



**Canadian Energy**  
SERVICES L.P.

**Annual Audited Consolidated Financial Statements**

**For the Year Ended December 31, 2008**

*Management's & Auditors' Reports*

## MANAGEMENT'S REPORT

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

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

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

*"Thomas J. Simons"*  
Thomas J. Simons  
President & Chief Executive Officer  
February 26, 2009

*"Craig F. Nieboer"*  
Craig F. Nieboer  
Chief Financial Officer  
February 26, 2009

## AUDITORS' REPORT

To the Unitholders of Canadian Energy Services L.P.:

We have audited the consolidated balance sheets of Canadian Energy Services L.P. (the "Partnership") as at December 31, 2008 and 2007 and the consolidated statements of operations, comprehensive earnings and deficit and cash flow for the years then ended. These consolidated financial statements are the responsibility of the Partnership's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Partnership as at December 31, 2008 and 2007 and the results of its operations and its cash flow for the years then ended in accordance with Canadian generally accepted accounting principles.

*"Deloitte & Touche LLP"*  
Deloitte & Touche LLP  
Chartered Accountants  
Calgary, Alberta  
February 20, 2009

**Consolidated Balance Sheets**  
(stated in thousands of dollars)

	<b>Dec 31, 2008</b>	Dec 31, 2007
<b>ASSETS</b>		
Current assets		
Accounts receivable	\$ 47,286	\$ 21,909
Inventory	10,903	6,186
Prepaid expenses	441	190
	<b>58,630</b>	28,285
Property and equipment (note 6)	12,519	6,724
Intangible assets (note 7)	4,199	95
Goodwill (note 8)	49,913	41,966
	<b>\$ 125,261</b>	\$ 77,070
<b>LIABILITIES AND UNITHOLDERS' EQUITY</b>		
Current liabilities		
Bank indebtedness (note 9)	\$ 12,702	\$ 4,548
Accounts payable and accrued liabilities	25,578	14,196
Contingent payable (note 4)	2,000	-
Distributions payable	1,225	1,084
Current portion of long-term debt (note 10)	1,300	905
	<b>42,805</b>	20,733
Long-term debt (note 10)	3,474	1,289
Future income tax liability (note 11)	2,004	2,001
	<b>5,478</b>	3,290
Unitholders' equity		
Class A Units (note 12)	84,352	66,959
Subordinated Class B Units (note 12)	21,514	21,514
Contributed surplus (note 12)	1,531	273
Deficit	(30,419)	(35,699)
	<b>76,978</b>	53,047
	<b>\$ 125,261</b>	\$ 77,070

Commitments (note 16)

APPROVED ON BEHALF OF THE BOARD:

*"Thomas J. Simons"*

Thomas J. Simons

President & Chief Executive Officer and Director

*"D. Michael Stewart"*

D. Michael Stewart

Director & Chairman, Audit Committee

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

**Consolidated Statements of Operations, Comprehensive Earning and Deficit**  
(stated in thousands of dollars except per unit amounts)

	Year Ended Dec 31, 2008	Year Ended Dec 31, 2007
Revenue	\$ 125,069	\$ 60,420
Cost of sales	88,373	41,345
Gross margin	36,696	19,075
Expenses		
Selling, general and administrative expenses	16,064	8,622
Amortization (note 7)	2,601	913
Unit-based compensation (note 13)	2,097	168
Interest expense	586	43
Loss on disposal of assets	37	27
	21,385	9,773
Net earnings for the year before taxes	15,311	9,302
Future income tax expense (note 11)	125	2,001
Net earnings for the year	15,186	7,301
Other comprehensive income	-	-
Comprehensive earnings for the year	15,186	7,301
Deficit, beginning of year	(35,699)	(34,084)
Unitholders' distributions declared (note 15)	(9,906)	(8,916)
Deficit, end of year	\$ (30,419)	\$ (35,699)
Net earnings per unit (note 14)		
Basic and diluted	\$ 1.46	\$ 0.78

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

**Consolidated Statements of Cash Flow**  
(stated in thousands of dollars)

	Year Ended Dec 31, 2008	Year Ended Dec 31, 2007
<b>CASH PROVIDED BY (USED IN):</b>		
<b>OPERATING ACTIVITIES:</b>		
Net earnings for the year	\$ 15,186	\$ 7,301
Items not involving cash:		
Amortization	2,601	913
Unit-based compensation	2,097	168
Future income tax expense	125	2,001
Loss on disposal of assets	37	27
Change in non-cash operating working capital (note 20)	(17,524)	(6,024)
	<b>2,522</b>	<b>4,386</b>
<b>FINANCING ACTIVITIES:</b>		
Repayment of long-term debt	(1,962)	(689)
Increase in long-term debt	2,750	1,000
Increase in bank indebtedness	8,154	4,548
Issue of class A units, net of share issue costs	11,932	-
Distributions to unitholders	(9,765)	(8,916)
	<b>11,109</b>	<b>(4,057)</b>
<b>INVESTING ACTIVITIES:</b>		
Investment in property and equipment (note 6)	(6,148)	(4,539)
Investment in intangible assets	(77)	(97)
Acquisition of Clear Environmental Solutions (note 4)	(7,529)	-
Proceeds on disposal of fixed assets	123	113
	<b>(13,631)</b>	<b>(4,523)</b>
<b>DECREASE IN CASH AND CASH EQUIVALENTS</b>	<b>-</b>	<b>(4,194)</b>
Cash and cash equivalents, beginning of year	-	4,194
Cash and cash equivalents, end of year	\$ -	\$ -
<b>SUPPLEMENTARY CASH FLOW DISCLOSURE</b>		
Interest paid	\$ 535	\$ 43
Taxes paid	\$ -	\$ -

