PHX
ENERGY SERVICES CORP.

ANNUAL REPORT 2018

Management's Discussion and Analysis

February 27, 2019

The following Management's Discussion and Analysis ("MD&A") of the financial condition, results of operations, and cash flow of PHX Energy Services Corp. ("PHX Energy" or the "Corporation") should be read in conjunction with the Corporation's annual audited consolidated financial statements for the years ended December 31, 2018 and 2017, and the accompanying notes contained therein, as well as other sections contained within the Corporation's 2018 annual report. Readers can also obtain additional information on the Corporation from its most recent Information Circular and Annual Information Form ("AIF") filed on SEDAR at www.sedar.com. This MD&A has been prepared taking into consideration information available up to and including February 27, 2019.

PHX Energy's audited annual financial statements for the years ended December 31, 2018 and 2017 has been prepared in accordance with International Financial Reporting Standards ("IFRS"). The MD&A and audited annual financial statements were reviewed by PHX Energy's Audit Committee and approved by PHX Energy's Board of Directors (the "Board") on February 27, 2019.

Cautionary Statement Regarding Forward-Looking Information and Statements

This MD&A contains certain forward-looking information and statements within the meaning of applicable securities laws. The use of "expect", "anticipate", "continue", "estimate", "objective", "ongoing", "may", "will", "project", "could", "should", "can", "believe", "plans", "intends", "strategy" and similar expressions are intended to identify forward-looking information or statements.

The forward-looking information and statements included in this MD&A are not guarantees of future performance and should not be unduly relied upon. These statements and information involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking statements and information. The Corporation believes the expectations reflected in such forward-looking statements and information are reasonable, but no assurance can be given that these expectations will prove to be correct. Such forward-looking statements and information included in this MD&A should not be unduly relied upon. These forward-looking statements and information speak only as of the date of this MD&A.

In particular, forward-looking information and statements contained in this MD&A include, without limitation:

- The Corporation expects the equipment that was on order as at December 31, 2018 to be delivered within the first half of 2019.
- PHX Energy currently anticipates that $15.0 million in capital expenditures will be spent in the 2019-year. Management intends to allocate $7.0 million of capital expenditures toward growing PHX Energy's Atlas High Performance motor fleet. The remaining $8.0 million in capital expenditures is anticipated to be focused on maintenance of the Velocity and Atlas High Performance motor fleets.
- Peters & Co. Limited forecasts that 2019 conventional capital spending in Canada will decline slightly as a result of the challenges the Canadian industry is facing related to its access to market.
- Capital spending for the most active operators in the US in 2018 is estimated by Peters & Co. Limited to be 28 percent higher than in 2017.
- The planned capital expenditures in 2019 are expected to be financed primarily by funds from operations. However, if a sustained period of market and commodity price uncertainty and financial market volatility persists in 2019, the Corporation's activity levels, cash flows and access to credit may be negatively impacted, in which event the proceeds from borrowing may be required to fund operations, and the expenditure level would be reduced accordingly. Conversely, if future growth opportunities present themselves, the Corporation might consider expanding this planned capital expenditure amount.

The above are stated under the headings: “Overall Performance”, “Industry Activity & Statistics”, and “Cash Requirements for Capital Expenditures”. In addition, statements regarding the expected impact of adopting Future Changes in Accounting Policies and all information contained within the Financial Instruments, Business Risk and Outlook section of this report contains forward-looking statements.

In addition to other material factors, expectations and assumptions which may be identified in this MD&A and other continuous disclosure documents of the Corporation referenced herein, assumptions have been made in respect of such forward-looking statements and information regarding, among other things: the Corporation will continue to conduct its operations in a manner consistent with past operations; the general continuance of current industry conditions; anticipated financial performance, business prospects, impact of competition, strategies, the general stability of the economic and political environment in which the Corporation operates; exchange and interest rates; the continuance of existing (and in certain circumstances, the implementation of proposed) tax, royalty and regulatory regimes; the sufficiency of budgeted capital expenditures in carrying out planned activities; the availability and cost of labour and services and the adequacy of cash flow; debt and ability to obtain financing on acceptable terms to fund its planned expenditures, which are subject to change based on commodity prices; market conditions and future oil and natural gas prices; and potential timing delays. Although Management considers these material factors, expectations, and assumptions to be reasonable based on information currently available to it, no assurance can be given that they will prove to be correct.

Readers are cautioned that the foregoing lists of factors are not exhaustive. Additional information on these and other factors that could affect the Corporation's operations and financial results are included in reports on file with the Canadian Securities Regulatory Authorities and may be accessed through the SEDAR website (www.sedar.com) or at the Corporation's website. The forward-looking statements and information contained in this MD&A are expressly qualified by this cautionary statement. The Corporation does not undertake any obligation to publicly update or revise any forward-looking statements or information, whether as a result of new information, future events or otherwise, except as may be required by applicable securities laws.

About PHX Energy Services Corp.

The Corporation, through its directional drilling subsidiary entities, provides horizontal and directional drilling technology and services to oil and natural gas producing companies in Canada, the US, Russia and Albania. PHX Energy also provides electronic drilling recorder ("EDR") technology and services.

PHX Energy's Canadian directional drilling operations are conducted through Phoenix Technology Services LP. The Corporation maintains its corporate head office, research and development, Canadian sales, service and operational centres in Calgary, Alberta. In addition, PHX Energy has a facility in Estevan, Saskatchewan. PHX Energy's US operations, conducted through the Corporation's wholly-owned subsidiary, Phoenix Technology Services USA Inc. ("Phoenix USA"), is headquartered in Houston, Texas. Phoenix USA has sales and service facilities in Houston, Texas; Denver, Colorado; Casper, Wyoming; Midland, Texas; Bellaire, Ohio; and Oklahoma City, Oklahoma. Internationally, PHX Energy has sales offices and service facilities in Albania and Russia, and administrative offices in Nicosia, Cyprus; Dublin, Ireland; and Luxembourg City, Luxembourg.

PHX Energy markets its EDR technology and services in Canada through its division, Stream Services ("Stream"), which has an office and operations center in Calgary, Alberta. EDR technology is marketed worldwide, outside Canada, through Stream's wholly-owned subsidiary Stream Services International Inc.

As at December 31, 2018, PHX Energy had 828 full-time employees and the Corporation utilized over 150 additional field consultants in 2018.

The common shares of PHX Energy trade on the Toronto Stock Exchange under the symbol PHX.

Financial Highlights

(Stated in thousands of dollars except per share amounts, percentages and shares outstanding)

	Three-month periods ended December 31,			Years ended December 31,		
	2018	2017	% Change	**2018**	2017	% Change
Operating Results	***(unaudited)***	*(unaudited)*				
Revenue	**92,335**	60,660	52	**317,135**	241,001	32
Net loss	**(18,355)**	(5,126)	258	**(18,947)**	(23,528)	(19)
Loss per share – diluted	**(0.32)**	(0.09)	256	**(0.33)**	(0.41)	(20)
Adjusted EBITDA (1)	**14,736**	4,684	215	**45,449**	20,103	126
Adjusted EBITDA (1) per share – diluted	**0.25**	0.08	213	**0.77**	0.34	126
Adjusted EBITDA (1) as a percentage of revenue	**16%**	8%		**14%**	8%	
Cash Flow						
Cash flows from operating activities	**(2,541)**	10,135	n.m.	**13,330**	225	n.m.
Funds from operations (1)	**12,803**	2,490	414	**37,178**	15,023	147
Funds from operations per share – diluted (1)	**0.22**	0.04	450	**0.63**	0.26	142
Capital expenditures	**19,196**	8,276	132	**35,027**	25,673	36
Financial Position, December 31,						
Working capital				**60,316**	49,787	21
Long-term debt				**11,821**	14,000	(16)
Shareholders' equity				**168,414**	181,538	(7)
Common shares outstanding				**57,963,720**	58,397,887	(1)

n.m. – not meaningful

(1) Non-GAAP measure that does not have any standardized meaning under IFRS and therefore may not be comparable to similar measures presented by other entities. Refer to non-GAAP measures section that follows the Outlook section of this MD&A.

Non-GAAP Measures

PHX Energy uses throughout this MD&A certain measures to analyze operational and financial performance that do not have standardized meanings prescribed under Canadian generally accepted accounting principles ("GAAP"). These non-GAAP measures include adjusted EBITDA, adjusted EBITDA per share, debt to covenant EBITDA, funds from operations, funds from operations per share and working capital. Management believes that these measures provide supplemental financial information that is useful in the evaluation of the Corporation's operations and are commonly used by other oil and natural gas service companies. Investors should be cautioned, however, that these measures should not be construed as alternatives to measures determined in accordance with GAAP as an indicator of PHX Energy's performance. The Corporation's method of calculating these measures may differ from that of other organizations, and accordingly, such measures may not be comparable. Please refer to the "Non-GAAP Measures" section following the Outlook section of this MD&A for applicable definitions and reconciliations.

Overall Performance

For the year-ended December 31, 2018, the Corporation achieved its highest adjusted EBITDA since 2014. In the 2018-year, PHX Energy realized adjusted EBITDA of $45.4 million (14 percent of revenue), which is more than double the $20.1 million (8 percent of revenue) reported for the 2017-year. The US industry continued its rally coming out of 2017, and PHX Energy capitalized on the US drilling activity's momentum while maintaining strong cost controls across the Corporation. In the three-month period ended December 31, 2018, adjusted EBITDA increased to $14.7 million (16 percent of revenue) from $4.7 million (8 percent of revenue) in the comparable 2017-quarter. The fourth quarter of 2018 is the highest level of adjusted EBITDA achieved since the third quarter of 2014.

For the year ended December 31, 2018, the Corporation's consolidated revenue increased by 32 percent to $317.1 million from $241.0 million in 2017 and consolidated operating days increased 11 percent to 26,140 days from 23,504 days in 2017. This represents the highest consolidated activity level achieved by the Corporation since 2014. For the fourth quarter of 2018, the Corporation generated revenue of $92.3 million as compared to $60.7 million in the 2017-quarter, an increase of 52 percent. Revenue growth in the 2018-year and fourth quarter was primarily driven by increased activity in the US, surcharges generated by premium motors and the increased deployment of the Corporation's high performance technologies, such as the Atlas High Performance motors, Velocity Real-Time systems ("Velocity"), and PowerDrive Orbit Rotary Steerable Systems ("RSS").

The Corporation reported a net loss of $18.9 million for the 2018-year, a 19 percent improvement compared to the $23.5 million of losses reported in the 2017-year. The 2018 net loss includes a pre-tax, equity-settled share-based payment expense of $1.4

million (2017 - $2.6 million), cash-settled share-based payment expense of $4.1 million (2017- $1.3 million), unrecognized deferred tax assets of $17.7 million (2017 - nil), and impairment losses of $4.5 million (2017 - nil).

As at December 31, 2018, PHX Energy had long-term debt of $11.8 million and working capital of $60.3 million.

Capital Spending

For the year ended December 31, 2018, the Corporation increased capital spending to $35.0 million compared to the $25.7 million spent in the 2017-year. Capital expenditures in 2018 were mostly directed towards Atlas High Performance motors, Velocity systems, PowerDrive Orbit RSS, and other machines and equipment. As at December 31, 2018, $8.0 million of equipment was on order and the Corporation expects delivery within the first half of 2019. These commitments include $5.3 million in Atlas High Performance motors, $2.3 million in Velocity systems, and $0.4 million in collars, tubulars, machines and other equipment.

PHX Energy currently anticipates that $15.0 million in capital expenditures will be spent in the 2019-year. The 2019 capital expenditure program is mainly allocated toward the Velocity and Atlas High Performance motor fleets in order to allow PHX Energy to further capitalize on these technologies, which offer significant advantages in key basins across North America.

Normal Course Issuer Bid

During the third quarter of 2018, the Toronto Stock Exchange ("TSX") approved the renewal of PHX Energy's Normal Course Issuer Bid ("NCIB") to purchase for cancellation, from time-to-time, up to a maximum of 2,915,311 common shares, representing 5 percent of the outstanding common shares at the time the NCIB was renewed. The NCIB commenced on August 8, 2018 and will terminate on August 7, 2019. Purchases of common shares are to be made on the open market through the facilities of the TSX and through alternative trading systems. The price which PHX Energy is to pay for any common shares purchased is to be at the prevailing market price on the TSX or alternate trading systems at the time of such purchase. Pursuant to the NCIB, 357,500 common shares were purchased by the Corporation in the second half of 2018 and cancelled.

The Corporation's previous NCIB commenced on June 26, 2017 and terminated on June 25, 2018. Pursuant to the prior NCIB, 125,000 common shares were purchased by the Corporation in the first six months of 2018 and cancelled.

In the 2018-year, the Corporation has purchased and cancelled 482,500 common shares. PHX Energy continues to use the NCIB as an additional tool to enhance total long-term shareholder returns in conjunction with management's disciplined capital allocation strategy.

Key Drivers of the Corporation's Business

PHX Energy considers the following to be the key drivers of its business:

- World demand for natural gas and oil commodities directly affect oil and natural gas prices. These in turn have a direct impact on the Corporation's customers' level of cash flows and their ability to fund capital drilling programs with the use of debt or equity financing, ultimately impacting PHX Energy's activity levels.
- New drilling technologies must be continually developed for the Corporation to further expand and meet the ongoing demands from its customers, oil and natural gas producing companies, for greater operating efficiencies.
- Superior customer service and satisfaction must be delivered and achieved consistently in order to retain business.
- The Corporation must attract, train and retain key personnel in order to ensure future growth.

Key Performance Measures

There are several performance measures that are used by the Corporation to assess its performance relative to its strategies and goals, the most significant of which are:

- Adjusted EBITDA(1) and adjusted EBITDA(1) as a percentage of revenue; and
- gross profit margin.

(1) Non-GAAP measure that does not have any standardized meaning under IFRS and therefore may not be comparable to similar measures presented by other entities. Refer to non-GAAP measures section that follows the Outlook section of this MD&A.

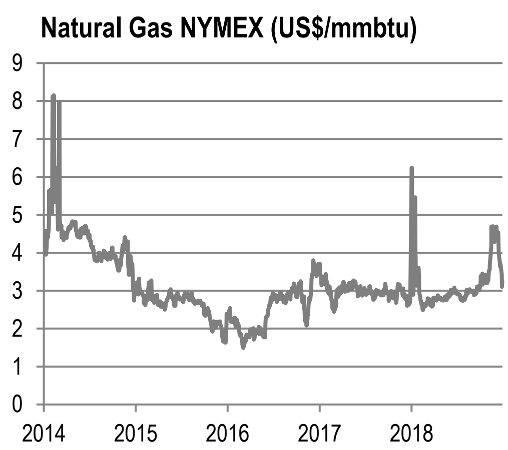
Industry Activity and Statistics

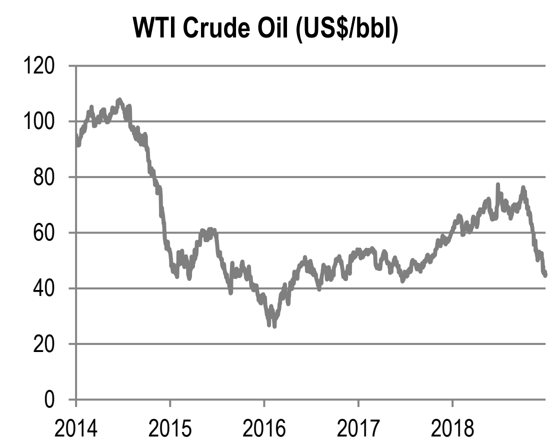
In 2018, the North American industry's modest recovery that started in 2017 continued with strengthening oil prices. However, while the US industry showed signs of improvement year-over-year, the Canadian industry activity was relatively flat primarily due to the take-away challenges in this market.

Commodity Price Trends

The price of crude oil fluctuated between $44 and $77 through 2018, with an average price of approximately $65 for the year (2017 - $52). This is the highest average price since 2014. However, in the fourth quarter, the price of crude oil began to decline and in December dropped to the lowest level of the year, hitting $44. In the first quarter in 2019, crude oil has rebounded slightly, averaging $52 from January 1 to mid-February. (Source: US Energy Information Administration, Cushing, OK WTI Spot Price FOB (Dollars per Barrel), Release Date 1-09-2019).

