# Seaway Energy Services Inc.
# Interim Financial Statements
# December 31, 2010
# (unaudited)

## Contents



## Notice for National Instrument 51-102

The accompanying unaudited interim financial statements of Seaway Energy Services Inc. for the three month period ended December 31, 2010 have been prepared by Management and approved by the Audit Committee and the Board of Directors of the Company. These statements have not been reviewed or audited by the Company's external auditors.

**Seaway Energy Services Inc.**
**Balance Sheets**
**(unaudited)**

| As at | December 31, 2010 | September 30, 2010 |
|---|---|---|
| **Assets** | | |
| **Current** | | |
| Cash and cash equivalents | $ 177,972 | $ 222,473 |
| Accounts receivable | 1,332,626 | 1,117,122 |
| Prepaid expenses | 22,103 | 29,142 |
| | 1,532,701 | 1,368,737 |
| **Property and equipment (Note 3)** | 21,516 | 20,601 |
| **Future income taxes** | 39,500 | 50,400 |
| | $ 1,593,717 | $ 1,439,738 |

| | December 31, 2010 | September 30, 2010 |
|---|---|---|
| **Liabilities and Shareholders' Equity** | | |
| **Current** | | |
| Accounts payable and accrued liabilities | $ 484,037 | $ 362,602 |
| Current portion of the convertible debentures (Note 4) | 275,000 | 275,000 |
| | 759,037 | 637,602 |
| **Subsequent event (Note 9)** | | |
| **Share capital (Note 5(b))** | 2,926,431 | 2,926,431 |
| **Contributed surplus (Note 5(d))** | 359,906 | 359,906 |
| **Deficit** | (2,451,657) | (2,484,201) |
| | 834,680 | 802,136 |
| | $ 1,593,717 | $ 1,576,008 |

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

## Seaway Energy Services Inc.
## Statements of Operations, Comprehensive Income and Deficit
## (unaudited)

| For the three months ended December 31, | 2010 | 2009 |
|---|---|---|
| **Revenues** | **$ 876,767** | $ 847,645 |
| **Expenses** | | |
| Operating | **686,058** | 626,987 |
| General and administrative | **139,034** | 130,546 |
| Interest | **6,913** | 13,500 |
| Financing cost accretion | **-** | 9,695 |
| Amortization of property and equipment | **1,494** | 1,840 |
| Amortization of intangible assets | **-** | 26,582 |
| | **833,499** | 809,150 |
| **Income before other and income taxes** | **43,268** | 38,495 |
| **Other item** | | |
| Interest income | **176** | 25 |
| **Income before income taxes** | **43,444** | 38,520 |
| **Income taxes** | | |
| Current | **-** | - |
| Future | **10,900** | 10,500 |
| | **10,900** | 10,500 |
| **Net and comprehensive income for the period** | **32,544** | 28,020 |
| Deficit, beginning of period | **(2,484,201)** | (2,546,281) |
| **Deficit, end of period** | **$ (2,451,657)** | $ (2,518,261) |
| **Net earnings per share - basic and diluted** | **$ 0.001** | $ 0.001 |
| **Weighted average shares outstanding - basic and diluted** *(1)* | **30,988,470** | 30,988,470 |

*(1) The options and warrants have been excluded from the diluted loss per share computation as they are anti-dilutive*

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

## Seaway Energy Services Inc.
## Statements of Cash Flows
## (unaudited)

| For the three months ended December 31, | 2010 | 2009 |
|---|---|---|
| **Cash flows from (used in) operating activities** | | |
| Net income for the period | $ 32,544 | $ 28,020 |
| Items not involving cash: | | |
| Financing cost accretion | - | 9,695 |
| Amortization of property and equipment | 1,494 | 1,840 |
| Amortization of intangible assets | - | 26,582 |
| Future income taxes (recovery) | 10,900 | 10,500 |
| | 44,938 | 76,637 |
| Change in non-cash working capital balances: | | |
| Accounts receivable | (215,504) | (7,772) |
| Prepaid expenses | 7,039 | 6,789 |
| Accounts payable and accrued liabilities | 121,435 | 13,277 |
| Cash flow from (used in) operating activities | (42,092) | 88,931 |
| **Cash flows from (used in) financing activities** | | |
| Issue of common shares | - | - |
| Repayment of promissory notes | - | (50,000) |
| Cash flow used in financing activities | - | (50,000) |
| **Cash flows from (used in) investing activities** | | |
| Proceeds on the sale of property and equipment | - | 1,533 |
| Expenditures on property and equipment | (2,410) | - |
| Cash flow from investing activities | (2,410) | 1,533 |
| **Increase in cash and cash equivalents** | (44,502) | 40,464 |
| Cash and cash equivalents, beginning of period | 222,473 | 65,074 |
| **Cash and cash equivalents, end of period** | $ 177,972 | $ 105,538 |