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

**Notes to the Consolidated Financial Statements for the Years Ended December 31, 2008 and 2007**  
(tabular amounts in thousands of dollars, except unit and per unit amounts)

## 1. The Partnership

Canadian Energy Services L.P. (the “Partnership”) is a limited partnership formed on January 13, 2006, pursuant to the *Limited Partnerships Act* (Ontario). The Partnership designs and implements drilling fluid systems for the oil and natural gas industry, in particular relating to drilling medium to deep vertical and directional wells and horizontal wells in the Western Canadian Sedimentary Basin and the United States through its subsidiary AES Drilling Fluids, LLC. The Western Canadian oil and natural gas drilling season is affected by weather. The industry is generally more active during the winter months of November through March, as the movement of heavy equipment is easier over the frozen ground. Wet weather in the spring and summer can hamper the movement of drilling rigs which has a direct impact upon generating revenue. Conversely, a longer colder winter as well as a dry spring and summer strengthen drilling operations.

## 2. Basis of Presentation

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

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

## 3. Significant Accounting Policies

### (a) Consolidation

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

### (b) Inventory

Inventory is stated at the lower of cost, determined on a first-in, first-out basis, and net realizable value.

### (c) Property and equipment

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

Computer equipment and software	3 years
Vehicles	3 years
Trucks	3-5 years
Field equipment	5 years
Leasehold improvements	4 years
Furniture and fixtures	5 years
Buildings	10-20 years
Tanks	15 years

The Partnership regularly reviews its property and equipment to account for impairment.

**Notes to the Consolidated Financial Statements for the Years Ended December 31, 2008 and 2007**  
(tabular amounts in thousands of dollars, except unit and per unit amounts)

**(d) Intangible assets**

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

**(e) Goodwill**

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

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

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

**(f) Revenue recognition**

The Partnership's revenue is primarily comprised of the sale of products and the provision of services. Revenue on sales of product is recognized based on fixed or determinable prices when the product has been delivered to the well site and the product has been mixed. For sales that are invoiced upon shipment of the product, deferred revenue is recorded for the portion of the product that has not been mixed. Revenue from field service and trucking charges is recognized based upon agreed daily, hourly or job rates, when the service is performed. Revenue will only be recognized when collection is reasonably assured.

**(g) Unit-based compensation**

The Partnership uses the fair value method to account for unit options granted to employees, officers and directors of the General Partner and certain service providers. Under the fair value method, the fair value of the unit options is estimated at the grant date using the Black-Scholes option pricing method, and such fair value is expensed over the vesting period, with a corresponding increase in contributed surplus. Any consideration received upon the exercise of the unit-based compensation together with the amount of non-cash compensation expense recognized in contributed surplus is recorded as an increase in unitholders' capital. The Partnership has not incorporated an estimated forfeiture rate for unit options that will not vest and accounts for forfeitures as they occur.

**(h) Income taxes**

The income earned directly by the Partnership is currently taxed at the partner level. As a result, provisions for income and capital taxes are not made by the Partnership except as noted below.

Effective January 1, 2011 the income of the Partnership will be subject to tax and accordingly future income taxes have been recorded relating to temporary differences expected to reverse after this date. The Partnership and its subsidiaries follow the liability method of recording future income taxes. Under this method, future tax assets and liabilities are recognized for the future taxes attributable to temporary differences between the financial statement carrying values of existing assets and liabilities and their respective tax carrying values. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the period in which those temporary differences

**Notes to the Consolidated Financial Statements for the Years Ended December 31, 2008 and 2007**  
(tabular amounts in thousands of dollars, except unit and per unit amounts)

reverse. Future income tax inflows and outflows are subject to estimation in terms of both timing and amount of future taxable earnings. Should these estimates change, the carrying value of income tax assets or liability may change. The effect of a change in tax rates on future tax assets and liabilities is recognized in income in the period that the legislation is enacted or substantively enacted.

These consolidated financial statements include the assets, liabilities, and operations of the Partnership and its subsidiaries and do not include the assets and liabilities, including income tax, of the partners.

**(i) Foreign currency translation**

Transactions in foreign currencies are translated at rates in effect at the time of the transaction. Monetary assets and liabilities are translated at the exchange rate in effect at the balance sheet date. Gains and losses are included in net earnings.

The accounts of the Partnership's integrated foreign subsidiary are translated into Canadian dollars using average exchange rates for the month of the respective transaction for revenue and expense. Monetary assets and liabilities are translated at the exchange rate in effect at the balance sheet date and non-monetary assets and liabilities are translated using historical exchange rates. Gains or losses resulting from these translation adjustments are included in net earnings.

**(j) Financial instruments**

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

The Partnership has classified its financial instruments as follows: cash – held for trading; accounts receivable – loans and receivables; and bank indebtedness, accounts payable and accrued liabilities, contingent payable, distributions payable and long-term debt – other financial liabilities.

Transaction costs relating to financial instruments are expensed as incurred and included in net earnings.

**(k) Earnings per unit**

Basic earnings per unit are computed by dividing net earnings by the weighted average number of units outstanding during the period. The Partnership uses the treasury stock method for calculating diluted earnings per unit. Diluted earnings per unit are computed similar to basic earnings per unit except that the weighted average units outstanding are increased to include additional units from the assumed exercise of unit options, if dilutive. The number of additional units is calculated by assuming that outstanding unit options were exercised and that the proceeds from such exercises and any unrecognized unit-based compensation in aggregate are used to acquire Class A Units at the average market price during the period.