Natural gas also reached its highest average price since 2014, however, this level remains relatively weak in historical terms. The average price of NYMEX was $3.15 in 2018 (2017 - $2.99). NYMEX was higher in the fourth quarter of the year as compared to the rest of the year, but has experienced a slight decline in the first few months of 2019. (Source: US Energy Information Administration, Cushing, OK WTI Spot Price FOB (Dollars per Barrel), Release Date 01-09-2019).



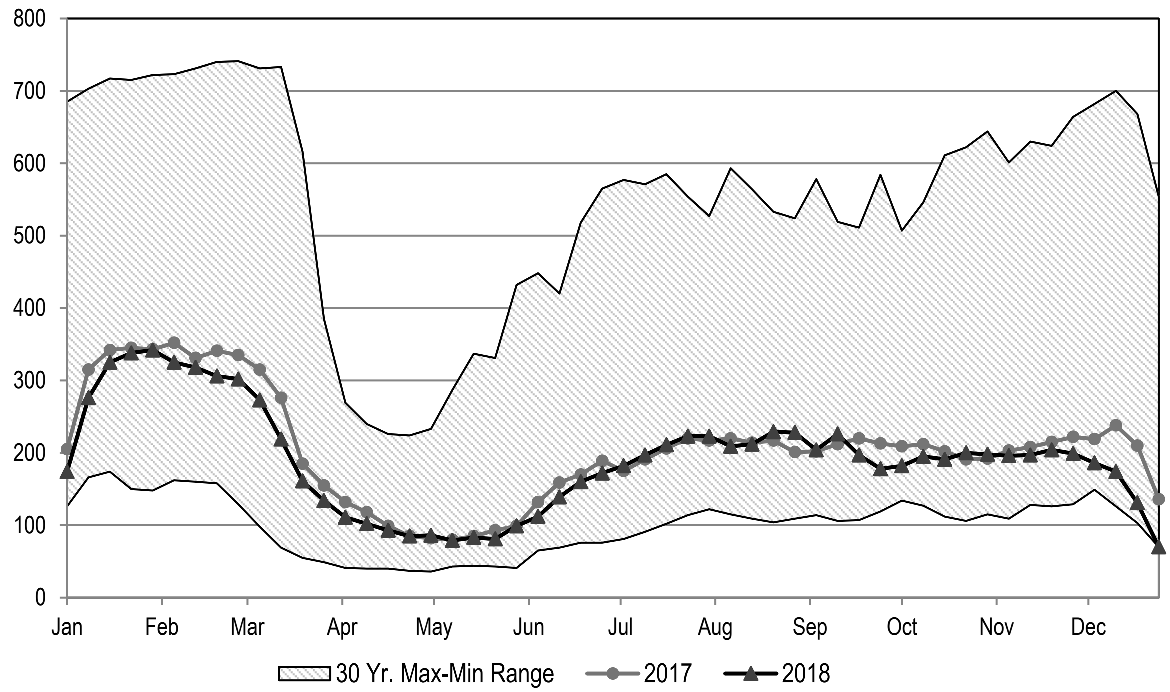


Source: US Energy Information Administration, Henry Hub Natural Gas Spot Price (Dollars per Million Btu), Release Date 1-09-2019
US Energy Information Administration, Cushing, OK WTI Spot Price FOB (Dollars per Barrel), Release Date 1-09-2019

Canadian Industry

WCSB Active Drilling Rig Count

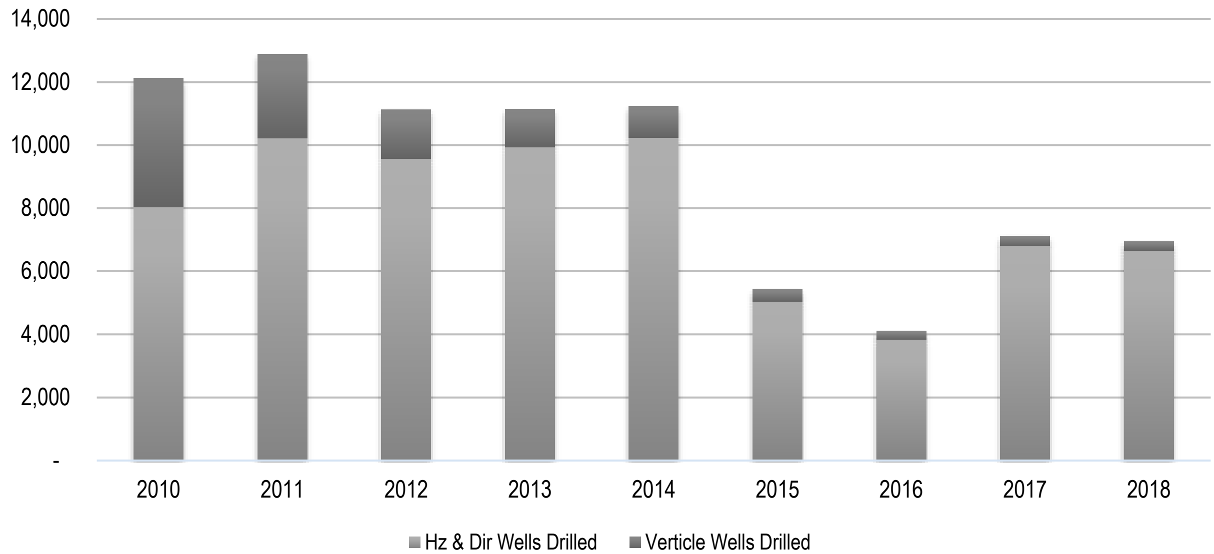
Source: Baker Hughes, North American Rotary Rig Count, 01-04-19



Activity levels in Canada were relatively on par with those achieved in the 2017-year with the exception of December. In 2018, there were 6,946 wells drilled; a slight decline from the 7,122 wells drilled in 2017. Although the activity in the past two years was an improvement over the severely depressed activity in 2016, the lowest point in the downturn, the volumes are still depressed as compared to the 30-year range. Horizontal and directional drilling continues to be the norm in the industry, and combined, horizontal and directional wells represented 96 percent of the total 2018 industry drilling days (2017 – 96 percent). Oil well drilling represented 63 percent of the Canadian industry's average active rig count in 2018 as compared to 53 percent in 2017 (Source: Daily Oil Bulletin, hz-dir days 181231, 01-09-2019 and Baker Hughes, North American Rotary Rig Count, 01-04-19).

Canadian producers' conventional capital spending was also relatively flat year-over-year according to Peters & Co. Limited, and they forecast that 2019 conventional capital spending will decline slightly as a result of the challenges the Canadian industry is facing related to its access to market. The recent announcement of the oil production curtailments by the Government of Alberta has resulted in an improvement to the Canadian differentials that had widened significantly in the fourth quarter of 2018, however, the Canadian market remains volatile with overall weakness in commodity prices, limited access to market and pipeline uncertainty. (Source: Peters & Co. Limited, Oilfield Services Update, 01-09-19).

Wells Drilled by Profile
Source: Daily Oil Bulletin, hz-dir days 181231, 01-09-2019



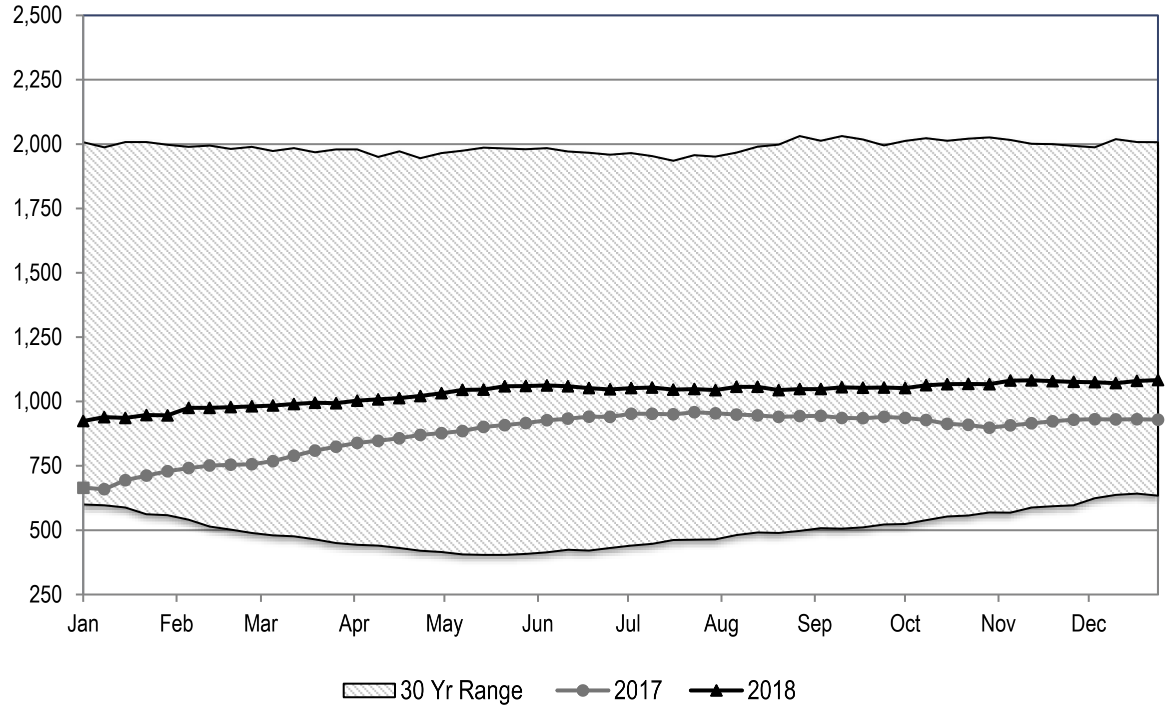
US Industry

In contrast to Canada, the volume of US drilling activity continued its recovery with the average number of active rigs in the year increasing 18 percent. The average rig count in 2018 was 1,032 in 2018, as compared to an average of 876 rigs in 2017 and the 2018 average is double the average of 509 rigs in 2016. The Permian basin continued to be the largest area of activity in the US, representing 45 percent of the average active rigs in 2018 (2017 - 40 percent), and the Permian, Eagle Ford and SCOOP/STACK combined represented approximately 70 percent of the US land rigs operating in 2018. Oil well drilling continued to dominate in the US and has represented approximately 80 percent of the average rig count for the past 3 years. The trend toward horizontal drilling continued to strengthen in 2018, representing 87 percent of active rigs (2017 - 84 percent) (Source: Peters & Co. Limited, Oilfield Services Update, 01-09-19 and Baker Hughes, North American Rotary Rig Count, 01-04-2019).

Capital spending for the most active operators in the US in 2018 is estimated by Peters & Co. Limited to be 28 percent higher than in 2017 (Source: Peters & Co. Limited, Oilfield Services Update, 01-09-19).

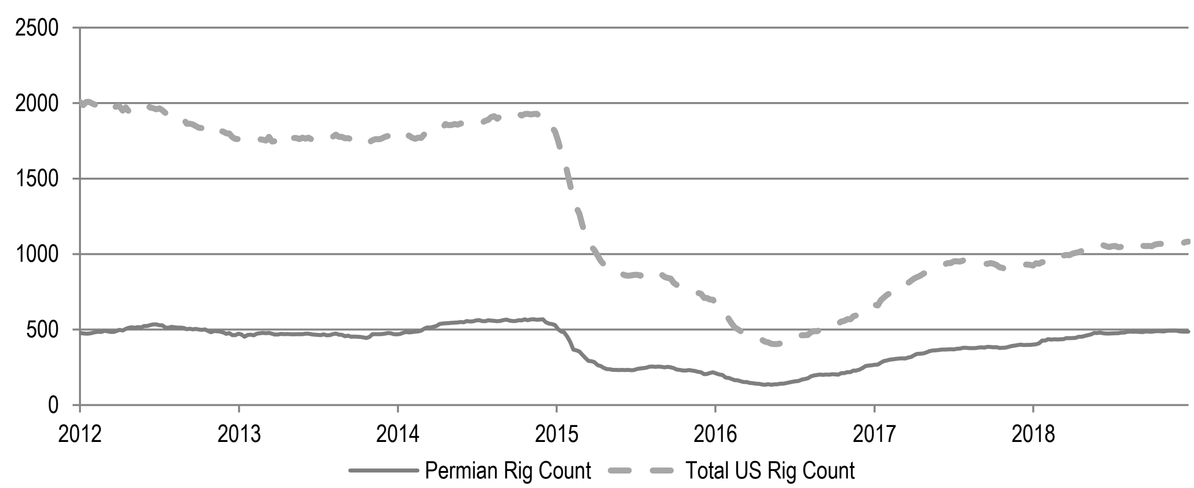
US Active Drilling Rig Count

Source: Baker Hughes, North American Rotary Rig Count, 01-04-19



US Total Rig Count and Permian Basin Rig Count

Source: Baker Hughes, North American Rotary Rig Count, 01-04-2019



Results of Operations

Three-Month Period and Year Ended December 31, 2018

Revenue

(Stated in thousands of dollars)

	Three-month periods ended December 31,			Years ended December 31,		
	2018	2017	% Change	**2018**	2017	% Change
Revenue	**92,335**	60,660	52	**317,135**	241,001	32

Consolidated revenue for the three-month period ended December 31, 2018, was $92.3 million compared to $60.7 million in the 2017-quarter, an increase of 52 percent. In the Canadian and US segments the Corporation realized higher average revenue per day as a result of the premiums and surcharges related to its high performance technologies and increased drilling activity in the fourth quarter of 2018 relative to the 2017-quarter. For the three-month period ended December 31, 2018, the average consolidated revenue per day, excluding the US motor rental and Stream divisions, was $12,929, which is 26 percent higher than the 2017-quarter's average revenue per day of $10,299. Consolidated operating days for the fourth quarter grew 20 percent to 6,920 days in the 2018-quarter as compared to 5,748 days in the 2017-quarter.

In the fourth quarter of 2018, the US and Canadian rig counts were on divergent paths, with the US industry experiencing a 17 percent increase in the average number of rigs operating per day and the Canadian industry experiencing a 12 percent decline in the average number of rigs operating per day quarter-over-quarter. This resulted in a slight gain in the overall North American rig count, with an average of 1,251 rigs running per day in the 2018-quarter (2017 - 1,207 rigs). In Canada there was an average of 179 active rigs per day in the fourth quarter of 2018 (2017 - 204 rigs) and in the US there was an average of 1,073 active rigs per day in the fourth quarter of 2018 (2017 - 921 rigs). The Permian basin remained the most active play in North America with a rig count of 489 active rigs in the fourth quarter of 2018. Horizontal and directional drilling continues to dominate the market representing 95 percent of the Canadian industry's operating days (2017 - 97 percent) and 93 percent of the US rigs running per day (2017 - 93 percent) (Source: Daily Oil Bulletin and Baker Hughes).

PHX Energy's consolidated revenue for the year ended December 31, 2018 increased by 32 percent to $317.1 million from $241.0 million in 2017. US and international revenue, as a percentage of total consolidated revenue were 66 percent (2017 – 57 percent) and 6 percent (2017 – 8 percent), respectively. For the year ended December 31, 2018, the growth in revenue was mainly driven by higher drilling activity and surcharges related to its high performance technologies. Consolidated operating days increased by 11 percent to 26,140 days for the 2018-year compared to 23,504 days in the 2017-year. In addition, the average consolidated revenue per day, excluding the US motor rental and Stream divisions, grew by 18 percent to $11,816 in the 2018-year relative to the revenue per day of $9,981 in the 2017-year. The strengthening of the US dollar year-over-year assisted the improvement in the revenue per day as did the increased deployment of PHX Energy high performance fleet of technologies.

Operating Costs and Expenses

(Stated in thousands of dollars except percentages)

	Three-month periods ended December 31,			Years ended December 31,		
	2018	2017	% Change	**2018**	2017	% Change
Direct costs	**78,454**	58,111	35	**276,250**	235,687	17
Gross profit as a percentage of revenue	**15%**	4%		**13%**	2%	
Depreciation & amortization (included in direct costs)	**10,126**	10,187	(1)	**39,738**	41,621	(5)
Gross profit as percentage of revenue excluding depreciation & amortization	**26%**	21%		**25%**	19%	

Direct costs are comprised of field and shop expenses, and include depreciation and amortization of the Corporation's equipment. For the quarter and year ended December 31, 2018, direct costs increased to $78.5 million and $276.3 million, respectively, from $58.1 million and $235.7 million in the comparable 2017-periods. Higher direct costs in the 2018-periods were primarily due to higher field labour and equipment and motor repair expenses associated with increased activity levels.

