the Production Services segment, would be disposed of in order for the Company to focus on its core business operations in western Canada. The disposal groups consisted of certain property and equipment including a building, field equipment and shop equipment used in the Production Services segment.

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Revenue from discontinued operations: | | | | |
| United States | $ - | $ 169 | $ - | $ 1,245 |
| International | 13 | 125 | 55 | 288 |
| | $ 13 | $ 294 | $ 55 | $ 1,533 |
| | | | | |
| Net income (loss) before tax from discontinued operations: | | | | |
| United States | $ (108) | $ (201) | $ (664) | $ (810) |
| International | (170) | 58 | (223) | 95 |
| | $ (278) | $ (143) | $ (887) | $ (715) |
| Income taxes | 91 | - | 91 | - |
| Net loss from discontinued operations | $ (369) | $ (143) | $ (978) | $ (715) |

The following table provides additional information with respect to amounts included in the September 30, 2010 balance sheet as assets and liabilities of discontinued operations:

| | United States | International | Total |
|---|---|---|---|
| Current assets: | | | |
| Accounts receivable | - | 35 | 35 |
| Prepaid expenses | - | 4 | 4 |
| Total current assets | $ - | $ 39 | $ 39 |
| | | | |
| Long-term assets: | | | |
| Property and equipment | $ 31 | $ - | $ 31 |
| Total long-term assets | $ 31 | $ - | $ 31 |
| | | | |
| Current liabilities: | | | |
| Accounts payable and accrued liabilities | $ 619 | $ 316 | $ 935 |
| Total current liabilities | $ 619 | $ 316 | $ 935 |

The cash flows from discontinued operations for the three months ended September 30, 2010 are as follows:

| | United States | International | Total |
|---|---|---|---|
| Operating activities: | | | |
| Net loss | $ (109) | $ (260) | $ (369) |
| Items not affecting cash: | | | |
| Loss on sale of assets | 22 | - | 22 |
| Unrealized foreign exchange (gain)/loss | (67) | - | (67) |
| Net change in non-cash working capital | 73 | 229 | 302 |
| | (81) | (31) | (112) |
| Investing activities: | | | |
| Proceeds on sale of property and equipment | 384 | - | 384 |
| | 384 | - | 384 |
| Increase (decrease) in cash and cash equivalents | $ 303 | $ (31) | $ 272 |

The cash flows from discontinued operations for the three months ended September 30, 2009 are as follows:

| | United States | International | Total |
|---|---|---|---|
| Operating activities: | | | |
| Net income (loss) | $ (201) | $ 58 | $ (143) |
| Items not affecting cash: | | | |
| Depreciation | 200 | - | 200 |
| Goodwill impairment | 113 | - | 113 |
| Unrealized foreign exchange (gain)/loss | (66) | 3 | (63) |
| Net change in non-cash working capital | 373 | 31 | 404 |
| | 419 | 92 | 511 |
| Investing activities: | | | |
| Proceeds on sale of property and equipment | 103 | - | 103 |
| | 103 | - | 103 |
| Financing activities: | | | |
| Payment of long-term debt | (616) | - | (616) |
| | (616) | - | (616) |
| Increase (decrease) in cash and cash equivalents | $ (94) | $ 92 | $ (2) |

The cash flows from discontinued operations for the nine months ended September 30, 2010 are as follows:

| | United States | International | Total |
|---|---|---|---|
| Operating activities: | | | |
| Net loss | $ (664) | $ (314) | $ (978) |
| Items not affecting cash: | | | |
| Loss on sale of assets | 1 | - | 1 |
| Unrealized foreign exchange loss | 161 | - | 161 |
| Net change in non-cash working capital | 433 | 209 | 642 |
| | (69) | (105) | (174) |
| Investing activities: | | | |
| Proceeds on sale of property and equipment | 1,694 | - | 1,694 |
| | 1,694 | - | 1,694 |
| Financing activities: | | | |
| Payment of long-term debt | (292) | - | (292) |
| | (292) | - | (292) |
| Increase (decrease) in cash and cash equivalents | $ 1,333 | $ (105) | $ 1,228 |

The cash flows from discontinued operations for the nine months ended September 30, 2009 are as follows:

| | United States | International | Total |
|---|---|---|---|
| Operating activities: | | | |
| Net income (loss) | $ (810) | $ 95 | $ (715) |
| Items not affecting cash: | | | |
| Depreciation | 644 | - | 644 |
| Goodwill impairment | 113 | - | 113 |
| Unrealized foreign exchange loss | 1,014 | 3 | 1,017 |
| Net change in non-cash working capital | 1,181 | 22 | 1,203 |
| | 2,142 | 120 | 2,262 |
| Investing activities: | | | |
| Proceeds on sale of property and equipment | 292 | - | 292 |
| Additions of property and equipment | (111) | - | (111) |
| | 181 | - | 181 |
| Financing activities: | | | |
| Payment of long-term debt | (1,589) | - | (1,589) |
| | (1,589) | - | (1,589) |
| Increase in cash and cash equivalents | $ 734 | $ 120 | $ 854 |

**13. Subsequent events**

Subsequent to September 30, 2010, Western sold auxiliary drilling equipment as part of the Impact acquisition, via an open bid process, for $2.6 million to a company that shares common directors with Western. The agreed upon sales price was deemed to be at fair value.

On October 18, 2010, the Company announced that it had entered into an Arrangement Agreement whereby, subject to certain conditions, the Company will acquire all of the issued and outstanding units of Pantera Drilling Income Trust ("Pantera") in exchange for approximately 226 million shares of Western. The total transaction value is approximately $64.1 million, including the assumption of approximately $16.6 million in net debt (estimated at closing), severance and transaction costs and an ascribed value of $0.21 per Western share. In accordance with CICA Handbook Section 1582, *Business Combinations*, the actual consideration will be determined based on the closing price of Western's shares immediately before the acquisition. The transaction is expected to be completed by way of a Plan of Arrangement under the Business Corporations Act of Alberta and is subject to normal stock exchange, court and regulatory approvals and the approval by at

least 66 2/3 percent of the outstanding units of Pantera voted at the special meeting. A special meeting of the unitholders of Pantera will be held in mid-December to vote on the Transaction.