**(l) Accounting changes**

On January 1, 2008, the Partnership adopted CICA Handbook Section 1535 – Capital Disclosures, Section 3031 – Inventories, Section 3862 – Financial Instruments – Disclosures and Section 3863 – Financial Instruments – Presentation. Section 1535 requires the entity to disclose information about its objectives, policies and processes for managing capital, as well as its compliance with any externally imposed capital requirements. Section 3031 replaces Section 3030 – Inventories, and requires enhanced disclosure and measurement of inventories at the lower of cost and net realizable value. Section 3862 requires the entity to disclose the nature and extent of risks arising from financial instruments and how the entity manages those risks and Section 3863 provides guidance on the presentation of financial instruments. The above statements were adopted prospectively and included as additional note disclosure in these financial statements.

**Notes to the Consolidated Financial Statements for the Years Ended December 31, 2008 and 2007**  
(tabular amounts in thousands of dollars, except unit and per unit amounts)

In February 2008, the CICA issued Handbook Section 3064, Goodwill and Intangible Assets, replacing Section 3062, Goodwill and Other Intangible Assets and Section 3450, Research and Development Costs. Various changes have been made to other sections of the CICA Handbook for consistency purposes. These new Sections will be applicable to financial statements relating to fiscal years beginning on or after October 1, 2008. Accordingly, the Partnership will adopt the new standards for its fiscal year beginning January 1, 2009. Section 3064 establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062. The impact of the initial application of these standards is not expected to be significant.

During 2008, the Canadian Accounting Standards Board (AcSB) confirmed that publicly accountable enterprises will be required to adopt International Financial Reporting Standards (IFRS) in place of Canadian GAAP for interim and annual reporting purposes. The required changeover date is for fiscal years beginning on or after January 1, 2011. At this time, the impact on the Partnership's consolidated financial statements is not reasonably determinable.

#### 4. Business Acquisitions

On June 12, 2008, the Partnership completed the acquisition of the business and assets of Clear Environmental Solutions Inc. ("Clear") for an aggregate purchase price of \$11.5 million, of which \$7.6 million was paid in cash (which includes costs relating to the purchase of \$0.2 million) and \$3.9 million was paid through the issuance of 380,488 Class A Units at a deemed price of \$10.25 per unit. Contingent consideration exists which consists of a potential single earn-out payment of up to a maximum of \$2.0 million, determined by subtracting \$2.4 million from the net income from operations before management bonuses and investment income of the Partnership attributable to the business and assets acquired in connection with the acquisition for the 12 month period beginning July 1, 2008 and multiplying the positive result, if any, by a four times multiple. The payment, if any, will be satisfied by the issuance of Class A Units to the vendor no later than the 60<sup>th</sup> day following the end of such 12 month period. The Class A Units will be issued at a price equal to the weighted average trading price of the Class A Units for the ten trading days preceding the earn-out payment date. At December 31, 2008, the Partnership amended the purchase price and recorded a contingent liability of \$2.0 million for the potential earn-out payment based upon Management's estimate of net income from operations from Clear before management bonuses and investment income for the 12 month period beginning July 1, 2008.

The acquisition has been accounted for using the purchase method, with the Partnership identified as the acquirer. The purchase price allocation was as follows:

<b>Net assets acquired</b>	
Current assets	\$ 1,610
Property and equipment	133
Customer relationships (note 7)	4,100
Goodwill (note 8)	7,947
Current liabilities	(318)
	<b>\$ 13,472</b>
<b>Consideration</b>	
Cash	\$ 7,400
Class A Units	3,900
Contingent payable	2,000
Closing costs	129
Working capital adjustment	43
	<b>\$ 13,472</b>

#### 5. Inventory

The cost of inventory expensed in cost of sales for the years ended December 31, 2008 and December 31, 2007 was \$61.7 million and \$32.2 million, respectively.

**Notes to the Consolidated Financial Statements for the Years Ended December 31, 2008 and 2007**  
(tabular amounts in thousands of dollars, except unit and per unit amounts)

**6. Property and Equipment**

December 31, 2008	Cost	Accumulated Amortization	Net Book Value
Trucks	\$ 3,842	\$ 511	\$ 3,331
Vehicles	4,052	1,166	2,886
Buildings	2,650	186	2,464
Field equipment	1,983	456	1,527
Land	981	-	981
Computer equipment and software	898	350	548
Tanks	505	44	461
Furniture and fixtures	364	89	275
Leasehold improvements	54	8	46
	<b>\$ 15,329</b>	<b>\$ 2,810</b>	<b>\$ 12,519</b>

December 31, 2007	Cost	Accumulated Amortization	Net Book Value
Buildings	\$ 1,678	\$ 78	\$ 1,600
Vehicles	1,898	555	1,343
Trucks	1,288	96	1,192
Field equipment	1,172	160	1,012
Land	842	-	842
Tanks	456	12	444
Computer equipment and software	376	163	213
Furniture and fixtures	115	37	78
	<b>\$ 7,825</b>	<b>\$ 1,101</b>	<b>\$ 6,724</b>

Details of investments in property and equipment are as follows:

	Year Ended Dec 31, 2008	Year Ended Dec 31, 2007
Total investment in property and equipment	\$ 7,748	\$ 5,551
Less:		
Vehicle financing	(1,791)	(810)
Plus:		
Decrease (increase) in non-cash investing working capital	191	(202)
Cash used for investment in property and equipment	<b>\$ 6,148</b>	<b>\$ 4,539</b>

**7. Intangible Assets**

	Cost	Accumulated Amortization	Dec 31, 2008 Net Book Value	Dec 31, 2007 Net Book Value
Customer relationships (note 4)	\$ 4,100	\$ 408	\$ 3,692	\$ -
Technology	600	250	350	-
Patents	172	15	157	95
	<b>\$ 4,872</b>	<b>\$ 673</b>	<b>\$ 4,199</b>	<b>\$ 95</b>

On June 26, 2008, the Partnership purchased technology used in designing certain drilling fluids systems (see note 12). On December 31, 2008, the Partnership determined that the carrying amount of the purchased technology exceeded its fair value and recorded an impairment charge of \$0.2 million.