For the quarter and year ended December 31, 2018, the gross profit as a percentage of revenue rose to 15 percent and 13 percent, respectively, an improvement over the comparable 2017-periods where gross profit as a percent of revenue was 4 percent and 2 percent, respectively. Excluding depreciation and amortization, gross profit as a percentage of revenue for the quarter and year ended December 31, 2018 improved to 26 percent (2017-quarter – 21 percent) and 25 percent (2017-year – 19 percent), respectively. The continued recovery in the US rig count contributed to increased drilling activity and revenue per day and helped generate stronger profitability in the 2018-periods. In addition, effective cost management executed throughout the year also aided in improving margins.

Lower depreciation and amortization expense for the quarter and year ended December 31, 2018 was primarily the result of assets purchased prior to the industry downturn in 2015 being fully depreciated in the 2017 and 2018 periods.

(Stated in thousands of dollars except percentages)

	Three-month periods ended December 31,			Years ended December 31,		
	2018	2017	% Change	**2018**	2017	% Change
Selling, general and administrative ("SG&A") costs	**10,707**	9,717	10	**41,472**	32,461	28
Equity-settled share-based payments (included in SG&A costs)	**168**	381	(56)	**1,369**	2,600	(47)
Cash-settled share-based payments (recoveries) (included in SG&A costs)	**44**	540	(92)	**4,120**	1,315	n.m.
Onerous contract rent expense (included in SG&A costs)	**(44)**	(165)	(73)	**(314)**	(437)	(28)
SG&A costs excluding share- based payments and onerous expenses as a percentage of revenue	**11%**	15%		**11%**	12%	

n.m. – not meaningful

SG&A costs for the quarter and year ended December 31, 2018 increased to $10.7 million and $41.5 million, respectively, from $9.7 million and $32.5 million in the comparable 2017-periods. These increases were primarily due to greater personnel-related costs resulting from higher activity levels in the 2018-periods. For the quarter and year ended December 31, 2018, excluding impacts of equity and cash-settled share-based payments and the provision for onerous contracts, SG&A costs as a percentage of revenue was 11 percent for both periods in comparison to 15 percent and 12 percent in the comparable 2017-periods. These improved percentages are primarily due to the increased revenues generated by the Corporation.

Equity-settled share-based payments relate to the amortization of the fair values of issued options of the Corporation using the Black-Scholes model. For the three-month period and year ended December 31, 2018, equity-settled share-based payments increased to $0.2 million and $1.4 million, respectively, compared to $0.4 million and $2.6 million in the comparable 2017-periods. The decrease in equity-settled share-based compensation is primarily due to fewer options granted in the 2018-periods relative to prior periods.

Cash-settled share-based retention awards, which are included in SG&A costs, are measured at fair value. For the three-month period ended December 31, 2018, cash-settled share-based payments decreased by 92 percent over the corresponding 2017-quarter. For the year ended December 31, 2018, cash-settled share-based payments were three times higher than in the 2017-year. The fluctuations in cash-settled share-based payment was mainly driven by movements in the Corporation's share price in both periods. In addition, for the year ended December 31, 2018, the number of cash-settled share-based retention awards granted increased compared to the 2017-year, which also contributed to higher cash-settled share-based payments in the 2018-period.

(Stated in thousands of dollars)

	Three-month periods ended December 31,			Years ended December 31,		
	2018	2017	% Change	**2018**	2017	% Change
Research and development expense	**847**	805	5	**3,354**	2,463	36

Research and development ("R&D") expenditures during the quarter and year ended December 31, 2018 were $0.8 million and $3.4 million, respectively, compared to $0.8 million and $2.5 million in the comparable 2017-periods. Higher R&D expenses in the 2018-periods mainly relate to increased personnel costs in the R&D department. PHX Energy continued to develop and expand services by focusing R&D efforts on developing new technology, decreasing costs, and improving reliability of equipment.

(Stated in thousands of dollars)

	Three-month periods ended December 31,			Years ended December 31,		
	2018	2017	% Change	**2018**	2017	% Change
Finance expense	**279**	516	(46)	**1,208**	2,011	(40)

Finance expenses relate to interest charges on the Corporation's long-term and short-term bank facilities. For the quarter and year ended December 31, 2018, the finance expense declined by 46 percent and 40 percent, respectively, relative to the same 2017-periods. The Corporation realized lower interest charges in the 2018-periods mainly due to lower levels of borrowings and lower borrowing rates compared to the 2017-periods.

(Stated in thousands of dollars)

	Three-month periods ended December 31,		Years ended December 31,	
	2018	2017	**2018**	2017
Net gain on disposition of drilling equipment	**(2,168)**	(2,273)	**(8,377)**	(6,061)
Foreign exchange (gain) loss	**503**	(126)	**199**	246
Provision for bad debts	**24**	103	**9**	479
Other income	**(1,641)**	(2,296)	**(8,169)**	(5,336)

For the quarter and year ended December 31, 2018, the Corporation realized other income of $1.6 million (2017 – $2.3 million) and $8.2 million (2017 – $5.3 million), respectively, which was primarily the result of gains on the disposition of drilling equipment. Gains on disposition of drilling equipment typically result from insurance programs undertaken whereby proceeds for the lost equipment are at current replacement values, which are higher than the respective equipment's book value. The recognized gain is net of losses, which typically result from any asset retirements that were made before the end of the equipment's useful life and self-insured downhole equipment losses. Fluctuations to gain on disposition of drilling equipment in the relevant periods are a result of the number of instances where downhole equipment losses occurred.

For the quarter and year ended December 31, 2018, the Corporation incurred a foreign exchange loss of $0.5 million (2017 - gain of $0.1 million) and $0.2 million (2017 - loss of $0.2 million), respectively. Changes in foreign exchange gains and losses result mainly from the settlement and revaluation of US-denominated trade and other payables in Canada.

(Stated in thousands of dollars except percentages)

	Three-month periods ended December 31,		Years ended December 31,	
	2018	2017	**2018**	2017
Provision for (Recovery of) income taxes	**17,546**	(1,066)	**17,469**	(2,757)
Effective tax rates	**n.m.**	(17%)	**n.m.**	10%

n.m. – not meaningful

The provision for income taxes for the three-month period ended December 31, 2018 was $17.5 million as compared to a recovery of income taxes of $1.1 million in the 2017-period. For the year ended December 31, 2018, the provision for income taxes was $17.5 million as compared to a recovery of income taxes of $2.8 million in 2017. The expected combined Canadian federal and provincial tax rate for 2018 is 27 percent. The effective tax rates for the three-month period and year ended December 31, 2018 were higher than the expected rate as a result of unrecognized deferred tax assets of $17.7 million with respect to deductible temporary differences in the Canadian jurisdiction.

(Stated in thousands of dollars except per share amounts and percentages)

	Three-month periods ended December 31,			Years ended December 31,		
	2018	2017	% Change	**2018**	2017	% Change
Net loss	**(18,355)**	(5,126)	258	**(18,947)**	(23,528)	(19)
Loss per share – diluted	**(0.32)**	(0.09)	256	**(0.33)**	(0.41)	(20)
Adjusted EBITDA(1)	**14,736**	4,684	215	**45,449**	20,103	126
Adjusted EBITDA(1) per share – diluted	**0.25**	0.08	213	**0.77**	0.34	126
Adjusted EBITDA(1) as a percentage of revenue	**16%**	8%		**14%**	8%	

(1) Non-GAAP measure that does not have any standardized meaning under IFRS and therefore may not be comparable to similar measures presented by other entities. Refer to non-GAAP measures section that follows the Outlook section of this MD&A.

In the fourth quarter of 2018, the Corporation derecognized deferred tax assets of $17.7 million due to a recent history of tax losses in the Corporation's entities under Canadian jurisdiction. Excluding the impact of the derecognized deferred tax assets, PHX Energy's net losses were significantly reduced as a result of improved drilling activity, higher average revenue per day, and the increased deployment of PHX Energy's high performance technology. Adjusted EBITDA as a percentage of revenue for the three-month period and year ended December 31, 2018 was 16 percent and 14 percent, respectively, compared to 8 percent recognized in both of the comparable 2017-periods.

Segmented Information

The Corporation reports three operating segments on a geographical basis throughout the Canadian provinces of Alberta, Saskatchewan, British Columbia, and Manitoba; throughout the Gulf Coast, Northeast and Rocky Mountain regions of the US; and internationally, mainly in Russia and Albania.

Canada

(Stated in thousands of dollars)

	Three-month periods ended December 31,			Years ended December 31,		
	2018	2017	% Change	**2018**	2017	% Change
Revenue	**24,302**	19,782	23	**90,610**	84,405	7
Reportable segment profit (loss) before tax	**3,982**	680	486	**2,513**	(5,162)	n.m.

n.m. - not meaningful

For the three-month period ended December 31, 2018, PHX Energy's Canadian division generated $24.3 million in revenue, an increase of 23 percent compared to $19.8 million in the 2017-quarter. Higher revenue in the 2018-quarter relates primarily to increased activity, which rose by 16 percent to 2,768 days compared to 2,384 days in the same 2017-quarter. In comparison, the number of horizontal and directional drilling days in the industry decreased by 5 percent quarter-over-quarter from 17,077 days in the 2017-quarter to 16,253 days in the 2018-quarter (Source: Daily Oil Bulletin) and the overall rig count in the Canadian industry declined by 12 percent quarter-over-quarter (Source: Baker Hughes). The average revenue per day in the 2018-quarter was $8,452 (2017 - $7,912), an increase of 7 percent over the 2017 fourth quarter that was primarily due to surcharges relating to premium motors. Due to improved revenue per day and volumes, PHX Energy's Canadian operations realized higher reportable segment profit before tax in the 2018-quarter of $4.0 million compared to $0.7 million the fourth quarter of 2017.

During the fourth quarter of 2018, oil drilling, as measured by drilling days, represented approximately 65 percent of PHX Energy's Canadian activity and the Corporation remained active in the Montney, Wilrich, Bakken, Shaunavon, Duvernay, Cardium and Viking areas.

For the year ended December 31, 2018, PHX Energy's Canadian division's revenue increased by 7 percent to $90.6 million in comparison to $84.4 million in the 2017-year. The Canadian segment also realized a reportable segment profit before tax of $2.5 million in the 2018-year while in the 2017-year a reportable segment loss before tax of $5.2 million was recognized. Improved revenues and profitability in the 2018-year primarily resulted from a higher average revenue per day of $8,287 (2017 - $7,395). The average revenue per day in 2018 was positively impacted by additional revenue generated from surcharges for premium motors. The impact of the higher revenue per day was partially offset by a 4 percent decrease in drilling activity as the Canadian segment recorded 10,462 operating days in 2018 compared to 10,882 days in 2017. Similarly, for the year ended

December 31, 2018, there were 66,398 horizontal and directional drilling days realized in the Canadian industry, which is a 2 percent decline as compared to the 67,784 days realized in 2017 (Sources: Daily Oil Bulletin). The overall rig count in the Canadian industry fell 9 percent year-over-year.

Stream Services

Included in the Canadian segment's revenue for the three-month period and year ended December 31, 2018 were Stream revenues of $0.9 million (2017 - $0.9 million) and $3.9 million (2017 - $3.9 million), respectively. For the three-month period and year ended December 31, 2018, activity increased to 1,631 operating days (2017 - 1,247 operating days) and 5,985 operating days, (2017 - 5,178 operating days). The increase in activity was offset by a decrease in the average revenue per day for the three-month period and year ended December 31, 2018 to $556 and $654, respectively, from $741 and $761 in the comparable 2017-periods. The increase in operating days and decrease in the average revenue per day in both the 2018-periods was primarily due to a higher share of lower rate services being provided.

For the three-month period and year ended December 31, 2018, the Stream division's reportable losses before tax was relatively flat at $1.0 million (2017 - $1.4 million) and $4.2 million (2017 - $4.3 million), respectively. Stream's losses include depreciation expense for the three-month period and year ended December 31, 2018, of $0.6 million and $2.3 million, respectively.

United States

(Stated in thousands of dollars)

	Three-month periods ended December 31,			Years ended December 31,		
	2018	2017	% Change	**2018**	2017	% Change
Revenue	**64,270**	36,264	77	**208,112**	137,625	51
Reportable segment income (loss) before tax	**1,854**	(5,460)	n.m.	**4,791**	(14,928)	n.m.

n.m. - not meaningful

The US segment maintained strong activity levels throughout the year, and achieved the second highest fourth quarter and annual US revenues in the Corporation's history, with the highest being achieved in the comparable 2014-periods. Revenue for the three-month period ended December 31, 2018 increased 77 percent to $64.3 million as compared to $36.3 million in the 2017-quarter. Higher revenue in the quarter was mainly due to improved drilling activity and revenue per day, which was buoyed by premium equipment offerings to clients, specifically Velocity, PowerDrive Orbit RSS, and Atlas High Performance motors. In the 2018-quarter, operating days improved by 37 percent to 3,765 days as compared to 2,744 days in the corresponding 2017-quarter. In comparison, industry activity grew 17 percent with the number of horizontal and directional rigs running per day climbing to 1,003 in the fourth quarter of 2018 from 858 rigs in the comparative 2017-quarter (Source: Baker Hughes). In the 2018-quarter, the average revenue per day, excluding the Corporation's US motor rental division, rose to

$16,508, an increase of 27 percent compared to $13,022 in the relative 2017-quarter. The average revenue per day increased partially due to the strengthening in the US dollar. US denominated average revenue per day, excluding the Corporation's motor rental division, increased by 22 percent quarter-over-quarter.

In the fourth quarter of 2018, horizontal and directional drilling continued to represent a large majority of the industry rig count, averaging 93 percent of the rigs running on a daily basis. Oil well drilling, as measured by wells drilled and excluding the motor rental and gyro surveying divisions, increased to 98 percent of PHX Energy's US activity in the 2018-quarter, as a large portion of the industry's drilling activity remained concentrated in Texas, specifically the Permian basin. During the fourth quarter of 2018, Phoenix USA remained active in the Permian, Mississippian/Woodford, Marcellus, Utica, Niobrara and Bakken basins.

For the year ended December 31, 2018, US revenue grew 51 percent from $137.6 million in 2017 to $208.1 million. Coming out of 2017, PHX Energy's US segment's strong performance continued and the division generated improvements in drilling activity and revenue per day in comparison to the 2017-year. The US segment's annual operating days in 2018 were 13,506 days, compared to 10,106 days in the 2017-year; an increase of 34 percent. In comparison, the US industry activity, as measured by the average number of horizontal and directional rigs running on a daily basis, grew by 20 percent to 969 rigs in 2018 compared from 807 rigs in 2017 (Source: Baker Hughes). For the year ended December 31, 2018, the average revenue per day, excluding the Corporation's US motor rental division, was $15,074 an increase of 13 percent in comparison to $13,373 in 2017. The average revenue per day increased partially due to the strengthening in the US dollar. US denominated average revenue per day, excluding the Corporation's motor rental division, increased by 12 percent year-over-year.

For the three-month period and year ended December 31, 2018, the US segment realized reportable segment income before tax of $1.9 million and $4.8 million, respectively, compared to the corresponding 2017-periods when the US segment had reportable segment losses before tax of $5.5 million and $14.9 million, respectively. The improved profitability in both 2018-periods was mainly due to higher drilling activity and increased deployment of Velocity systems, Atlas High Performance motors and PowerDrive Orbit RSS.