| | | |
|---|---|---|
| **Supplemental information** | | |
| Interest paid | $ 6,188 | $ - |
| Taxes paid | $ - | $ 11,000 |

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

## 1. Nature of Operations

The interim unaudited financial statements of Seaway Energy Services Inc. ("Seaway" or "the Company") have been prepared by management, in accordance with Canadian generally accepted accounting principles. The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the interim consolidated financial statements and accompanying notes. Actual results could differ from those estimates. The interim financial statements have, in management's opinion, been properly prepared using careful judgment with reasonable limits of materiality. These interim financial statements do not include all the note disclosures required for annual financial statements and therefore they should be read in conjunction with the Company's audited financial statements for the year ended September 30, 2010. The interim financial statements have been prepared following the same significant accounting policies as the most recently reported audited financial statements of Seaway.

## 2. Property and Equipment

| **December 31, 2010** | **Cost** | **Accumulated amortization** | **Net book value** |
|---|---|---|---|
| Equipment | **$ 23,500** | **$ 18,818** | **$ 4,682** |
| Computer equipment | **65,317** | **55,812** | **9,505** |
| Computer software | **70,411** | **69,149** | **1,262** |
| Furniture and fixtures | **18,770** | **12,703** | **6,067** |
| | **$ 177,998** | **$ 156,482** | **$ 21,516** |

| September 30, 2010 | Cost | Accumulated amortization | Net book value |
|---|---|---|---|
| Field equipment | $ 23,500 | $ 18,572 | $ 4,928 |
| Computer equipment | 63,598 | 55,037 | 8,561 |
| Computer software | 70,411 | 68,969 | 1,442 |
| Furniture and fixtures | 18,080 | 12,410 | 5,670 |
| | $ 175,589 | $ 154,988 | $ 20,601 |

## 3. Bank Loan

The Company has a $600,000 (2010 - $600,000) revolving demand loan facility with a chartered bank. As at December 31, 2010 and September 30, 2010, the facility has not been drawn on. The loan bears interest at bank prime plus 1½ percent, with an effective rate of 3.75% at December 31, 2010 (2010 – 3.75%). A general assignment of book debts, and a first floating charge debenture over all the assets of the Company has been pledged as collateral. The availability under the facility is subject to periodic review with the next review due by the end of March 2011.

## 4. Convertible Debentures

The convertible debentures are due to a Director and Officer of the Company, bear interest at 9% per annum, convertible into common shares of the Company at $0.15 per share and mature on April 4, 2011. The convertible debenture is subordinated to the bank loan (Note 3).

## 5. Share Capital

(a) Authorized
Unlimited number of preferred shares
Unlimited number of common voting shares without nominal or par value
Unlimited number of share purchase warrants

(a) Issued and outstanding

| | **December 31, 2010** | | | September 30, 2010 | | |
|---|---|---|---|---|---|---|
| **Common shares** | **Shares** | | **Amounts** | Shares | | Amounts |
| Balance, beginning and end of period | **30,988,470** | **$** | **2,910,431** | 30,988,470 | $ | 2,910,431 |
| **Warrants** | | | | | | |
| Balance, beginning and end of period *(1)* | **5,000,000** | **$** | **16,000** | 5,000,000 | $ | 16,000 |
| | | **$** | **2,926,431** | | $ | 2,926,431 |