**Notes to the Consolidated Financial Statements for the Years Ended December 31, 2008 and 2007***(tabular amounts in thousands of dollars, except unit and per unit amounts)***8. Goodwill**

Balance, December 31, 2007 and 2006	\$ 41,966
Clear acquisition (note 4)	7,947
Balance, December 31, 2008	\$ 49,913

At December 31, 2008, the Partnership completed its annual goodwill impairment test. Management estimated the fair value of the Partnership's drilling fluids and environmental businesses using a number of industry accepted valuation methodologies including discounted future cash flows, comparable industry valuation multiples, recent trading activity and capital market pricing of the Partnership's units. Management concluded that the carrying value of goodwill was less than the estimated fair value and therefore no reduction in the carrying value was necessary.

**9. Bank Indebtedness**

At December 31, 2008, the Partnership had a revolving demand loan with a commercial bank permitting it to borrow up to \$20.0 million, subject to the value of certain accounts receivable and inventory, with amounts drawn on the facility incurring interest at the bank's prime rate plus 0.65%. The facility is secured by a general security agreement creating a first priority security interest in all personal property of the General Partner, the Partnership and its subsidiaries, an unlimited corporate guarantee of the indebtedness of the Partnership given by the General Partner and the Partnership's subsidiaries, and a demand collateral mortgage on the Partnership's Edson, Alberta property.

At December 31, 2008, the Partnership had drawn \$12.0 million on the facility and had outstanding cheques payable of \$0.7 million. At December 31, 2007, the Partnership had drawn \$3.3 million on its debt facility and had outstanding cheques payable of \$1.2 million.

The effective rate of interest paid on bank indebtedness was 4.91% and 5.18% for the years ended December 31, 2008 and 2007 respectively.

**10. Long-Term Debt**

The Partnership has long-term debt as follows:

	Dec 31, 2008	Dec 31, 2007
Vehicle financing loans	\$ 2,258	\$ 1,277
Other long-term debt	2,516	917
	4,774	2,194
Less current portion	(1,300)	(905)
	\$ 3,474	\$ 1,289

On February 26, 2008, the Partnership established a committed loan with a commercial bank for \$1.75 million. On October 8, 2008, the Partnership amended the loan to \$1.68 million. At December 31, 2008, there was \$1.65 million outstanding on the committed loan. The loan is repayable in fixed monthly principal payments of \$9,725 plus interest at the bank's prime rate plus 0.75%. This loan has an initial term of five years, with the bank reserving the right to extend the term by two further five year periods at its discretion.

Also on February 26, 2008, the Partnership established a second committed loan with the same commercial bank for \$1.0 million. At December 31, 2008, there was \$0.86 million outstanding on the committed loan. The loan is repayable over five years in fixed monthly principal payments of \$16,667 plus interest at the bank's prime rate of interest plus 0.75%.

The long-term debt facilities are secured by the same general security agreement as the revolving demand loan creating a first priority security interest in all personal property of the General Partner, the Partnership and its subsidiaries, an unlimited corporate guarantee of the indebtedness of the Partnership given by the General Partner and the Partnership's subsidiaries, and a demand collateral mortgage on the Partnership's Edson, Alberta property. These facilities were used to repay and cancel the Partnership's bank debt that was in place at December 31, 2007.

**Notes to the Consolidated Financial Statements for the Years Ended December 31, 2008 and 2007**  
(tabular amounts in thousands of dollars, except unit and per unit amounts)

Vehicle financing loans are secured by each related vehicle, and incur interest at rates ranging from 0% to 17.1% and are repayable in monthly payments ranging from \$800 - \$2,100. Vehicle financing loans mature from January 2009 to December 2012.

Principal payments are as follows for the years ending December 31:

2009	\$	1,300
2010		1,135
2011		738
2012		353
2013		1,248
<b>Total</b>	<b>\$</b>	<b>4,774</b>

The effective rate of interest paid on long-term debt was 5.08% and 5.12% for the years ended December 31, 2008 and 2007 respectively.

## 11. Future Income Taxes

Based on its assets and liabilities as at December 31, 2008 and 2007, the Partnership estimated the amount of its temporary differences which were previously not subject to tax and the period in which these differences will reverse. Details of taxable (deductible) temporary differences are as follows:

	<b>Dec 31, 2008</b>	Dec 31, 2007
Property and equipment	<b>\$ 637</b>	\$ 13
Goodwill	<b>2,003</b>	1,648
Share issuance costs	<b>(2,922)</b>	(3,160)
Non-capital losses of US subsidiary	<b>(2,701)</b>	-
<b>Net deductible temporary differences</b>	<b>\$ (2,983)</b>	<b>\$ (1,499)</b>

The Partnership estimated that \$7.3 million of net taxable temporary differences will reverse after January 1, 2011, resulting in a \$2.0 million future income tax liability at December 31, 2008. The taxable temporary differences relate principally to the projected excess of net book value of goodwill over the projected remaining tax pools attributable thereto at January 1, 2011.

As at December 31, 2008, CES had unused US non-capital loss tax pools of \$2.7 million (December 31, 2007 - \$nil). The US non-capital losses available for carry forward expire in 2028. The Partnership has recorded a full valuation allowance of \$0.8 million at the end of 2008.