International

(Stated in thousands of dollars)

	Three-month periods ended December 31,			Years ended December 31,		
	2018	2017	% Change	**2018**	2017	% Change
Revenue	**3,763**	4,614	(18)	**18,413**	18,971	(3)
Reportable segment profit (loss) before tax	**(306)**	(174)	76	**525**	(959)	n.m.

n.m. - not meaningful

For the three-month period and year ended December 31, 2018, primarily due to lower drilling activity in Russia, the Corporation's international segment revenue decreased to $3.7 million and $18.4 million respectively, compared to revenue of $4.6 million and $19.0 million in the comparable 2017-periods. For the three-month period and year ended December 31, 2018, operating days, excluding the measurement while drilling ("MWD") rental activity, were 387 days (2017 – 620 operating days) and 2,172 days (2017 – 2,517 operating days), respectively. The international segment achieved reportable segment profit before tax of $0.5 million for the 2018-year, due to increased activity in Albania and greater MWD rental revenue in Russia, in comparison to reportable segment loss before tax of $1.0 million in the 2017-year. Reportable segment loss before tax was $0.3 million in the 2018-quarter relative to $0.2 million in 2017-quarter.

In the second half of 2018, the Russian division's key customers in the region experienced lower activity. As a result, for the three-month period and year ended December 31, 2018, operating days dropped to 171 days and 1,639 days, respectively, from 620 days and 2,254 days in the same 2017-periods. Lower activity was partially offset by increases to MWD rental services, which is a higher margin business for the division.

PHX Energy's Albania operations had one active rig throughout the first half of 2017, however, operations were suspended in the third quarter of 2017. PHX Energy's Albania operations re-commenced operations in the latter half of the first quarter of 2018 with one rig, a second rig was added to the operation in the latter half of the second quarter, and subsequently a third rig was added in the latter half of the fourth quarter. As a result, operating days significantly increased for the three-month period and year ended December 31, 2018 compared to corresponding 2017-periods. PHX Energy's Albanian operations achieved 216 operating days in the fourth quarter of 2018 and 533 operating days in the year compared to nil and 262 days in the corresponding 2017-periods.

Liquidity

(Stated in thousands of dollars)

	Three-month periods ended December 31,		Years ended December 31,	
	2018	2017	**2018**	2017
Funds from operations(1)	**12,803**	2,490	**37,178**	15,023

	Dec. 31, '18	Dec. 31, '17
Working capital(1)	**60,316**	49,787

(1) Non-GAAP measure that does not have any standardized meaning under IFRS and therefore may not be comparable to similar measures presented by other entities. Refer to non-GAAP measures section that follows the Outlook section of this MD&A.

For the quarter and year ended December 31, 2018, funds from operations were $12.8 million and $37.2 million, respectively, as compared to $2.5 million and $15.0 million in the comparable 2017-periods. The improvement in funds from operations in both 2018-periods was primarily attributed to higher activity levels and average revenue per day that resulted in improved operating margins relative to the same 2017-periods.

As at December 31, 2018, the Corporation had working capital of $60.3 million, an increase of $10.5 million from the $49.8 million reported at December 31, 2017. The increased working capital at December 31, 2018 was mainly due to higher trade and other receivables resulting from higher revenues in the fourth quarter of 2018, compared to the revenues in the fourth quarter of 2017.

Investing Activities

Net cash used in investing activities for the year ended December 31, 2018 was $18.2 million (2017 - $16.4 million). During 2018, the Corporation purchased $35.0 million of drilling and other equipment (2017 - $25.7 million) and received proceeds of $14.6 million from the disposition of drilling equipment, primarily related to involuntary disposal of drilling equipment in well bores (2017 - $11.6 million). The 2018 expenditures included:

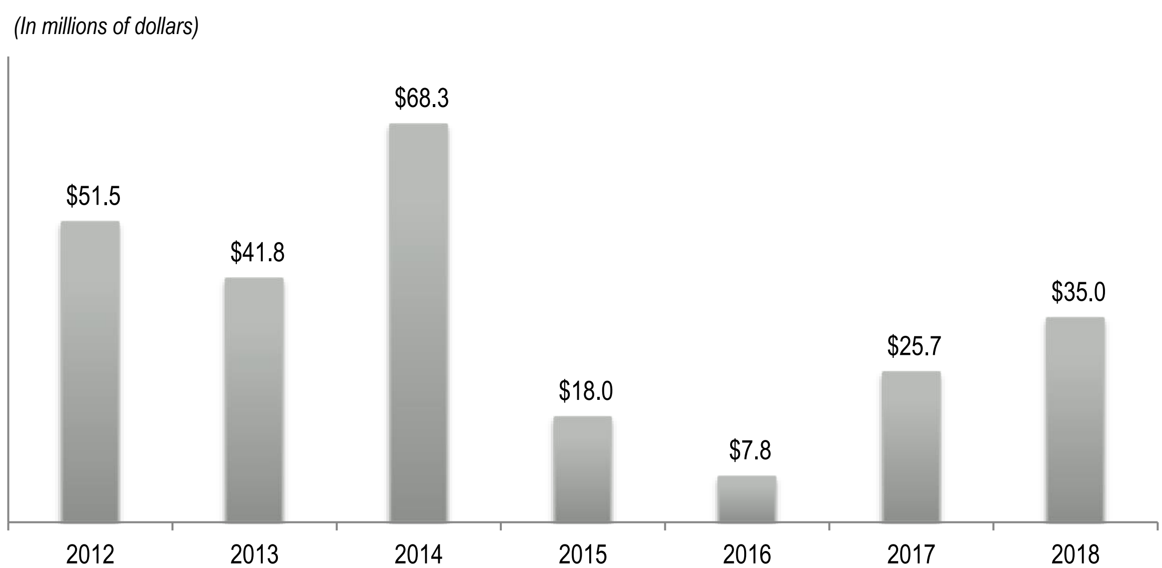
- $17.4 million in downhole performance drilling motors;
- $8.8 million in MWD systems and spare components;
- $6.0 million in RSS tools; and
- $2.8 million in other assets including machinery and equipment, collars, and vehicles.

The capital expenditure program undertaken in the period was financed from funds from operations and drawdowns on credit facilities.

During the year, the Corporation spent $3.1 million on intangible assets of which a majority relates to the PowerDrive Orbit RSS license.

The change in non-cash working capital balances of $5.3 million (source of cash) for the year ended December 31, 2018, relates to the net change in the Corporation's trade payables that are associated with the acquisition of capital assets. This compares to a $0.6 million (source of cash) for the year ended December 31, 2017.

Capital Expenditures



In 2018, the Corporation continued to preserve cash flows, however, with the modest rebound in commodity prices and rig counts, capital spending was increased primarily to expand the Corporation's fleet of performance drilling motors including its Atlas High Performance motor, Velocity systems, and PowerDrive Orbit RSS tools.

Financing Activities

The Corporation reported cash from financing activities of $4.4 million in 2018 as compared to $13.3 million in 2017. In the 2018-year:

- total proceeds of $7.7 million was received on the Corporation's Operating Facility;
- a total repayment of $2.2 million was made on the Corporation's Syndicated Facility;
- under the Corporation's NCIB, $1.2 million was spent on repurchase of common shares; and
- 48,333 common shares were issued for proceeds of $0.1 million upon the exercise of share options.

Capital Resources

As of December 31, 2018, the Corporation had $5.0 million drawn on its Syndicated Facility, $13.3 million drawn on its Canadian Operating Facility and USD $5.0 million drawn on its US Operating Facility.

As at December 31, 2018, the Corporation was in compliance with all its financial covenants as follows:

Ratio	Covenant	**As at December 31, 2018**
Debt to covenant EBITDA[1]	<3.0x	**0.55**
Interest coverage ratio	>3.0x	**37.80**
Net capital expenditures and intangible asset acquisitions	<$30 million	**$23.5 million**

[1] Non-GAAP measure that does not have any standardized meaning under IFRS and therefore may not be comparable to similar measures presented by other entities. Refer to non-GAAP measures section that follows the Outlook section of this MD&A.

The Corporation has approximately CAD$44.7 million available to be drawn from its credit facilities as at December 31, 2018. The credit facilities are secured by substantially all of the Corporation's assets.

Cash Requirements for Capital Expenditures

Historically, the Corporation has financed its capital expenditures and acquisitions through cash flows from operating activities, debt and, from time-to-time, the issuance of equity. The 2019 capital budget has been set at $15.0 million subject to quarterly review of the Board. These planned expenditures are expected to be financed primarily by funds from operations. However, if a sustained period of market and commodity price uncertainty and financial market volatility persists in 2019, the Corporation's activity levels, cash flows and access to credit may be negatively impacted, in which event the proceeds from borrowing may be required to fund operations, and the expenditure level would be reduced accordingly. Conversely, if future growth opportunities present themselves, the Corporation might consider expanding this planned capital expenditure amount.

Off-Balance Sheet Arrangements

The Corporation had no off-balance sheet arrangements as at December 31, 2018 and 2017, other than operating leases.

Proposed Transactions

The Corporation reviews and evaluates any material business or asset acquisitions or capital asset divestitures in the normal course of its operations. In 2019, the Corporation has currently budgeted to spend $15.0 million in capital expenditures.

Critical Accounting Estimates and Judgments

The preparation of the consolidated financial statements in conformity with IFRS requires Management to make estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

Assumptions and estimation uncertainties that have a significant risk of material adjustment within the next financial year include the following:

- estimated useful lives of drilling and other equipment and intangible assets,
- key assumptions used in the valuation of drilling and other equipment, goodwill and intangible assets not yet in use,
- recognition of deferred tax assets based on estimates of the availability of future taxable profit against which carry-forward tax losses can be used,
- key assumptions used in the valuation of inventory,
- valuation of accounts receivable, and
- valuation of equity-settled and cash-settled share-based payments.

Critical judgments in applying accounting policies that have the most significant effect on the amounts recognized in the consolidated financial statements are:

- determination of cash generating units, and
- assessment of whether impairment indicators exist and impairment testing is required.

Future Changes in Accounting Policies

Certain new standards, interpretations, amendments and improvements to existing standards are effective for accounting periods beginning on after January 1, 2019. These standards have not been applied in preparing these consolidated financial statements. Those, which may be relevant to the Corporation, are set out below.

a) IFRS 16 Leases

In January 2016, the International Accounting Standards Board issued the final version of IFRS 16, Leases. IFRS 16 will replace the existing leases Standard, IAS 17 Leases, and related Interpretations. The Standard sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract (i.e., the lessee and the lessor). IFRS 16 introduces a single lessee accounting model and requires a lessee to recognize assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. Currently, operating lease expenses are charged to the statement of comprehensive income (loss). The Standard also contains enhanced disclosure requirements for lessees. IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17.

The effective date for adoption of IFRS 16 is annual periods beginning on or after January 1, 2019, though early adoption is permitted for companies applying IFRS 15 Revenue from Contracts with Clients. The Corporation will adopt IFRS 16 for the annual period beginning on January 1, 2019. The transition to IFRS 16 consists of three key phases: scoping all identified leases, analyzing impact of transition, and implementing changes to policies and internal controls. The Corporation has completed its identification of all outstanding leases as at December 31, 2018. In addition, the Corporation has substantively completed the impact of the transition to IFRS 16, as at January 1, 2019.

In the context of transition to IFRS 16, as of January 1, 2019 the Corporation will recognize right-of-use ("ROU") assets and lease liabilities in the statements of financial position. The Corporation has substantially completed its calculations and is finalizing transition results for the 2019 first quarter report. The Corporation will transition to IFRS

16 in accordance with the modified retrospective approach. Impacts of IFRS 16 prior to January 1, 2019 are not adjusted. As part of the initial application of IFRS 16, the Corporation chose to apply the following transition options and exemptions:

- The modified retrospective approach will be applied. Beginning January 1, 2019, all identified leases are reflected in the statements of financial position as a ROU asset, lease liability, and an adjustment to equity. Subsequent to January 1, 2019, the aforementioned leases will be adjusted through the statements of comprehensive income (loss) as depreciation and amortization, and finance expense.
- The Corporation will rely on previous assessment of whether leases are onerous in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets as an alternative to performing an impairment review.
- Initial direct costs will be excluded from the measurement of ROU assets at the date of initial application.
- When determining the lease term of contracts prior to January 1, 2019 the Corporation will use hindsight.
- Discount rates for a portfolio of leases with reasonably similar characteristics will be the same if the discount rate is not implicit in the lease contract, and applying this standard will not result in any material differences.
- Leases with a term of 12 months or less will be excluded from the IFRS 16 lessee model and will be recognized directly in the statements of comprehensive income (loss) in line with historical treatment.
- Leases of low-value items will be excluded from the IFRS 16 lessee model and recognized in line with historical treatment.

Critical judgements and estimates will be applied in the transition to IFRS 16, such as assessing whether an arrangement contained a lease, determining the lease term, and calculating discount rates on a lease-by-lease basis. These aforementioned estimates have a significant risk of material adjustment within the next financial year.

In January 2019, the Corporation amended its syndicated loan agreement in connection with the effect of IFRS 16. The calculation relating to financial covenants shall be made with regard to generally accepted accounting principles in effect on December 31, 2018, thus negating IFRS 16.

As at December 31, 2018, the Corporation has substantially completed the transition to IFRS 16 and is in the process of finalizing the calculation of discount rates as well as changes in policies and internal controls.

Financial Instruments

Credit Risk

The Corporation is exposed to normal credit risks of its customers that exist within the oil and natural gas exploration and development industry. The Corporation's credit risk associated with these customers can be directly impacted by a decline in economic conditions, which would impair the customers' ability to satisfy their obligations to the Corporation. During the year ended December 31, 2018, one customer comprised 6 percent of the total revenue (2017 - 8 percent of revenue). The customer's revenue is reported within the US operating segment.

As at December 31, 2018, the ageing of trade and other receivables that were not impaired was as follows:

(Stated in thousands of dollars)		**2018**
Neither past due nor impaired	**$**	**49,160**
Past due 1-30 days		**27,023**
Past due 31-60 days		**17,803**
Past due 61-90 days		**4,985**
Past due over 90 days		**5,017**
	$	**103,988**

The Corporation's standard customer payment terms are 30 days after job completion or invoice issuance date, after which, the balance becomes past due. The Corporation will assess for impairment once the receivable becomes past due. All accounts receivable balances that are past due for more than 90 days and were not impaired represent 5 percent or approximately $5.0 million of total receivables on the statement of financial position at December 31, 2018. Management believes that the unimpaired amounts that are past due are still collectible in full, based on historic payment behavior and extensive analysis of customer credit risk. Management has provided an allowance of $0.5 million for all amounts it considers uncollectable at December 31, 2018 (2017 - $0.8 million).

The Corporation has a credit management program to assist in managing this risk, which consists of conducting financial and other assessments to establish and monitor a customer's creditworthiness. The Corporation monitors and manages its credit risk on an ongoing basis.

Liquidity Risk

Liquidity risk is the risk that the Corporation will not be able to meet its financial obligations as they fall due. The Corporation has financial liabilities, thus, is exposed to liquidity risk. The Corporation's approach to managing liquidity risk is to ensure that it always has sufficient cash and credit facilities to meet its obligations when due. Management typically forecasts cash flows for a period of twelve months to identify financing requirements. These requirements are then addressed through a combination of demand credit facilities and access to capital markets. The Corporation believes that future cash flows generated by the operations and access to additional liquidity through capital and banking markets will be adequate to meet its financial obligations.

The following table reflects the Corporation's anticipated payment of contractual obligations related to continuing operations as at December 31, 2018:

(Stated in thousands of dollars)

	2019	2020	2021	2022	2023
Loans and borrowings	13,349	11,821	-	-	-
Drilling and other equipment purchase commitments	7,954	-	-	-	-
Trade and other payables	64,578	-	-	-	-
	85,881	11,821	-	-	-

Fair Values of Financial Instruments

The Corporation has designated its trade and other payables as other financial liabilities carried at amortized cost. Accounts receivable are designated as loans and receivables, measured at amortized cost. The Corporation's carrying values of these items approximate their fair value due to the relatively short periods to maturity of the instruments. Loans and borrowings have been designated as an other financial liability, and are measured at amortized cost. The fair value of loans and borrowings included in the consolidated statement of financial position approximates carrying values as the indebtedness is subject to floating rates of interest.

Interest Rate Risk

Interest rate risk is created by fluctuations in the fair values of financial instruments due to changes in the market interest rates. The Corporation has variable interest long-term debt which exposes it to fluctuations in cash interest payment amounts.