*(1) On March 25, 2010, the Company issued 1,900,000 units at a price of $0.05 per unit for gross proceeds of $95,000. On May 21, 2010, the Company closed the second tranche of a private placement whereby 3,100,000 units were issued for gross proceeds of $155,000. Each unit consisted of one common share and one share purchase warrant. Each warrant entitles the holder to acquire one common share with an exercise price of $0.10 per share until March 25, 2011 and May 21, 2011. The fair value of the warrants was determined using the Black-Scholes option pricing model with the following assumptions dividend yield – Nil, expected volatility 50%, risk free rate of return 2.0%, weighted average life – 2 years.*

(c) Stock options
The Company has a stock option plan that provides for the issuance to its directors, officers, employees and consultants options to purchase from treasury a number of common shares not exceeding 10% of the common shares that are outstanding from time to time which is the number of shares reserved for issuance under the plan. Options granted under the plan have varying vesting periods as determined by the Board at the grant date. Options can be exercisable for a maximum of five years from the effective date. The options are non-transferable if not exercised. Pursuant to the Stock Option Plan, the exercise price of options will be set by the Board at the time options are granted and cannot be less than the discounted market price, except as permitted by the Exchange. A summary of the status of the Company's stock option plan as at December 31, 2010 and September 30, 2010 and changes during the periods ending on those dates are presented below.

| | **December 31, 2010** | | September 30, 2010 | |
|---|---|---|---|---|
| **Stock Options** | **Number of options** | **Weighted average Exercise price** | Number of options | Weighted average exercise price |
| Beginning of period | **945,000** | **$0.18** | **945,000** | **$0.18** |
| Granted | **-** | **-** | **-** | **-** |
| Exercised | **-** | **-** | **-** | **-** |
| Expired | **(405,000)** | **$0.10** | **-** | **-** |
| End of period | **540,000** | **$0.24** | **945,000** | **$0.18** |
| Exercisable, end of period | **540,000** | **$0.24** | **945,000** | **$0.18** |

## 5. Share Capital - continued

The following table summarizes the stock options outstanding and exercisable at December 31, 2010:

| Options outstanding | Option price | Weighted average exercise price | Weighted average remaining contractual life | Number of options currently exercisable | Weighted average exercise price of options currently exercisable |
|---|---|---|---|---|---|
| 540,000 | $0.24 | $0.24 | 0.8 | 540,000 | $0.24 |

(d) Contributed surplus

| | **December 31, 2010** | September 30, 2010 |
|---|---|---|
| Balance, beginning of period | **$ 359,906** | $ 290,881 |
| Transfer on the expiry of warrants | **-** | - |
| Transfer on the expiry of the debentures | **-** | 69,025 |
| Stock based compensation | **-** | - |
| Balance, end of period | **$ 359,906** | $ 359,906 |

## 6. Related Party Transactions

Except as disclosed elsewhere in these consolidated financial statements the Company had the following related party transactions:

(a) During the period, the Company incurred approximately $5,186 in management fees, which is included in general and administrative expenses, to company controlled by a Officer of which $5,186 is included in accounts payable and accrued liabilities at December 31, 2010.

(b) Included in interest expense is $6,187 related to interest on the debentures of which $6,187 is included in accounts payable and accrued liabilities at December 31, 2010.

All related party transactions are in the normal course of operations and have been measured at the agreed to exchange amounts, which is the amount of consideration established and agreed to by the related parties and which is similar to those negotiated with third parties.

## 7. Financial Instruments

The Company holds various forms of financial instruments. The nature of these instruments and the Company's operations expose the Company to interest rate and foreign currency, liquidity, and fair value risks. The Company manages its exposure to these risks by operating in a manner that minimizes its exposure to the extent practical. These risks are outlined more fully below.

| Financial instrument: | Category: |
|---|---|
| Cash and cash equivalents | Held for trading |
| Accounts receivable | Loans receivable |
| Accounts payable and accrued liabilities | Other financial liabilities |
| Current portion of convertible debentures | Other financial liabilities |

## 7. Financial Instruments - continued

(a) Credit risk

The Company is subject to a concentration of credit risk in its accounts receivable as all of the Company's customers are in the oil and gas sector. Management is of the opinion that any risk of loss is reduced due to the financial strength of its customers. Concentration of credit risk is mitigated by having concentrations with credit worthy clients and broadening the Company's customer base. As at December 31, 2010 the total trade accounts receivable with five customers accounted for 78% (2010 – four customers accounted for 57%) of the Company's current accounts receivable.