On June 22, 2007 the Government of Canada enacted new legislation imposing additional income taxes upon specified investment flow-through ("SIFT") entities including public partnerships such as Canadian Energy Services L.P., effective January 1, 2011. While the Partnership believes it will be subject to tax under the new legislation, the tax rate on temporary difference reversals after 2010 may change in future periods. The amount and timing of reversals of temporary differences will also depend on the Partnership's future operating results, financings and asset acquisitions and dispositions.

SIFT tax does not apply to a SIFT that was publicly traded on October 31, 2006 until 2011 unless the SIFT exceeds "normal growth" in the interim period as determined by reference to guidelines released on December 15, 2006. Under those guidelines, normal growth is an increase of equity capital (including new securities convertible into equity, but excluding equity issued on the conversion of convertible securities existing on October 31, 2006) each year until 2011 of not more than an amount equal to the greater of \$50 million and a cumulative safe harbour amount (a specified portion of its market capitalization as of the end of trading on October 31, 2006).

**Notes to the Consolidated Financial Statements for the Years Ended December 31, 2008 and 2007**  
(tabular amounts in thousands of dollars, except unit and per unit amounts)

A reconciliation of income taxes at Canadian statutory rates with reported income taxes is as follows:

	<b>Year Ended Dec 31, 2008</b>	Year Ended Dec 31, 2007
Net earnings for the year before taxes	\$ 15,311	\$ 9,302
Combined federal and provincial tax rate on SIFT entities	0%	0%
Income tax expense at statutory rates	\$ -	\$ -
Increase (decrease) resulting from:		
Effect of future tax rates on temporary differences	125	2,251
Effect of change in enacted future rates during the year	-	(250)
Future income tax expense for the year	\$ 125	\$ 2,001

## 12. Unitholders' Equity

The Partnership is authorized to issue an unlimited number of Class A Units and Subordinated Class B Units.

On June 5, 2008, the Partnership and a syndicate of underwriters closed a bought deal equity financing pursuant to which the syndicate sold 1,234,200 Class A Units for gross proceeds of \$12.7 million (\$10.25 per Class A Unit). Net proceeds after offering expenses and underwriters' commissions of \$0.9 million net of tax of \$0.1 million, were \$11.9 million.

In connection with the acquisition of Clear on June 12, 2008 (see note 4), the Partnership issued 380,488 Class A Units to the vendors. The Class A Units are held in escrow with one-half of the units to be released from escrow on the first anniversary of the date of the acquisition, and the remaining units to be released on the second anniversary of the date of the acquisition.

On June 26, 2008 the Partnership issued 75,000 Class A Units in connection with the acquisition of technology used in designing certain drilling fluids systems ("Drilling Fluid Technology") from a private company owned by a former employee of the Partnership. The Class A Units were valued at \$8.00 per unit based on the fair value of the units when the transaction was approved by the Board of Directors of Canadian Energy Services Inc., the general partner of the Partnership. Of the Class A Units issued, 50,000 were held in escrow with one-half of the units to be released on January 16, 2009 and the remaining units to be released on January 16, 2010. On January 9, 2009, the Partnership repurchased for cancellation at \$1 the 50,000 units held in escrow and transferred the Drilling Fluid Technology back to the same private company.

During the year ended December 31, 2008, the Partnership issued 75,500 Class A Units under the Unit Bonus Plan and recognized an expense relating to this issue of \$810,030 (see note 13).

A summary of changes to the unitholders' equity for the years ended December 31, 2008 and 2007 is presented below:

	2008		2007	
	Number of Units	Amount	Number of Units	Amount
<b>Class A Units</b>				
Balance, beginning of year	7,229,460	\$ 66,959	7,229,460	\$ 66,959
Equity issue, net of share issue costs and tax	1,234,200	11,868	-	-
Consideration for acquired business (note 4)	380,488	3,900	-	-
Consideration for acquisition of intangible asset	75,000	600	-	-
Issued pursuant to Unit Bonus Plan (note 13c)	75,500	810	-	-
Issued pursuant to Unit Option Plan (note 13a)	23,475	215	-	-
Issued pursuant to Distribution Rights Plan (note 13b)	192	-	-	-
Balance, end of year	9,018,315	\$ 84,352	7,229,460	\$ 66,959

**Notes to the Consolidated Financial Statements for the Years Ended December 31, 2008 and 2007**  
(tabular amounts in thousands of dollars, except unit and per unit amounts)

Class B Units	2008		2007	
	Number of Units	Amount	Number of Units	Amount
Balance, end of year	2,151,486	\$ 21,514	2,151,486	\$ 21,514

Contributed Surplus	2008	2007
Balance, beginning of year	\$ 273	\$ 105
Unit-based compensation	1,287	168
Exercise of unit options	(29)	-
Balance, end of year	\$ 1,531	\$ 273

On March 2, 2006, the Partnership completed the acquisition of the drilling fluid businesses from Impact Fluid Systems Inc. (“Impact”) and Canadian Fluid Systems Ltd. (“CFS” and collectively with Impact, the “Vendors”). In connection with the acquisition of the drilling fluid businesses, the Partnership issued an aggregate of 860,594 Class A Units and 2,151,486 Subordinated Class B Units to the Vendors as partial consideration for the acquired businesses. Of the Class A Units issued to the Vendors 706,890 Class A Units were held in escrow with one-half of the units being released from escrow on March 2, 2007, and the remaining units released on March 2, 2008. The Subordinated Class B Units issued to the Vendors in connection with the acquisition are non-transferable (except to certain shareholders, associates or affiliates of the respective Vendors) and are only exchangeable into Class A Units on or after March 2, 2009, unless a take-over bid is made for the Class A Units and certain other limited circumstances. Distributions on the Subordinated Class B Units are paid quarterly subject to achieving certain distribution targets on the Class A Units. The above business acquisitions were transacted with certain individuals, or entities controlled by them, who as a result of the acquisitions are significant unitholders of the Partnership. Certain of these individuals or persons related to them have continued in key management or director roles with the General Partner.