A one percent change in interest rates would have increased or decreased the Corporation's profit by $103,642 for the year ended December 31, 2018.

Foreign Exchange Risk

Foreign exchange risk is created by fluctuations in the fair values of financial instruments due to changes in foreign exchange rates. Due to operations of the Corporation's subsidiaries in the US and Russia, the Corporation has an exposure to foreign currency exchange rates. The carrying values of Canadian dollar, US dollar and Russian ruble ("RUB") denominated monetary assets and liabilities and earnings are subject to foreign exchange risk. For the year ended December 31, 2018, foreign exchange losses of $0.2 million (2017 – $0.2 million) resulted mainly from fluctuations in the USD-CAD exchange rates. The Corporation reviews options with respect to managing its foreign exchange risk periodically.

The following chart represents the Corporation's exposure to foreign currency risk:

As at December 31, 2018	**CAD**	**USD**	**RUB**
Cash and cash equivalents	**-**	**404,362**	**98,377,373**
Trade and other receivables	**-**	**4,919**	**258,474,591**
Trade and other payables	**-**	**(2,425,966)**	**(8,783,015)**
Intercompany receivables	**2,815,843**	**-**	**-**
Intercompany payables	**(6,049,850)**	**-**	**-**
Statement of financial position exposure	**(3,234,007)**	**(2,016,685)**	**348,068,949**

As at December 31, 2017	CAD	USD	RUB
Cash and cash equivalents	-	(22,376)	90,149,327
Trade and other receivables	-	79,230	223,816,391
Trade and other payables	-	(2,245,877)	(216,501)
Intercompany receivables	6,004,858	-	-
Intercompany payables	(8,460,819)	-	-
Statement of financial position exposure	(2,455,961)	(2,189,023)	313,749,217

The following significant exchange rates applied during the year ended December 31:

	Average Rate		December 31, Close Rate	
	2018	2017	**2018**	2017
USD	**1.2961**	1.2980	**1.3642**	1.2545
RUB	**48.4518**	44.9743	**50.9614**	45.9258

A strengthening of the Canadian dollar, US dollar, and Russian ruble against all other currencies as at December 31 would have affected the measurement of financial instruments denominated in a foreign currency and affected profit or loss by the amounts shown below. The analysis assumes that all other variables remain constant.

Gain (Loss)		**2018**		2017
CAD (10% strengthening)	**$**	**(237,063)**	$	(195,772)
USD (10% strengthening)		**(275,116)**		(274,613)
RUB (10% strengthening)		**620,914**		621,060

Business Risk Factors

The Corporation's operations are subject to certain factors that are beyond its control. A significant portion of the Corporation's operating costs are variable in nature and, as a result, the impact of a significant decline in demand for the Corporation's goods and services on its financial results is lessened. Management has identified herein certain key risks and uncertainties associated with PHX Energy's business that could impact financial results. More detailed disclosure of such risk factors are included in the Corporation's, most recently filed AIF under the heading "*Risk Factors*", which is available under the Corporation's profile at www.sedar.com. Such risks include, but are not limited to:

Commodity Price Volatility & Current Industry Environment

While oil prices have increased from the lows of 2016, they remain volatile and North American natural gas prices remain low by historical standards. As a result, there continues to be significant uncertainty and volatility in the oil and gas industry, particularly in Canada where oil and natural gas drilling and completion activity remains relatively low. Low activity levels have resulted in continued price competition for the products and services provided by the Corporation, particularly in Canada. As a service provider to the energy sector, PHX Energy will continue to work with its customers during this challenging time and adjust its strategies and expenditures as required. The full duration and effect of the industry downturn and its impact on the Corporation's activity and results will depend on a variety of factors that are difficult to predict and cash flows may be materially adversely affected.

Capital Requirements

If the Corporation's revenues decline because of continued and sustained weakness in industry activity levels, it may be required to reduce its planned capital expenditures. In addition, continued sector, global and political volatility and resulting uncertain levels of near-term industry activity coupled, exposes the Corporation to additional capital risk. There can be no assurance that debt or equity financing, or cash generated by operations will be available, or sufficient, to meet these capital expenditure requirements or for other corporate purposes, or if debt or equity financing is available, that it will be on terms acceptable to the Corporation. The inability of the Corporation to access sufficient capital for its operations could have a material adverse effect on the Corporation's business, financial condition, results of operations and prospects.

Third Party Credit Risk

The Corporation is exposed credit risks of its customers that exist within the oil and natural gas exploration and development industry. As a result of the challenging oil and natural gas market conditions, particularly in Canada, the Corporation may face heightened counterparty credit risk as a substantial portion of the Corporation's dealings are with entities involved in the oil and gas industry. The Corporation's credit risk associated with its customers can be directly impacted by a sustained decline in economic conditions, which would impair the customer's ability to satisfy their obligations to the Corporation.

Environmental Risks

All phases of the oil and natural gas business present environmental risks and hazards and are subject to environmental regulation pursuant to a variety of federal, provincial and local laws and regulations. Compliance with such legislation can require significant expenditures and a breach may result in the imposition of fines and penalties, some of which may be material. Environmental legislation is evolving in a manner expected to result in stricter standards and enforcement, larger fines and liability, and potentially increased capital expenditures and operating costs. Implementation of strategies for reducing greenhouse gases could have a material impact on the nature of oil and natural gas operations, including those of the Corporation and the Corporation's customers. Given the evolving nature of the debate related to climate change and the control of greenhouse gases and the possible resulting requirements, it is not possible to predict either the nature of those requirements or the impact on the Corporation and its operations and financial condition.

Climate Change and Carbon Pricing Risk

In Canada, the federal and certain provincial governments have implemented legislation aimed at incentivizing the use of alternative fuels and in turn reducing carbon emissions. The taxes placed on carbon emissions could have the effect of decreasing the demand for oil and natural gas products which could have a material impact on the Corporation's customers and thereby adversely effect the Corporation's profitability and financial condition.

Reliance on Key Personnel

The success of the Corporation will be dependent upon key personnel. Losing the services of such persons could have a material adverse effect on the business and operations of the Corporation. The Corporation does not have any key personnel insurance in effect. The contributions of the existing management team and other key personnel to the immediate and near-term operations of the Corporation are likely to be of central importance. There can be no assurance that the Corporation will be able to continue to attract and retain all key personnel necessary for the successful development and operation of its business.

Availability and Cost of Equipment and Development of New Technology

The industry in which the Corporation operates is categorized by rapid and significant technological advancements and introductions of new products and services utilizing new technologies. The ability of the Corporation to compete and expand its business is dependent upon it having access to certain industry-leading drilling equipment and specialized components at a reasonable cost, as well as upon its ability to develop or acquire new competitive technology. The Corporation purchases equipment from various suppliers in the oil and natural gas drilling service industry. There can be no assurance that these sources for equipment will be maintained or available at acceptable cost. If such equipment is not available, and is not available from any other source, the Corporation's ability to compete may be impaired. If the Corporation is unable to continue to offer advanced and industry leading technologies to its customers, or is unsuccessful in implementing certain technologies, its business and results of operations could also be adversely affected.

Competition

The Corporation's major competitors are principally large multinational companies with significantly greater resources available for marketing and R&D programs. The Corporation also competes with a number of other small and medium sized companies. Like the Corporation, these companies have certain competitive advantages, such as low overhead costs and specialized regional strengths. The Corporation's ability to generate revenue depends on its ability to successfully compete, continue to obtain contracts and to perform services within projected times and costs.

Oil and Natural Gas Industry Risk

There are risks associated with the provision of drilling services to the oil and natural gas industry. The Corporation may become liable for risks against which it may choose not to insure due to high premium costs, or which may exceed the limits of policy coverage. Interruptions and delays caused by adverse weather conditions, equipment failures or other events can significantly adversely affect revenue. While the Corporation maintains liability insurance, the insurance is subject to exceptions and coverage limits. There can be no assurance that insurance will continue to be available to the Corporation on commercially reasonable terms, that the possible types of liabilities that may be incurred by the Corporation will be covered by its insurance, or that the dollar amount of such liabilities will not exceed policy limits. Even a partially uninsured claim, if successful and of sufficient magnitude, could have a material adverse effect on business, results of operations and prospects.

Seasonality

In general, the level of activity of the Canadian and certain parts of the US and international oilfield service industry is influenced by seasonable weather patterns. Wet weather and the spring thaw may make the ground unstable. Consequently, municipalities and provincial or state transportation departments enforce road bans that restrict the movement of rigs and other heavy equipment, thereby reducing activity levels. Additionally, certain oil and natural gas producing areas, located where the ground consists of swampy terrain known as muskeg, are inaccessible except during winter months.

Geopolitical Risks

Political events throughout the world that cause disruptions in the supply of oil continuously affect the marketability and price of oil and natural gas. Conflicts, or conversely peaceful developments, arising outside of Canada, including changes in political regimes or the parties in power, have a significant impact on the price of oil and natural gas. Any particular event could result in a material decline in prices, and result in a reduction of the operations of the Corporation's customers and thereby adversely impact the Corporation's profitability and financial condition. In the last several years, the United States and certain European countries have experienced significant political events that have cast uncertainty on global financial and economic markets. Since the 2016 US presidential election, the American administration commenced taking steps to implement certain of its promises made during the campaign. Included in the actions that the administration has discussed, or in some cases implemented, are the renegotiation of the terms of the North American Free Trade Agreement ("NAFTA"), execution of the Canada, US Mexico Agreement to replace NAFTA, withdrawal of the United States from the Trans-Pacific Partnership, imposition of a tax on the importation of goods into the United States, reduction of regulation and taxation in the United States, and introduction of laws to reduce immigration and restrict access into the United States for citizens of certain countries. It is presently unclear exactly what other actions the US administration will implement, and if implemented, how these actions may impact Canada and in particular the oil and gas industry. Any actions taken by the current US administration may have a negative impact on the economy and on the businesses, financial conditions, results of operations and the valuation of Canadian oil and gas companies, including the Corporation.

In addition to the political disruption in the United States, the citizens of the United Kingdom voted to withdraw from the European Union and the Government of the United Kingdom has taken steps to implement such withdrawal. The terms of the United Kingdom's exit from the European Union and whether it will occur at all remains to be determined.

Some European countries have also experienced the rise of anti-establishment political parties and public protests held against open-door immigration policies, trade and globalization. To the extent that certain political actions taken in North America, Europe and elsewhere in the world result in a marked decrease in free trade, access to personnel and freedom of movement it could have an adverse effect on the Corporation's ability to market its products internationally, increase costs for goods and services required for the Corporation's operations, reduce access to skilled labour and negatively impact the Corporation's business, operations, financial conditions and the market value of its common shares.

A change in federal, provincial or municipal governments in Canada may also have an impact on the directions taken by such governments on matters that may impact the oil and natural gas industry in Canada including the balance between economic development and environmental policy.

Foreign Operations

The Corporation will conduct a certain portion of its business in the US, Albania, and Russia. Any change in government policies could have a significant impact on business. Risks of foreign operations include, but are not necessarily limited to changes of laws affecting foreign ownership, government participation, taxation, royalties, duties, rates of exchange, inflation, exchange control, sanctions, and repatriation of earnings. There are no assurances that the economic and political conditions in the countries in which the Corporation operates will continue as they are at the present time. The effect and impact of these factors cannot be accurately predicted.

Changing Investor Sentiment

A number of factors, including the concerns of the effects of the use of fossil fuels on climate change and the impact of oil and natural gas operations on the environment, have affected certain investors sentiments towards investing in the oil and natural gas industry. Any reduction in the investor base interested or willing to invest in the oil and natural gas industry may result in limiting the Corporation's access to capital, increasing the cost of capital and potentially impacting the price and liquidity of the Corporation's common shares even if the Corporation's operating results, underlying asset values or prospects have not been negatively affected.

Information Technology Systems, Cyber-Security and Social Media

The Corporation is subject to a variety of information technology and system risks as part of its normal course operations, including potential breakdown, invasion, virus, cyber-attack, cyber-fraud, security breach and destruction or interruption of the Corporation's information technology systems by third parties or insiders. Any breaches of the Corporation's cyber-security and loss of, or access to, sensitive electronic data may adversely impact the Corporation's operations and financial position. Cyber-phishing, in which a malicious party attempts to obtain sensitive corporate information, in particular has become more widespread and sophisticated in recent years including increasingly through social media as a vehicle to carry out such attacks. While the Corporation takes steps to alleviate such risks, despite its efforts, social media continues to grow in influence and as access to social media platforms becomes increasingly prevalent, the Corporation may not be able to completely alleviate such risks and, in certain circumstances, such risks may be material and could negatively impact the Corporation's business, financial conditions and results of operations.

Corporate Governance

This MD&A has been prepared by the management of PHX Energy and it has been reviewed and approved by the Audit Committee and the Board of the Corporation. Additional information relating to the Corporation’s Corporate Governance can be found in the Corporation’s AIF and in its Information Circular in respect of its annual meeting of Shareholders, each of which are annually filed on SEDAR at www.sedar.com.

Disclosure Controls and Procedures

The Corporation's Chief Executive Officer and Chief Financial Officer have designed, or caused to be designed under their supervision, disclosure controls and procedures. Such officers have evaluated, or caused to be evaluated under their supervision, the effectiveness of the disclosure controls and procedures at the financial year end of the Corporation and have concluded that the Corporation's disclosure controls and procedures are effective, at the financial year end of the Corporation, to provide reasonable assurance that: (i) material information relating to the Corporation is made known to the Corporation's Chief Executive Officer and Chief Financial Officer by others, particularly during the period in which the annual and interim filings are being prepared; and (ii) information required to be disclosed by the Corporation in its annual filings, interim filings or other reports filed or submitted by it under securities legislation is recorded, processed, summarized and reported within the time period specified in securities legislation.

Internal Controls Over Financial Reporting

The Corporation's Chief Executive Officer and Chief Financial Officer have designed, or caused to be designed under their supervision, internal controls over financial reporting related to the Corporation, including its consolidated subsidiaries. Such officers have also evaluated, or caused to be evaluated under their supervision, the effectiveness of the Corporation's internal controls over financial reporting at the financial year end of the Corporation, and have concluded that such internal controls over financial reporting are effective, at the financial year end of the Corporation, to provide reasonable assurance regarding the reliability of the Corporation's financial reporting and preparation of financial statements together with other financial information for external purposes in accordance with IFRS.

In May of 2013, The Committee of Sponsoring Organizations of the Treadway Commission ("COSO") released an updated Internal Control - Integrated Framework ("2013 COSO Framework"). PHX Energy has adopted the 2013 COSO Framework as of January 1, 2014.

The Corporation is required to disclose herein any change in the Corporation's internal controls over financial reporting that occurred during the period beginning on October 1, 2018 and ending on December 31, 2018 that has materially affected, or is reasonably likely to materially affect, the Corporation's internal controls over financial reporting. No material changes in the Corporation's internal controls over financial reporting were identified during such period that has materially affected, or are reasonably likely to materially affect, the Corporation's internal controls over financial reporting.

It should be noted that a control system, including the Corporation's disclosure and internal controls and procedures, no matter how well conceived, can provide only reasonable, but not absolute, assurance that the objectives of the control system will be met and it should not be expected that the disclosure and internal controls and procedures will prevent all errors or fraud.

Outstanding Corporation Share Data

	As at February 27, 2019
Common shares outstanding	57,963,720
Dilutive securities:	
Options	5,291,101
Corporation shares – diluted	63,254,821

Selected Annual Financial Information

The following selected annual financial information was obtained from the audited consolidated financial statements prepared in accordance with IFRS.