| | | **December 31, 2010** | | September 30, 2010 |
|---|---|---|---|---|
| 1-30 days | **$** | **666,064** | $ | 989,785 |
| 31-60 days | | **196,324** | | 72,950 |
| 61 + days | | **491,299** | | 75,448 |
| Total trade receivables | | **1,353,687** | | 1,138,183 |
| Allowance for doubtful accounts | | **(21,061)** | | (21,061) |
| Total accounts receivable | **$** | **1,332,626** | $ | 1,117,122 |

(b) Interest rate risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Company is exposed to interest rate fluctuations as the promissory notes bear interest at a floating rate. As at December 30, 2010, a difference in the interest rate of one percent would change net earnings by approximately $Nil assuming all other variables are constant.

Fixed rate debt is subject to interest rate price risk, as the value will fluctuate as a result of changes in market rates. As at December 31, 2010, the Company has fixed interest rates on 100% of its interest bearing obligations. As the interest rates approximate the prevailing market rates, the fair value of these debt instruments approximate its carrying values.

(c) Liquidity risk

Liquidity risk includes the risk that, as a result of our operational liquidity requirements:

- The Company will not have sufficient funds to settle a transaction on the due date;
- The Company will be forced to sell financial assets at a value which is less than what they are worth; or
- The Company may be unable to settle or recover a financial asset at all.

Seaway expects that cash flows from operations commencing, together with its credit facilities, will be more than sufficient to fund its requirements for investments in working capital, capital expenditures and scheduled debt repayment. As these variables change, liquidity risks may necessitate the need for the Company to conduct equity issues or obtain additional debt financing.

(d) Fair value of financial instruments

The Company has determined that the fair values of the financial instruments consisting of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities and convertible debentures are not materially different from the carrying values of such instruments reported on the balance sheet due to their short-term nature.

## 7. Financial Instruments - continued

The Company classifies the fair value of these financial instruments according to the following hierarchy based on the amount of observable inputs used to value the instrument.

- Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis.
- Level 2 – Pricing inputs are other than quoted prices in active markets included in Level 1. Prices in Level 2 are either directly or indirectly observable as of the reporting date. Level 2 valuations are based on inputs, including quoted forward prices for commodities, time value and volatility factors, which can be substantially observed or corroborated in the marketplace.
- Level 3 – Valuations in this level are those with inputs for the asset or liability that are not based on observable market data.

All financial assets (except for cash and cash equivalents which are classified as held for trading), are classified as either loans or receivables and are accounted for on an amortized cost basis. All financial liabilities are classified as other liabilities. There are no financial assets on the balance sheet that have been designated as available-for-sale. There have been no changes to the aforementioned classifications during the period ended December 31, 2011.

## 8. Capital Risk Management

The Company's objectives when managing capital is to safeguard the entity's ability to continue as a going concern, so that it can continue to provide returns for shareholders and benefits for other stakeholders. Managed capital consists of the Company's current working capital (current assets less current liabilities). The Company sets the amount of capital in proportion to risk. The Company manages the capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. The Company's objective is met by retaining adequate equity to provide for the possibility that cash flows from assets will not be sufficient to meet future cash flow requirements. The Board of Directors does not establish quantitative return on capital criteria for management; but rather promotes year over year sustainable profitable growth. The Company is not subject to any externally imposed capital requirements other than maximum credit facility which is based on 75% of the Company's accounts receivable under 90 days.

## 9. Subsequent Event

Subsequent to the period end, the Company has filed and received notice that the TSX Venture Exchange has accepted a notice with the intention to make a normal course issuer bid. During the 12-month period commencing February 17, 2011, and ending February 17, 2012, purchase on the TSX Venture Exchange up to 3,098,847 common shares, being approximately 10 per cent of the "public float" of the common shares of Seaway. The price which Seaway will pay for any such shares will be the market price at the time of acquisition. The actual number of common shares which may be purchased and the timing of any such purchases will be determined by Seaway.