### 13. Unit-Based Compensation

During the year ended December 31, 2008, \$2.1 million of compensation costs were recorded in the statement of operations in respect of the Partnership’s unit option, distribution rights and unit bonus plans. During the year ended December 31, 2007, \$0.2 million of compensation costs were recorded in the statement of operations in respect of the Partnership’s unit option, distribution rights and unit bonus plans.

#### a) Partnership Unit Option Plan

The Partnership may provide additional compensation to the employees, officers and directors of the General Partner and certain service providers by issuing options to acquire Class A Units under the Partnership’s unit option plan (the “Unit Option Plan”). Unit options granted vest as to one-third on each of the first, second and third anniversary dates of the grant and expire no later than five years after grant.

A summary of changes to the Unit Option Plan for the years ended December 31 is presented below:

	2008		2007	
	Options	Average Exercise Price	Options	Average Exercise Price
Outstanding, beginning of year	695,000	\$ 8.78	669,500	\$ 9.16
Granted during year	158,500	10.27	75,000	6.07
Exercised during the year	(23,475)	7.92	-	-
Forfeited during year	(104,525)	9.15	(49,500)	9.80
Outstanding, end of year	725,500	\$ 9.08	695,000	\$ 8.78
Exercisable, end of year	377,505	\$ 9.07	206,667	\$ 9.10

**Notes to the Consolidated Financial Statements for the Years Ended December 31, 2008 and 2007***(tabular amounts in thousands of dollars, except unit and per unit amounts)*

The following table summarizes information about the Unit Options outstanding for the year ended December 31, 2008:

Range of exercise price	Options outstanding		Options exercisable		
	Options	Weighted average exercise price	Weighted average remaining term in years	Options	Weighted average exercise price
\$6.07-\$8.00	262,000	\$ 7.29	2.5	149,670	\$ 7.50
\$8.01-\$11.31	463,500	10.09	3.0	227,835	10.11
<b>Total</b>	<b>725,500</b>	<b>\$ 9.08</b>	<b>2.8</b>	<b>377,505</b>	<b>\$ 9.07</b>

The fair value of the unit options granted during the year ended December 31, 2008 was \$772,186 (December 31, 2007 - \$62,675). During the same year, compensation costs of \$1,131,219 (December 31, 2007 - \$168,152) were recorded in the statement of operations. The compensation costs for unit options granted during the year ended December 31, 2008 were calculated using the Black-Scholes option pricing model, assuming a risk-free interest rate of 3.1%, a yield of 0%, an expected volatility of 51% and expected lives of unit options of five years. The compensation costs for unit options granted during the year ended December 31, 2007 were calculated using the Black-Scholes option pricing model, assuming a risk-free interest rate of 4.5%, a yield of 11%, an expected volatility of 31% and expected lives of unit options of five years.

**(b) Partnership Distribution Rights Plan**

The Partnership's Distribution Rights Plan, which was approved by the unit holders on May 12, 2008, provides long-term incentive to directors, officers, employees and service providers of the Partnership who are providing services to the Partnership, the General Partner or their affiliates through the issuance of Distribution Rights which are redeemable for Class A Units on the basis of distributions paid by the Partnership, thereby reflecting the total returns to holders of Class A Units. In respect of the adoption of the Distribution Rights Plan, for unit options outstanding on the adoption date of May 12, 2008, \$1,348,540 of incremental value will be recognized as unit-based compensation over the remaining vesting period of the unit options. The incremental value was calculated as the difference between the fair value of the existing unit options immediately before and after the adoption date using the same assumptions except the dividend yield, which was 9.09% and 0%, respectively. For unit options granted subsequent to May 12, 2008, a dividend yield of 0% was assumed. Distribution Rights vest with the Unit Options to which the Distribution Rights relate.

A summary of changes to the Distribution Rights Plan for the year ended December 31, 2008 is presented below.

	<b>Number of Distribution Rights</b>
Outstanding, beginning of year	-
Granted during year	<b>51,290</b>
Redeemed during the year	<b>(192)</b>
Forfeited during year	<b>(4,286)</b>
<b>Outstanding, end of year</b>	<b>46,812</b>

**(c) Partnership Unit Bonus Plan**

The Partnership's Unit Bonus Plan, which was approved by the unit holders on May 12, 2008, provides additional compensation to the employees, officers and certain service providers of the Partnership, subsidiaries of the Partnership or the General Partner by issuing up to 125,000 Class A Units under the Partnership's Unit Bonus Plan. During the year ended December 31, 2008, the Partnership issued 75,500 Class A Units under the Unit Bonus Plan and recognized an expense relating to this issue of \$810,030. Additionally, the Partnership approved the grant of 20,500 Class A Units to be issued on April 1, 2009 upon satisfaction of certain conditions. For the conditional grant of Class A Units, the Partnership recognized compensation expense of \$155,911 for the year ended December 31, 2008.

**Notes to the Consolidated Financial Statements for the Years Ended December 31, 2008 and 2007**  
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**14. Earnings Per Unit**

The computations for basic and diluted earnings per unit are as follows:

	Year Ended Dec 31, 2008	Year Ended Dec 31, 2007
Earnings	\$ 15,186	\$ 7,301
Weighted average number of units outstanding:		
Basic	10,391,369	9,380,946
Effect of unit-based compensation plans	-	2,269
Diluted	10,391,369	9,383,215
Earnings per unit:		
Basic and diluted	\$ 1.46	\$ 0.78

For the year ended December 31, 2008, there was no effect of dilutive securities with respect to unit-based compensation plans as they were all anti-dilutive. For the year ended December 31, 2007, 243,720 unit options were anti-dilutive.