(Stated in thousands of dollars except per share amounts)

Years ended December 31,	**2018**	2017	2016
Revenue	**317,135**	241,001	148,401
Net loss	**(18,947)**	(23,528)	(46,517)
Loss per share – basic	**(0.33)**	(0.41)	(1.01)
Loss per share – diluted	**(0.33)**	(0.41)	(1.01)
Dividends paid	**-**	-	416
Dividends per share	**-**	-	0.01
Long-term debt	**11,821**	14,000	29,014
Total assets	**264,180**	246,615	248,494

In 2018, the Corporation's drilling activity and revenue per day increased, which drove improved profitability. Revenue began to recover in 2017 and increased 32 percent in 2018. The Corporation has recorded a net loss the past three years, due to the onset of the industry downturn that resulted in North American drilling activity being at some of the lowest levels in the last 30 years. However in 2018 there was an improvement, and net losses were reduced compared to 2017 by 19 percent. Improvements in net losses were partially offset by an impairment loss of $4.5 million and unrecognized deferred tax assets of $17.7 million in the 2018-year. The Corporation has maintained a disciplined cost approach and focused on areas of growth, such as the US segment and new technology development. With the continued losses, PHX Energy's objective is to maintain the stability of the Corporation's financial position. Cash flows were and will continue to be preserved wherever possible. The Corporation made significant repayments on its operating and syndicated facilities, resulting in a 59 percent reduction in its long-term debt from 2016 to 2018. As at December 31, 2018, PHX Energy's total assets increased to $264.2 million primarily due to higher trade and other receivables reflective of increases to quarterly revenues.

Summary of Quarterly Results

(Stated in thousands of dollars except per share amounts)

	Dec-18	**Sept-18**	**Jun-18**	**Mar-18**	Dec-17	Sept-17	Jun-17	Mar-17
Revenue	**92,335**	**85,033**	**69,009**	**70,759**	60,660	65,396	53,822	61,122
Net earnings (loss)	**(18,355)**	**3,743**	**(84)**	**(4,251)**	(5,126)	(846)	(10,412)	(7,143)
Income (loss) per share – basic	**(0.32)**	**0.06**	**-**	**(0.07)**	(0.09)	(0.01)	(0.18)	(0.13)
Income (loss) per share – diluted	**(0.32)**	**0.06**	**-**	**(0.07)**	(0.09)	(0.01)	(0.18)	(0.13)
Adjusted EBITDA[(1)]	**14,736**	**13,934**	**10,013**	**6,768**	4,684	11,689	(13)	3,743
Funds from operations[(1)]	**12,803**	**11,461**	**7,158**	**5,757**	2,490	8,436	113	3,983

[(1)] Non-GAAP measure that does not have any standardized meaning under IFRS and therefore may not be comparable to similar measures presented by other entities. Refer to non-GAAP measures section that follows the Outlook section of this MD&A.

Activity levels in western Canada vary considerably due to seasonal weather patterns. Traditionally, the first quarter of the calendar year is the most active for service companies due to cold weather. The ability to move heavy equipment in the Canadian oil and natural gas fields is dependent on weather conditions. As warm weather returns in the spring, the winter's frost comes out of the ground rendering many secondary roads incapable of supporting the weight of heavy equipment until they have thoroughly dried out. The duration of this "spring break-up" has a direct impact on the Corporation's activity levels. As a result, late March through May is traditionally the Corporation's slowest time, as such, the operating results of the Corporation vary on a quarterly basis. The Corporation's activity levels in the US and international regions are not impacted to the same extent during this Canadian spring break-up period.

Outlook

The 2018-year produced many positive results for the Corporation including the highest adjusted EBITDA and highest consolidated activity levels since 2014. PHX Energy has been strategically focused on growth in the US market and expanding its product offering to include disruptive high margin technologies. These initiatives fueled the achievements in the 2018-year with the US segment generating strong financial and operational performance and its fleet of high performance technologies contributing to increased revenue and improved profitability.

As expected in the fourth quarter and throughout 2018, the US division remained the largest area of opportunity for the Corporation. PHX Energy is generating operational and financial results in the US that are some of the highest achievements in its history. In the 2018-year, PHX Energy's US growth outpaced the industry and the division increased its market share, which can be partially attributed to the Atlas High Performance motor and Velocity fleet. The division's profitability was also positively impacted by the acquisition of PowerDrive Orbit RSS systems in the fourth quarter of the year. The majority of the Corporation's services and assets were deployed to the US market where the industry remains favorable and PHX Energy will continue this focus in 2019. The US market is subject to the current commodity price volatility and some short-term take away constraints, and this is anticipated to temper industry activity in 2019. PHX Energy remains optimistic that its unique suite of high performance technology will allow its strong performance and momentum in the US to continue through 2019.

In contrast, 2018 was a challenging year for the Canadian industry and as a result also for PHX Energy's Canadian operations. Commodity price volatility, limited access to market and overall uncertainty surrounding the entire energy industry hampered opportunity in this market. PHX Energy remains committed to the Canadian market and its new technologies have aided its ability to maintain its strong position. Looking forward into 2019, activity levels in Canada are forecasted to decline as the challenges the industry faces persist. Through this, PHX Energy will continue to diligently monitor its cost controls and strive to support its clients and the industry by delivering reliable, innovative and cost effective solutions.

PHX Energy's international operations saw a slight decrease in revenue in the fourth quarter as well as in the 2018-year. In Russia, the Corporation was adversely impacted by a key operators' lower activity and the division is focused on diversifying its client base as it continues to target both the MWD rental and full service sides of the business. In Albania, additional rigs were added in the latter part of 2018, which offset declines in Russia. However, the Albania operations are sensitive to the volatility in commodity prices and PHX Energy remains focused on providing exceptional service to our clients.

Technology Update

The Corporation has been strategically focused on setting itself apart as a leader in high performance technology and as a result of its technology initiatives has become one of the top competitors in the North American land based drilling market.

In 2018, the Atlas High Performance motor fleet delivered the expected results, being recognized as a robust and powerful motor and consequently generated additional revenue and higher margins. PHX Energy had a small fleet of these motors in 2018, and has dedicated a large portion of the 2018 and 2019 capital expenditure programs to grow its capacity. With the success of the initial Atlas motor design, PHX Energy is expanding its fleet to include additional configurations for a greater variety of drilling applications. These configurations as well as the additional capacity within the current fleet is anticipated to further aid profitability in the latter part of 2019, as the new assets are expected to arrive in the first half of the year.

During the fourth quarter of 2018, PHX Energy entered into a purchase agreement with Schlumberger to purchase an initial fleet of PowerDrive Orbit RSS systems and an accompanying license to operate this system in the US. There is a high demand for RSS services and this capability adds another high margin technology to PHX Energy's product offering. In the 2018-fourth quarter, RSS services contributed to the higher revenue per day and profitability achieved in the US segment.

The PowerDrive RSS technology adds to the suite of differentiating technology PHX Energy has been developing and, when these technologies are operated in conjunction with each other, provides PHX Energy with a proprietary drilling solution to offer the market. PHX Energy looks to further build upon the platform it has developed with Atlas High Performance motors, Velocity and PowerDrive RSS and has dedicated engineering efforts to additional new technology initiatives.

There were many financial, operational and technological achievements in 2018 for PHX Energy and the Corporation intends to build upon this momentum where possible. That being said, the outlook for the North American industry remains divided and fragile. The fourth quarter saw commodity prices fall, losing the gains achieved in the first part of the year and although they have subtlety recovered, this has led to uncertainty in the industry and 2019 may retract slightly when compared to the 2018-year. PHX Energy has built a strong financial position with a low level of debt and improved margins and it will strive to continue this with its diligent cost management and deployment and development of high performance technologies through the 2019-year.

Michael Buker, President
February 27, 2019

Non-GAAP Measures

Adjusted EBITDA

Adjusted EBITDA, defined as earnings before finance expense, income taxes, depreciation and amortization, impairment losses on intangible assets, equity-settled share-based payments, and unrealized foreign exchange gains or losses, does not have a standardized meaning and is not a financial measure that is recognized under GAAP. However, Management believes that adjusted EBITDA provides supplemental information to net earnings that is useful in evaluating the results of the Corporation's principal business activities before considering certain charges, how it was financed and how it was taxed in various countries. Investors should be cautioned, however, that adjusted EBITDA should not be construed as an alternative measure to net earnings determined in accordance with GAAP. PHX Energy's method of calculating adjusted EBITDA may differ from that of other organizations and, accordingly, its adjusted EBITDA may not be comparable to that of other companies.

The following is a reconciliation of the Corporation's net earnings (loss) to adjusted EBITDA:

(Stated in thousands of dollars)

	Three-month periods ended December 31,		Years ended December 31,	
	2018	2017	**2018**	2017
Net loss	**(18,355)**	(5,126)	**(18,947)**	(23,528)
Add:				
Depreciation and amortization	**10,126**	10,187	**39,738**	41,621
Provision for (Recovery of) income taxes	**17,546**	(1,066)	**17,469**	(2,757)
Finance expense	**279**	516	**1,208**	2,011
Impairment	**4,498**	-	**4,498**	-
Equity-settled share-based payments	**168**	381	**1,369**	2,600
Unrealized foreign exchange (gain) loss	**474**	(208)	**114**	156
Adjusted EBITDA as reported	**14,736**	4,684	**45,449**	20,103

Adjusted EBITDA per share - diluted is calculated using the treasury stock method whereby deemed proceeds on the exercise of the share options are used to reacquire common shares at an average share price. The calculation of adjusted EBITDA per share on a dilutive basis does not include anti-dilutive options.

Funds from Operations

Funds from operations is defined as cash flows from operating activities before changes in non-cash working capital, interest paid, and income taxes paid. This non-GAAP measure does not have a standardized meaning and is not a financial measure recognized under GAAP. Management uses funds from operations as an indication of the Corporation's ability to generate funds from its operations before considering changes in working capital balances and interest and taxes paid. Investors should be cautioned, however, that this financial measure should not be construed as an alternative measure to cash flows from operating activities determined in accordance with GAAP. PHX Energy's method of calculating funds from operations may differ from that of other organizations and, accordingly, it may not be comparable to that of other companies.

The following is a reconciliation of the Corporation's cash flows from operating activities to funds from operations:

(Stated in thousands of dollars)

	Three-month periods ended December 31,		Years ended December 31,	
	2018	2017	**2018**	2017
Cash flows from operating activities	**(2,541)**	10,135	**13,330**	225
Add (deduct):				
Changes in non-cash working capital	**15,454**	(8,401)	**23,388**	17,065
Interest paid	**84**	223	**526**	962
Income taxes paid (received)	**(194)**	533	**(66)**	(3,229)
Funds from operations	**12,803**	2,490	**37,178**	15,023

Funds from operations per share - diluted is calculated using the treasury stock method whereby deemed proceeds on the exercise of the share options are used to reacquire common shares at an average share price. The calculation of funds from operations per share on a dilutive basis does not include anti-dilutive options.

Debt to Covenant EBITDA Ratio

Debt is represented by loans and borrowings. Covenant EBITDA, for purposes of the calculation of this covenant ratio, is represented by net earnings for a rolling four quarter period, adjusted for finance expense, provision for income taxes, depreciation and amortization, equity-settled share-based payments, impairment losses on goodwill and intangible assets, and onerous contracts, subject to the restrictions provided in the Corporation's credit agreement, as it may be amended from time-to-time.

Working Capital

Working capital is defined as the Corporation's current assets less its current liabilities and is used to assess the Corporation's short-term liquidity. This non-GAAP measure does not have a standardized meaning and is not a financial measure recognized under GAAP. Management uses working capital to provide insight as to the Corporation's ability to meet obligations as at the reporting date. PHX Energy's method of calculating working capital may differ from that of other organizations and, accordingly, it may not be comparable to that of other companies.

Definitions

When the Corporation refers to operating days throughout this document, it is referring to the billable days on which PHX Energy is providing services to the client at the rig site. Average operating revenue per day is calculated by dividing revenue by the number of operating days. Average consolidated revenue per day is calculated by dividing consolidated revenue by the consolidated number of operating days.

Independent Auditors' Report

To the Shareholders of PHX Energy Services Corp.

Opinion

We have audited the consolidated financial statements of PHX Energy Services Corp. (the "Company"), which comprise:

- the consolidated statements of financial position as at December 31, 2018 and December 31, 2017;
- the consolidated statements of comprehensive income (loss) for the years then ended;
- the consolidated statements of changes in equity for the years then ended;
- the consolidated statements of cash flows for the years then ended;
- and notes to the consolidated financial statements, including a summary of significant accounting policies.

Hereinafter referred to as the "financial statements".

In our opinion, the accompanying financial statements present fairly, in all material respects, the consolidated financial position of the Company as at December 31, 2018 and December 31, 2017, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards ("IFRS").

Basis for Opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the "*Auditors' Responsibilities for the Audit of the Financial Statements*" section of our auditors' report.

We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in Canada and we have fulfilled our other ethical responsibilities in accordance with these requirements.

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

Other Information

Management is responsible for the other information. Other information comprises:

- the information included in Management's Discussion and Analysis to be filed with the relevant Canadian Securities Commissions.
- the information, other than the financial statements and the auditor's report thereon, included in a document likely to be entitled "2018 Annual Report".

Our opinion on the financial statements does not cover the other information and we do not and will not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

We obtained the Management's Discussion and Analysis to be filed with the relevant Canadian Securities Commissions as at the date of this auditors' report. If, based on the work we have performed on this other information, we conclude that there is a material misstatement of this other information, we are required to report that fact in the auditors' report. We have nothing to report in this regard.

Information, other than the financial statements and the auditors' report thereon, included in a document likely to be entitled "2018 Annual Report" is expected to be made available to us after the date of this auditors' report. If, based on the work we will perform on this other information, we conclude that there is a material misstatement of this other information, we are required to report that fact to those charged with governance.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with IFRS, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit.

We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion.
- The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements

or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Company to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represents the underlying transactions and events in a manner that achieves fair presentation.
- Communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.
- Provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

The engagement partner on the audit resulting in this auditors' report is Lee Bardwell.

KPMG LLP

Chartered Professional Accountants
Calgary, Canada
February 27, 2019

Consolidated Statements of Financial Position

		December 31, 2018		December 31, 2017
ASSETS				
Current assets:				
Cash and cash equivalents	$	**3,643,418**	$	4,122,539
Trade and other receivables (Note 18a)		**103,987,716**		66,635,311
Inventories (Note 5)		**27,558,003**		22,009,483
Prepaid expenses		**2,428,221**		2,915,878
Current tax assets		**625,964**		1,353,622
Total current assets		**138,243,322**		97,036,833
Non-current assets:				
Drilling and other long-term assets (Note 6)		**94,164,880**		98,569,594
Intangible assets (Note 8)		**22,301,680**		26,925,046
Goodwill (Note 7)		**8,876,351**		8,876,351
Deferred tax assets (Note 10)		**594,049**		15,206,884
Total non-current assets		**125,936,960**		149,577,875
Total assets	$	**264,180,282**	$	246,614,708
LIABILITIES AND SHAREHOLDERS' EQUITY				
Current liabilities:				
Operating facility (Note 9)	$	**13,348,562**	$	5,620,464
Trade and other payables		**64,578,428**		41,629,783
Total current liabilities		**77,926,990**		47,250,247
Non-current liabilities:				
Loans and borrowings (Note 9)		**11,821,000**		14,000,000
Deferred tax liability (Note 10)		**2,886,606**		378,170
Provision for onerous contracts		**1,832,000**		2,015,000
Deferred income		**1,300,007**		1,433,339
Total non-current liabilities		**17,839,613**		17,826,509
Equity:				
Share capital (Note 11a)		**265,760,391**		266,838,036
Contributed surplus		**10,631,982**		9,315,926
Retained earnings		**(125,385,208)**		(106,438,399)
Accumulated other comprehensive income		**17,406,514**		11,822,389
Total equity		**168,413,679**		181,537,952
Total liabilities and equity	$	**264,180,282**	$	246,614,708

See accompanying notes to consolidated financial statements.

Consolidated Statements of Comprehensive Income (Loss)

Years ended December 31,	2018	2017
Revenue (Note 16)	$ 317,135,411	$ 241,000,892
Direct costs (Note 13)	276,249,509	235,687,393
Gross profit	40,885,902	5,313,499
Expenses:		
Selling, general and administrative expenses (Note 13)	41,471,955	32,460,524
Research and development expenses (Note 13)	3,353,746	2,463,114
Finance expense	1,208,344	2,010,678
Impairment loss on intangible assets (Note 8)	4,498,066	-
Other income (Note 14)	(8,168,677)	(5,336,197)
	42,363,434	31,598,119
Loss before income taxes	(1,477,532)	(26,284,620)
Provision for (Recovery of) income taxes (Note 15)		
Current	177,826	411,765
Deferred	17,291,451	(3,168,411)
	17,469,277	(2,756,646)
Net loss	(18,946,809)	(23,527,974)
Other comprehensive income (loss)		
Foreign currency translation	5,584,125	(5,118,782)
Total comprehensive loss for the period	$ (13,362,684)	$ (28,646,756)
Loss per share – basic (Note 11c)	$ (0.33)	$ (0.41)
Loss per share – diluted (Note 11c)	$ (0.33)	$ (0.41)

See accompanying notes to consolidated financial statements.