**15. Cash Distributions**

The Partnership declares monthly distributions of cash to Class A unitholders of record as at the close of business on each monthly distribution record date. In addition, the Partnership declares quarterly distributions on the Subordinated Class B Units to unitholders of record at the close of business on each quarterly distribution record date, subject to achieving certain distribution targets on the Class A Units. The amounts of the distributions are determined by the General Partner in accordance with the Partnership Agreement on a discretionary basis. Such distributions are recorded as reductions of equity upon declaration of the distribution. The Partnership has declared distributions to holders of Class A Units and Subordinated Class B Units for the year ended December 31, 2008 as follows:

Distribution Period 2008	Distribution Record Date	Date of Distribution	Per Class A Unit	Per Subordinated Class B Unit	Total
Jan 1 – 31	Jan 31	Feb 15	\$ 0.0792	\$ -	\$ 573
Feb 1 – 29	Feb 29	Mar 14	0.0792	-	573
Mar 1 – 31	Mar 31	Apr 14	0.0792	-	573
Jan 1 – Mar 31	Mar 31	Apr 14	-	0.2376	510
Apr 1 – 30	Apr 30	May 15	0.0792	-	573
May 1 – 31	May 31	Jun 13	0.0792	-	573
Jun 1 – 30	Jun 30	Jul 15	0.0792	-	714
Apr 1 – Jun 30	Jun 30	Jul 15	-	0.2376	511
Jul 1 – 31	Jul 31	Aug 15	0.0792	-	714
Aug 1 – 31	Aug 31	Sep 15	0.0792	-	714
Sep 1 – 30	Sep 30	Oct 15	0.0792	-	714
Jul 1 – Sep 30	Sep 30	Oct 15	-	0.2376	511
Oct 1 – 31	Oct 31	Nov 15	0.0792	-	714
Nov 1 – 30	Nov 30	Dec 14	0.0792	-	714
Dec 1 – 31	Dec 31	Jan 15	0.0792	-	714
Oct 1 – Dec 31	Dec 31	Jan 15	-	0.2376	511
Total distributions declared during the year			\$ 0.9504	\$ 0.9504	\$ 9,906

**Notes to the Consolidated Financial Statements for the Years Ended December 31, 2008 and 2007**  
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The Partnership declared distributions to holders of Class A Units and Subordinated Class B Units for the year ended December 31, 2007 as follows:

Distribution Period 2007	Per Unit	Total
Class A Units	\$ 0.9504	\$ 6,876
Class B Units	\$ 0.9504	2,040
<b>Total distributions declared during the year</b>		<b>\$ 8,916</b>

## 16. Commitments

The Partnership has commitments with payments due for the years ending December 31 as follows:

	Office rent	Vehicle leases	Total
2009	\$ 923	\$ 24	\$ 947
2010	329	5	334
2011	329	-	329
2012	116	-	116
2013	30	-	30
<b>Total</b>	<b>\$ 1,727</b>	<b>\$ 29</b>	<b>\$ 1,756</b>

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

## 17. Financial Instruments

### (a) Fair value

The carrying values of financial liabilities where interest is charged based on a variable rate are equal to fair value. The carrying value of long-term debt where interest is charged at a fixed rate is not significantly different than fair value. The carrying values of all other financial instruments approximate their fair value due to the relatively short period to maturity of the instruments.

### (b) Credit risk

The Partnership 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 includes balances from a large number of customers operating primarily in the oil and gas industry. Accordingly, the Partnership views the credit risks on these amounts as normal for the industry.

An analysis of accounts receivable that are past due but not impaired is as follows:

	Dec 31, 2008	Dec 31, 2007
Past due 61-90 days	\$ 3,450	\$ 2,787
Past due 91-120 days	1,491	510
Past 120 days	318	127
	<b>\$ 5,259</b>	<b>\$ 3,424</b>

The Partnership reduces an accounts receivable to its estimated recoverable amount as soon as it is known to be not collectible in full. If it is expected that further losses will be incurred, an allowance for doubtful accounts is recorded. As at December 31, 2008 the Partnership had recorded an allowance of \$427,228 (December 31, 2007 - \$68,097) in accounts receivable as not collectible.

**Notes to the Consolidated Financial Statements for the Years Ended December 31, 2008 and 2007***(tabular amounts in thousands of dollars, except unit and per unit amounts)***(c) Interest rate risk**

The Partnership is exposed to interest rate risk as it borrows funds at both fixed and floating interest rates. The Partnership manages this risk by continuously monitoring interest rate trends and forecasted economic conditions. The exposure to interest rate risk on financial liabilities is detailed in the liquidity risk section of this note.

A 50 basis point increase or decrease is used when reporting interest rate risk internally to key management personnel 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 Partnership's net earnings and other comprehensive earnings would have decreased/increased by approximately \$48,000.

**(d) Foreign currency risk**

The Partnership's foreign currency risk arises from portions of the Partnership's accounts receivable, accounts payable and long-term debt that are denominated in U.S. dollars. Gains or losses resulting from this risk are included in earnings. Based on these U.S. dollar financial instrument closing balances, 2008 net earnings and other comprehensive earnings would have increased/decreased by approximately \$47,000 for every 1% decrease/increase in the value of the U.S./Canadian exchange rate.

**(e) Liquidity risk**

The following table details the remaining contractual maturities of the Partnership's financial liabilities at December 31, 2008 (includes interest and principal cash flows where applicable):

	Less than 3 months	3 months to 1 year	1-5 years	5+ years	Total
Accounts payable, accrued liabilities and contingent payable	\$ 23,778	\$ 3,800	\$ -	\$ -	\$ 27,578
Long-term debt at fixed interest rates	295	821	1,323	-	2,439
Long-term debt at variable interest rates	107	317	2,459	-	2,883
	<b>\$ 24,180</b>	<b>\$ 4,938</b>	<b>\$ 3,782</b>	<b>\$ -</b>	<b>\$ 32,900</b>

The Partnership manages liquidity risk by maintaining banking facilities and continuously monitoring forecasted and actual cash flows.

**18. Capital Management**

The Partnership considers capital to include unitholders' equity, long-term debt (including current portion), cash and cash equivalents and bank indebtedness. The Partnership's objectives when managing capital are to safeguard its ability to continue as a going concern and to maintain and grow the business while incurring an acceptable level of risk and providing unitholders with targeted distributions.

Management of the Partnership sets the amount of capital in proportion to risk, and manages the capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust the capital structure, the Partnership may adjust the level of distributions paid to unitholders, return capital to unitholders, issue new units, sell assets to reduce debt or issue new debt.

In addition to monitoring the externally imposed capital requirements detailed below, the Partnership manages capital by analyzing working capital levels, payout ratio, forecasted cash flows and general economic conditions. Payout ratio is calculated as distributions declared as a percentage of cash flow from operations before changes in non-cash operating working capital.

The Partnership has the following externally imposed capital requirements pursuant to the revolving demand facility agreement: its ratio of debt to equity must not exceed 2.50 to 1.00 (tested quarterly); its ratio of current assets to current liabilities must not be less than 1.25 to 1.00 (tested quarterly); and its debt service coverage ratio must not be less than 1.25 to 1.00 (tested annually based on the audited consolidated financial statements). The ratio of debt to equity is calculated as total

**Notes to the Consolidated Financial Statements for the Years Ended December 31, 2008 and 2007***(tabular amounts in thousands of dollars, except unit and per unit amounts)*

liabilities per the consolidated financial statements, less future income taxes and net of any cash credit balances, divided by total unitholders' equity per the consolidated financial statements, less any intangible assets including goodwill. The ratio of current assets to liabilities is calculated as total current assets per the consolidated financial statements divided by current liabilities per the consolidated financial statements less current portion of long-term debt. The debt service coverage ratio is calculated as net earnings for the period, before interest expense, future income tax expense, unit-based compensation and amortization divided by the sum of all interest and principal payments for the period. If the Partnership does not meet any one of these requirements, it is considered to be in default of the agreement and is restricted from making any distributions to unitholders without prior written consent of the commercial bank. As at December 31, 2008, the Partnership has met all of the financial requirements under this agreement.

**19. Payments to the General Partner**

The General Partner will be allocated 0.01% of the income of the Partnership for each fiscal year and 99.99% of the income of the Partnership will be allocated to the holders of Class A Units and Subordinated Class B Units.

**20. Supplemental Information**

Components of change in non-cash working capital balances:	Year Ended Dec 31, 2008	Year Ended Dec 31, 2007
Operating:		
Accounts receivable	\$ (23,812)	\$ 1,824
Inventory	(4,717)	(3,573)
Prepaid expenses	(207)	(10)
Accounts payable and accrued liabilities	11,212	(3,838)
Deferred revenue	-	(427)
	(17,524)	(6,024)
Investing:		
Accounts payable and accrued liabilities	(191)	202
	\$ (17,715)	\$ (5,822)

**21. Segmented Information**

The Partnership has two reportable segments as determined by management, which are the Drilling Fluids 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 Environmental Services segment is comprised of the Partnership's environmental division, Clear. The Environmental Services segment provides environmental and drilling fluids waste disposal services mostly to oil and gas producers active in the shallow natural gas producing areas of Alberta as well as to Alberta's oil sands.

	Year Ended December 31, 2008		
	Drilling Fluids	Environmental Services <sup>(1)</sup>	Total
Revenue from external customers	\$ 114,618	\$ 10,451	\$ 125,069
Gross margin	33,128	3,568	36,696
Amortization of capital assets	2,556	45	2,601
Interest Expense	586	-	586
Future income tax expense (recovery)	153	(28)	125
Net earnings before taxes	12,994	2,317	15,311
Total assets	107,763	17,498	125,261
Goodwill additions	-	7,947	7,947
Capital expenditures	\$ 7,714	\$ 34	\$ 7,748

**Notes to the Consolidated Financial Statements for the Years Ended December 31, 2008 and 2007***(tabular amounts in thousands of dollars, except unit and per unit amounts)*

	Year Ended December 31, 2007		
	Drilling Fluids	Environmental Services	Total
Revenue from external customers	\$ 60,420	\$ -	\$ 60,420
Gross margin	19,075	-	19,075
Amortization of capital assets	913	-	913
Interest Expense	43	-	43
Future income tax expense	2,001	-	2,001
Net earnings before taxes	9,302	-	9,302
Total assets	77,070	-	77,070
Capital expenditures	\$ 5,551	\$ -	\$ 5,551

**Notes:**

<sup>1</sup> The Environmental Services segment is comprised of the Partnership's environmental division, Clear, which was acquired on June 12, 2008.

	Revenue for the years ended Dec 31,		Capital Assets and Goodwill As at Dec 31,	
	2008	2007	2008	2007
Canada	\$ 120,341	\$ 60,420	\$ 60,758	\$ 48,690
United States <sup>(1)</sup>	4,728	-	1,674	-
Total	\$ 125,069	\$ 60,420	\$ 62,432	\$ 48,690

## Note

(1) AES began operations in the United States in Calendar 2008

**22. Economic Dependence**

For the year ended December 31, 2008, one customer accounted for 10.6% of revenue. For the year ended December 31, 2007, no customer represented greater than 10% of revenue.