Consolidated Statements of Changes in Equity

Year Ended December 31, 2018	**Share Capital Number**		**Share Capital Amount ($)**		**Contributed Surplus**		**Accumulated Other Comprehensive Income**		**Retained Earnings**		**Total Equity**
Balance, December 31, 2017	**58,397,887**	**$**	**266,838,036**	**$**	**9,315,926**	**$**	**11,822,389**	**$**	**(106,438,399)**	**$**	**181,537,952**
Issuance of share capital (Note 11a)	**48,333**		**76,916**		**-**		**-**		**-**		**76,916**
Common shares repurchased (Note 11a)	**(482,500)**		**(1,207,324)**		**-**		**-**		**-**		**(1,207,324)**
Share-based payments	**-**		**-**		**1,368,819**		**-**		**-**		**1,368,819**
Fair value of options exercised	**-**		**52,763**		**(52,763)**		**-**		**-**		**-**
Net loss	**-**		**-**		**-**		**-**		**(18,946,809)**		**(18,946,809)**
Foreign currency translation	**-**		**-**		**-**		**5,584,125**		**-**		**5,584,125**
Balance, December 31, 2018	**57,963,720**	**$**	**265,760,391**	**$**	**10,631,982**	**$**	**17,406,514**	**$**	**(125,385,208)**	**$**	**168,413,679**

Year Ended December 31, 2017	Share Capital Number		Share Capital Amount ($)		Contributed Surplus		Accumulated Other Comprehensive Income		Retained Earnings		Total Equity
Balance, December 31, 2016	50,810,721	$	237,539,242	$	6,817,458	$	16,941,171	$	(82,910,425)	$	178,387,446
Issuance of share capital (Note 11a)	7,779,166		29,623,708		-		-		-		29,623,708
Common shares repurchased (Note 11a)	(192,000)		(426,461)		-		-		-		(426,461)
Share-based payments	-		-		2,600,015		-		-		2,600,015
Fair value of options exercised	-		101,547		(101,547)		-		-		-
Net loss	-		-		-		-		(23,527,974)		(23,527,974)
Foreign currency translation	-		-		-		(5,118,782)		-		(5,118,782)
Balance, December 31, 2017	58,397,887	$	266,838,036	$	9,315,926	$	11,822,389	$	(106,438,399)	$	181,537,952

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

Years ended December 31,		2018		2017
Cash flows from operating activities:				
Net loss	$	(18,946,809)	$	(23,527,974)
Adjustments for:				
Depreciation and amortization (Note 13)		39,738,406		41,620,740
Provision for (Recovery of) income taxes (Note 15)		17,469,277		(2,756,646)
Intangible asset impairment loss (Note 8)		4,498,066		-
Unrealized foreign exchange loss		114,325		155,832
Gain on disposition of drilling equipment (Note 14)		(8,376,711)		(6,061,340)
Equity-settled share-based payments (Note 12a)		1,368,819		2,600,015
Finance expense		1,208,344		2,010,678
Provision for bad debts (Note 14)		9,458		478,707
Provisions for inventory (Note 5,13)		542,941		1,072,851
Provision for onerous contracts (Note 13)		(314,000)		(437,000)
Amortization of deferred income		(133,332)		(133,332)
Interest paid		(525,741)		(962,240)
Income taxes recovered		65,611		3,229,839
Change in non-cash working capital (Note 17)		(23,388,445)		(17,065,226)
Net cash from operating activities		13,330,209		224,904
Cash flows from investing activities:				
Proceeds on disposition of drilling equipment		14,583,922		11,575,430
Acquisition of drilling and other equipment (Note 6)		(35,027,380)		(25,673,004)
Acquisition of intangible assets (Note 8)		(3,052,146)		(2,916,211)
Change in non-cash working capital (Note 17)		5,267,584		601,139
Net cash used in investing activities		(18,228,020)		(16,412,646)
Cash flows from financing activities:				
Proceeds from (Repayment of) operating facility		7,728,098		(411,083)
Repayment of loans and borrowings		(2,179,000)		(15,014,050)
Repurchase of common shares under the NCIB (Note 11a)		(1,207,324)		(426,461)
Proceeds from issuance of share capital (Note 11a)		76,916		29,154,582
Net cash from financing activities		4,418,690		13,302,988
Net decrease in cash and cash equivalents		(479,121)		(2,884,754)
Cash and cash equivalents, beginning of year		4,122,539		7,007,293
Cash and cash equivalents, end of year	$	3,643,418	$	4,122,539

See accompanying notes to consolidated financial statements.

Notes to the Consolidated Financial Statements

For the years ended December 31, 2018 and 2017

In Canadian dollars

1. Reporting Entity

PHX Energy is a publicly-traded Corporation listed on the Toronto Stock Exchange ("TSX") under the symbol "PHX". The Corporation's registered office is at Suite 1400, 250 - 2nd Street SW Calgary, Alberta Canada.

The Corporation, through its subsidiaries, provides horizontal and directional drilling services, as well as web-based remote electronic drilling recorder ("EDR") technology and services, to oil and natural gas exploration and development companies in Canada, United States, Russia, and Albania. The Corporation also develops and manufactures technologies that are made available for internal operational use.

The consolidated financial statements include the accounts of the Corporation and its wholly owned subsidiaries.

2. Basis of Preparation

a) Statement of Compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). Details of the Corporation's accounting policies, including changes during the year, are included in Note 3.

The consolidated financial statements were authorized for issue by the Board of Directors (the "Board") on February 27, 2019.

b) Basis of Measurement

The consolidated financial statements have been prepared on a going concern basis using the historical cost basis except for liabilities for cash-settled share-based payment arrangements, which are measured at fair value and included in trade and other payables in the statement of financial position.

c) Functional and Presentation Currency

These consolidated financial statements are presented in Canadian dollars ("CAD"), which is the Corporation's functional currency.

d) Use of Estimates

The preparation of the consolidated financial statements in conformity with IFRS requires Management to make estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

Assumptions and estimation uncertainties that have a significant risk of material adjustment within the next financial year include the following:

- estimated useful lives of drilling and other equipment and intangible assets,
- key assumptions used in the valuation of drilling and other equipment, goodwill and intangible assets not yet in use,
- recognition of deferred tax assets based on estimates of the availability of future taxable profit against which carry-forward tax losses can be used,
- key assumptions used in the valuation of inventory,
- valuation of accounts receivable, and
- valuation of equity-settled and cash-settled share-based payments.

e) Critical Judgments

Critical judgments in applying accounting policies that have the most significant effect on the amounts recognized in the consolidated financial statements are:

- determination of cash generating units, and
- assessment of whether impairment indicators exist and impairment testing is required.

3. Significant Accounting Policies

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements.

a) Basis of Consolidation

i. Business Combinations

Business acquisitions are accounted for using the acquisition method when control is transferred to the Corporation. The consideration transferred in the acquisition is generally measured at fair value, as are the identifiable net assets acquired. Any goodwill that arises is tested annually for impairment. Any gain on a bargain purchase is recognized in profit or loss immediately. Transaction costs are expensed as incurred, except if related to the issue of debt or equity securities.

The consideration transferred does not include amounts related to the settlement of pre-existing relationships. In a business combination achieved in stages, the acquirer re-measures its previously held equity interest in the acquiree at its acquisition-date fair value and recognizes the resulting gain or loss, if any, in profit or loss.

Any contingent consideration payable is measured at fair value at the acquisition date. If the contingent consideration is classified as equity, then it is not re-measured and settlement is accounted for within equity. Otherwise, subsequent changes in the fair value of the contingent consideration are recognized in profit or loss.

ii. Subsidiaries

Subsidiaries are entities controlled by the Corporation. The Corporation controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

iii. Loss of Control

When the Corporation loses control over a subsidiary it derecognizes the assets and liabilities of the subsidiary, and any other related components of equity. Any resulting gain or loss is recognized in profit or loss. Any interest retained in the former subsidiary is measured at fair value when control is lost.

iv. Transactions Eliminated on Consolidation

Intra-group balances and transactions, and any unrealized income and expenses arising from intra-group transactions, are eliminated. Unrealized gains arising from transactions with equity-accounted investees are eliminated against the investment to the extent of the Corporation's interest in the investee. Unrealized losses are eliminated in the same way as unrealized gains, but only to the extent that there is no evidence of impairment.

v. Foreign Currency Transactions

Transactions in foreign currencies are translated to the respective functional currencies of the Corporation's entities at exchange rates at the dates of the transactions. The methods used to account for assets and liabilities relating to foreign currency transactions entered into by the Corporation's entities, and to measure the foreign exchange risk arising on such transactions, depend upon whether the asset or liability in question is classified as a monetary or non-monetary item.

Receivables, liabilities and other monetary assets denominated in foreign currencies at the reporting date are translated at the functional currency spot exchange rate at the statement of financial position date. Exchange differences that arise between the rate at the transaction date and the one in effect at the payment date or the rate at the statement of financial position date are recognized in the statement of comprehensive income as other income or expense.

Drilling and other equipment, inventories and other non-monetary items purchased in foreign currencies and that are measured on the basis of historical cost are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value is determined.

vi. Foreign Operations

When entities, which prepare their financial statements in a functional currency other than Canadian dollars, are recognized in the consolidated financial statements, the income and expenses are translated at the monthly average exchange rates. The assets and liabilities of foreign operations are translated to Canadian dollars at the rate of exchange prevailing at the statement of financial position date.

Foreign currency differences are recognized in other comprehensive income in the accumulated other comprehensive income account. The exchange differences arising on the translation to the Corporation's presentation currency are recognized directly in the cumulative translation reserve as a separate component of equity. When a foreign operation is disposed of in its entirety or partially such that control, significant influence or joint control is lost, the cumulative amount in the translation reserve related to that foreign operation is reclassified to profit or loss as part of the gain or loss on disposal.

When the settlement of a monetary item receivable from or payable to a foreign operation is neither planned nor likely in the foreseeable future, foreign exchange gains and losses arising from such a monetary item are considered to form part of a net investment in a foreign operation and are recognized in other comprehensive income, and are presented within equity in accumulated other comprehensive income.

b) Financial Instruments

i. Non-Derivative Financial Instruments

The Corporation initially recognizes trade and other receivables on the date that they originate. All other financial assets (including assets designated at fair value through profit or loss) are recognized initially on the trade date at which the Corporation becomes a party to the contractual provisions of the instrument.

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when the Corporation has a legal right to offset the amounts and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

During the year, the Corporation had the following non-derivative financial assets: financial assets at fair value through profit or loss and trade and other receivables.

Cash and cash equivalents

Cash and cash equivalents are comprised of cash balances and deposits with original maturities of three-months or less.

Trade and other receivables

Trade and other receivables are financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, loans and receivables are measured at amortized cost using the effective interest method less any impairment losses. Loans and receivables are comprised of trade and other receivables.

Other financial liabilities

The Corporation initially recognizes debt securities issued and subordinated liabilities on the date that they are originated. All other financial liabilities are recognized initially on the trade date at which the Corporation becomes a party to the contractual provisions of the instrument.

The Corporation derecognizes a financial liability when its contractual obligations are discharged, cancelled or expire.

The Corporation has the following non-derivative financial liabilities: loans and borrowings, operating facility, and trade and other payables.

Such financial liabilities are recognized initially at fair value net of any directly attributable transaction costs. Subsequent to initial recognition, these financial liabilities are measured at amortized cost using the effective interest method.

ii. Share Capital

Common shares

Common shares are classified as equity. Incremental costs directly attributable to the issue of ordinary shares and share options are recognized as a deduction from equity, net of any tax effects.

Repurchase and reissue of common shares (treasury shares)

When shares recognized as equity are repurchased, the amount of the consideration paid, which includes directly attributable costs, net of any tax effects, is recognized as a deduction from equity. Repurchased shares are classified as treasury shares and are presented in the treasury share reserve. When treasury shares are sold or reissued subsequently, the amount received is recognized as an increase in equity and the resulting surplus or deficit on the transaction is presented within contributed surplus.

c) Drilling and Other Equipment

i. Recognition and Measurement

Items of drilling and other equipment are measured at cost less accumulated depreciation and accumulated impairment losses.

Cost is comprised of the acquisition price, costs directly attributable to the acquisition and preparation costs of the asset until the time when it is ready to be put into operation. Where material, borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset (one that takes a substantial period of time to be ready for use) are included in capitalized cost. Borrowing costs have not been material to the cost of assets for any period presented. The cost of self-constructed assets includes the cost of materials and any other costs directly attributable to bringing the assets to a working condition for their intended use. No borrowing costs were capitalized in 2018 and 2017.

Drilling and other equipment also includes parts and raw materials awaiting assembly. These assets are recorded at cost and no depreciation is taken until the asset is completed and available for intended use.

When parts of an item of drilling and other equipment have different useful lives, they are accounted for as separate items (major components) of drilling and other equipment.

Gains and losses on disposal of an item of drilling and other equipment are determined by comparing the proceeds from disposal with the carrying amount of drilling and other equipment, and are recognized net within other income in the Corporation's profit or loss.

ii. Subsequent Costs

The cost of replacing a part of an item of drilling and other equipment is recognized in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Corporation, and its cost can be measured reliably. The carrying amount of the replaced part is derecognized. The costs of the day-to-day servicing of drilling and other equipment (repair and maintenance) are recognized in the Corporation's profit or loss as incurred.

iii. Depreciation

Depreciation expense is recognized in profit or loss on a straight-line basis over the estimated useful lives of drilling and other equipment and is calculated using the depreciable amount, which is the cost of an asset, or other amount substituted for cost, less its residual value.

Significant components of individual assets are assessed, and if a component has a useful life that is different from the remainder of that asset, then that component is depreciated separately.

The estimated useful lives for the current period are as follows:

Directional drilling equipment	3 to 8 years straight-line
EDR equipment	2 to 10 years straight-line
Office and computer equipment	3 to 5 years straight-line
Machinery and equipment	5 years straight-line
Vehicles	5 years straight-line
Building	20 years straight-line

Depreciation methods, useful lives and residual values are reviewed at each financial year-end and adjusted if appropriate.

d) Intangible Assets and Goodwill

i. Goodwill

Goodwill arising on the acquisition of subsidiaries is measured at cost less accumulated impairment losses.

ii. Research and Development Costs

Expenditure on research activities undertaken with the prospect of gaining new scientific or technical knowledge and understanding is recognized in profit or loss as incurred.

Development activities involve a plan or design for the production of new or substantially improved product and process. Development expenditure is capitalized only if development costs can be measured reliably, the product or process is technically and commercially feasible, future economic benefits are probable, and the Corporation intends to and has sufficient resources to complete development and to use or sell the asset. The expenditure capitalized includes the cost of materials, direct labour, overhead costs that are directly attributable to preparing the asset for its intended use, and borrowing costs. Other development expenditures are recognized in profit or loss as incurred.

Capitalized development expenditure is measured at cost less accumulated amortization and accumulated impairment losses.

iii. Other Intangible Assets

Other intangible assets that are acquired by the Corporation and have finite useful lives are measured at cost less accumulated amortization and any accumulated impairment losses.

iv. Subsequent Expenditures

Subsequent expenditures are capitalized only when they increase the future economic benefits embodied in the specific asset to which they relate. All other expenditures, including expenditures on internally generated goodwill, are recognized in profit or loss as incurred.

v. Amortization

Amortization is calculated to write-off the costs of intangible assets less their estimated residual values using the straight-line method over their estimated useful lives, and is generally recognized in profit or loss. Goodwill is not amortized.

The estimated useful lives are as follows:

Licenses	10 to 15 years
Technology	10 years

Amortization methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

e) Inventories

Inventories are measured at the lower of cost and net realizable value. The cost of inventories is based on the first-in first-out method, and includes expenditures incurred in acquiring the inventories, production or conversion costs and other costs incurred in bringing them to their existing location and condition.

Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

f) Impairment

i. Financial Assets (Including Receivables)

A financial asset not carried at fair value through profit or loss is assessed at each reporting date to determine whether there is objective evidence that it is impaired. A financial asset is impaired if objective evidence indicates that a loss event has occurred after the initial recognition of the asset, and that the loss event had a negative effect on the estimated future cash flows of that asset that can be estimated reliably.

The Corporation considers evidence of impairment for receivables at a specific asset level. When determining whether the credit risk of a financial asset has increased significantly since initial recognition and when estimating 'expected credit loss' ("ECL"), the Corporation considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes both quantitative and qualitative information and analysis based on the Corporation's historical experience, informed credit assessment, and forward-looking information. The Corporation has elected to measure loss allowances for trade and other receivables at an amount equal to the ECL over the expected life of a financial instrument.

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. Losses are recognized in profit or loss and are reflected in an allowance account against receivables. Interest on the impaired asset continues to be recognized through the unwinding of the discount. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through profit or loss.

ii. Non-Financial Assets

The carrying amounts of the Corporation's non-financial assets, other than inventories and deferred tax assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. For goodwill and intangible assets that have indefinite useful lives or that are not yet available for use, the recoverable amount is estimated each year at the same time.

The recoverable amount of an asset or cash-generating unit ("CGU") is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets. For the purposes of goodwill impairment testing, goodwill acquired in a business combination is allocated to the group of CGUs that is expected to benefit from the synergies of the combination. This allocation is subject to an operating segment ceiling test and reflects the lowest level at which that goodwill is monitored for internal reporting purposes.

The Corporation's corporate assets do not generate separate cash inflows. If there is an indication that a corporate asset may be impaired, then the recoverable amount is determined for the CGU to which the corporate asset belongs.

An impairment loss is recognized if the carrying amount of an asset or its CGU exceeds its estimated recoverable amount. Impairment losses are recognized in profit or loss. Impairment losses recognized in respect of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the units, and then to reduce the carrying amounts of the other assets in the unit (group of units) on a pro rata basis.

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognized in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

iii. Employee Benefits

Short-term employee benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided.

A liability is recognized for the amount expected to be paid under short-term cash bonus plans if the Corporation has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee, and the obligation can be estimated reliably.

Share-based payment transactions

The grant date fair value of share-based payment awards granted to employees is recognized as an employee expense, with a corresponding increase in equity, over the period that the employees unconditionally become entitled to the awards (vesting period). The amount recognized as an expense is adjusted to reflect the number of awards for which the related service and non-market vesting conditions are expected to be met, such that the amount ultimately recognized as an expense is based on the number of awards that do meet the related service and non-market performance conditions at the vesting date.

The fair value of the amount payable to employees in respect of Retention Awards, which are settled in cash, is recognized as an expense with a corresponding increase in liabilities, over the period that the employees unconditionally become entitled to payment. The liability is re-measured at each reporting date and at settlement date. Any changes in the fair value of the liability are recognized as personnel expense in profit or loss.

g) Provisions

A provision is recognized if, as a result of a past event, the Corporation has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. The unwinding of the discount is recognized as finance cost.

h) Revenue

Revenue is recognized when a client obtains control of the goods or services. Determining the timing of the transfer of control – at a point in time or over time – requires judgement. Revenue is measured based on the consideration specified in the contract with a client and excludes amounts collected on behalf of third parties. The Corporation recognizes revenue when it transfers control over a product or service to a client. The Corporation’s services are sold based upon bid acceptance or contracts with clients that includes fixed or determinable prices based upon daily, hourly, or job rates.

The Corporation has the following services from which it generates revenue:

Services	Nature, timing of satisfaction of performance obligation and payment terms
Drilling Services Revenue	For drilling services, the client is charged a flat day rate for each day the rig requires directional drilling services. The day rate includes personnel assistance as well as use of equipment. The Corporation recognizes revenue daily based on the daily drilling rate. The Corporation's performance obligation is the bundling of its services relating to directional drilling activities, which distinctly benefit the client each day of active drilling. The Corporation recognizes this benefit to revenue daily, over a period of time, as services have been provided. An invoice is sent to the client upon completion of the well, also revenues are accrued based on daily services provided at period end. Clients are expected to pay the Corporation 30 days after the invoice has been received.
EDR Rental Revenue	EDR equipment is attached to the drilling equipment and provides the operator with real-time measurement of drilling activity. The client is charged a flat day rate, which includes personnel assistance as well as use of equipment. The Corporation recognizes revenue daily based on the daily EDR rental rate. The Corporation's performance obligation is the bundling of its services relating to EDR activities, which distinctly benefit the client for each day of activity. The Corporation recognizes this benefit to revenue daily, over a period of time, as services have been provided. An invoice is sent to the client upon completion of the well or service, also revenues are accrued based on daily services provided at period end. Clients are expected to pay the Corporation 30 days after the invoice has been received.

Instances where there are equipment failures or delays, a sales credit will be issued upon review with the client. The Corporation will accrue a sales credit when it is highly probable, and the magnitude of the reversal is significant.

i) Leases

i. Determining Whether an Arrangement Contains a Lease

At inception of an arrangement, the Corporation determines whether the arrangement is or contains a lease.

At inception or on re-assessment of an arrangement that contains a lease, the Corporation separates payments and other consideration required by the arrangement into those for the lease and those for other elements on the basis of their relative fair values. If the Corporation concludes for a finance lease that it is impractical to separate the payments reliably, then an asset and a liability are recognized at an amount equal to the fair value of the underlying asset; subsequently, the liability is reduced as payments are made and an imputed finance cost on the liability is recognized using the Corporation's incremental borrowing rate.

ii. Leased Assets

Assets held by the Corporation under leases that transfer to the Corporation substantially all of the risks and rewards of ownership are classified as finance leases. The leased assets are measured initially at an amount equal to the lower of their fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the assets are accounted for in accordance with the accounting policy applicable to that asset.

Assets held under other leases are classified as operating leases and are not recognized in the Corporation's statement of financial position.

iii. Lease Payments

Payments made under operating leases are recognized in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognized as an integral part of the total lease expense, over the term of the lease.

j) Finance Income and Expense

Finance income comprises of interest income on funds invested. Interest income is recognized as it accrues in the Corporation's profit or loss, using the effective interest method.

Finance expense comprises interest expense on borrowings. Borrowing costs that are not directly attributable to the acquisition, construction or production of a qualifying asset are recognized in the Corporation's profit or loss using the effective interest method.

k) Income Tax

Income tax expense comprises current and deferred tax. Current tax and deferred tax are recognized in profit or loss except to the extent that it relates to a business combination or items recognized directly in equity or in other comprehensive income.

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized for the following temporary differences: the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss, and differences relating to investments in subsidiaries and jointly controlled entities to the extent that it is probable that they will not reverse in the foreseeable future. In addition, deferred tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

A deferred tax asset is recognized for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

The criteria for recognizing deferred tax assets arising from unused tax losses is the same as the criteria arising from temporary differences between the carrying amounts of asset and liabilities for tax purposes. However, the Corporation under the circumstances of having unused tax losses due to a history of recent losses recognizes deferred tax assets to the extent there is convincing other evidence that sufficient taxable income will be available against the unused losses.

Tax exposures

In determining the amount of current and deferred tax, the Corporation takes into account the impact of uncertain tax positions and whether additional taxes and interest may be due. This assessment relies on estimates and assumptions and may involve a series of judgements about future events. New information may become available that causes the Corporation to change its judgement regarding the adequacy of existing tax liabilities; such changes to tax liabilities will impact tax expense in the period that such a determination is made.

l) Earnings per Share

The Corporation presents basic and diluted earnings per share data for its ordinary shares. Basic per share amounts are calculated by dividing the earnings or loss attributable to ordinary shareholders of the Corporation by the weighted-average number of ordinary shares outstanding during the period, adjusted for own shares held. Diluted per share amounts are calculated by adjusting the earnings or loss attributable to ordinary shareholders and the weighted-average number of common shares outstanding, adjusted for own shares held, for the effects of all dilutive potential ordinary shares, which comprise share options granted to employees.

m) Segment Reporting

An operating segment is a component of the Corporation that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the Corporation's other components. All operating segments' operating results are reviewed regularly by the Corporation's Chief Executive Officer ("CEO") to make decisions about resources to be allocated to the segment and assess its performance, and for which discrete financial information is available.

Segment results that are reported to the CEO include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated items comprise mainly of corporate assets (primarily the Corporation's headquarters), head office expenses, and income tax assets and liabilities.

Segment capital expenditure is the total cost incurred during the period to acquire drilling and other equipment, and intangible assets other than goodwill.

4. New Standards and Interpretations Not Yet Adopted

Certain new standards, interpretations, amendments and improvements to existing standards are effective for accounting periods beginning on after January 1, 2019. These standards have not been applied in preparing these consolidated financial statements. Those, which may be relevant to the Corporation, are set out below.

a) IFRS 16 Leases

In January 2016, the International Accounting Standards Board issued the final version of IFRS 16, Leases. IFRS 16 will replace the existing leases Standard, IAS 17 Leases, and related Interpretations. The Standard sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract (i.e., the lessee and the lessor). IFRS 16 introduces a single lessee accounting model and requires a lessee to recognize assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. Currently, operating lease expenses are charged to the statement of comprehensive income (loss). The Standard also contains enhanced disclosure requirements for lessees. IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17.

The effective date for adoption of IFRS 16 is annual periods beginning on or after January 1, 2019, though early adoption is permitted for companies applying IFRS 15 Revenue from Contracts with Clients. The Corporation will adopt IFRS 16 for the annual period beginning on January 1, 2019. The transition to IFRS 16 consists of three key phases: scoping all identified leases, analyzing impact of transition, and implementing changes to policies and internal controls. The Corporation has completed its identification of all outstanding leases as at December 31, 2018. In addition, the Corporation has substantively completed the impact of the transition to IFRS 16, as at January 1, 2019.

In the context of transition to IFRS 16, as of January 1, 2019 the Corporation will recognize right-of-use ("ROU") assets and lease liabilities in the statements of financial position. The Corporation has substantially completed its calculations and is finalizing transition results for the 2019 first quarter report. The Corporation will transition to IFRS 16 in accordance with the modified retrospective approach. Impacts of IFRS 16 prior to January 1, 2019 are not adjusted. As part of the initial application of IFRS 16, the Corporation chose to apply the following transition options and exemptions:

- The modified retrospective approach will be applied. Beginning January 1, 2019, all identified leases are reflected in the statements of financial position as a ROU asset, lease liability, and an adjustment to equity. Subsequent to January 1, 2019, the aforementioned leases will be adjusted through the statements of comprehensive income (loss) as depreciation and amortization, and finance expense.

- The Corporation will rely on previous assessment of whether leases are onerous in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets as an alternative to performing an impairment review.
- Initial direct costs will be excluded from the measurement of ROU assets at the date of initial application.
- When determining the lease term of contracts prior to January 1, 2019 the Corporation will use hindsight.
- Discount rates for a portfolio of leases with reasonably similar characteristics will be the same if the discount rate is not implicit in the lease contract, and applying this standard will not result in any material differences.
- Leases with a term of 12 months or less will be excluded from the IFRS 16 lessee model and will be recognized directly in the statements of comprehensive income (loss) in line with historical treatment.
- Leases of low-value items will be excluded from the IFRS 16 lessee model and recognized in line with historical treatment.

Critical judgements and estimates will be applied in the transition to IFRS 16, such as assessing whether an arrangement contained a lease, determining the lease term, and calculating discount rates on a lease-by-lease basis. These aforementioned estimates have a significant risk of material adjustment within the next financial year.

In January 2019, the Corporation amended its syndicated loan agreement in connection with the effect of IFRS 16. The calculation relating to financial covenants shall be made with regard to generally accepted accounting principles in effect on December 31, 2018, thus negating IFRS 16.

As at December 31, 2018, the Corporation has substantially completed the transition to IFRS 16 and is in the process of finalizing the calculation of discount rates as well as changes in policies and internal controls.

5. Inventories

Inventories are mainly comprised of drilling and other equipment repair parts. In 2018, consumed repair parts, which are included in direct costs, amounted to $33.8 million (2017 - $24.8 million). For the year ended December 31, 2018, the Corporation recognized a provision for obsolete inventory of $0.5 million (2017 - $1.1 million)

6. Drilling and Other Long-Term Assets

(Stated in thousands of dollars)

	Directional Drilling Equipment	EDR Equipment	Machinery and Equipment	Office and Computer Equipment	Development Costs	Vehicles	Building	Land	Total
Cost									
At January 1, 2018	**254,784**	**8,789**	**18,555**	**15,908**	**3,791**	**1,020**	**3,138**	**164**	**306,149**
Additions	**33,052**	**85**	**1,343**	**339**	**-**	**208**	**-**	**-**	**35,027**
Disposals	**(15,422)**	**(46)**	**(1,462)**	**-**	**-**	**(15)**	**-**	**-**	**(16,945)**
Effect of movement in exchange rate	**8,439**	**(140)**	**555**	**517**	**-**	**112**	**275**	**14**	**9,772**
At December 31, 2018	**280,853**	**8,688**	**18,991**	**16,764**	**3,791**	**1,325**	**3,413**	**178**	**334,003**
Accumulated Depreciation									
At January 1, 2018	**173,770**	**4,200**	**13,214**	**11,205**	**3,697**	**542**	**951**	**-**	**207,579**
Depreciation	**30,415**	**1,394**	**2,215**	**2,078**	**44**	**192**	**144**	**-**	**36,482**
Disposals	**(9,490)**	**(40)**	**(885)**	**-**	**-**	**(15)**	**-**	**-**	**(10,430)**
Effect of movement in exchange rate	**5,369**	**(165)**	**402**	**442**	**-**	**68**	**91**	**-**	**6,207**
At December 31, 2018	**200,064**	**5,389**	**14,946**	**13,725**	**3,741**	**787**	**1,186**	**-**	**239,838**
Carrying amount at December 31, 2018	**80,789**	**3,299**	**4,045**	**3,039**	**50**	**538**	**2,227**	**178**	**94,165**

(Stated in thousands of dollars)

	Directional Drilling Equipment	EDR Equipment	Machinery and Equipment	Office and Computer Equipment	Development Costs	Vehicles	Building	Land	Total
Cost									
At January 1, 2017	258,447	6,058	19,517	15,719	3,791	782	3,359	175	307,848
Additions	21,491	2,855	357	613	-	357	-	-	25,673
Disposals	(15,323)	(74)	(581)	-	-	(52)	-	-	(16,030)
Effect of movement in exchange rate	(9,831)	(50)	(738)	(424)	-	(67)	(221)	(11)	(11,342)
At December 31, 2017	254,784	8,789	18,555	15,908	3,791	1,020	3,138	164	306,149
Accumulated Depreciation									
At January 1, 2017	158,468	2,906	11,384	8,929	3,685	435	869	-	186,676
Depreciation	32,457	1,366	2,568	2,574	12	202	144	-	39,323
Disposals	(10,130)	(48)	(286)	-	-	(52)	-	-	(10,516)
Effect of movement in exchange rate	(7,025)	(24)	(452)	(298)	-	(43)	(62)	-	(7,904)
At December 31, 2017	173,770	4,200	13,214	11,205	3,697	542	951	-	207,579
Carrying amount at December 31, 2017	81,014	4,589	5,341	4,703	94	478	2,187	164	98,570

Assets with a carrying amount of $6.5 million (2017 - $5.5 million) were disposed of as a result of tools lost downhole and scrapped assets, resulting in a net gain on disposition of $8.4 million (2017 - $6.1 million), which is included in other income in the consolidated statement of comprehensive income (loss).

a) Capital Commitments

As at December 31, 2018, the Corporation has entered into commitments to purchase drilling and other equipment for $8.0 million (2017 - $5.4 million); delivery is expected to occur within the first half of 2019.

7. Goodwill

Goodwill is not amortized but is tested for impairment at the end of each year, or more frequently if events or changes in circumstances indicate that the asset might be impaired.

For the purpose of impairment testing, goodwill is allocated to the Corporation's CGUs, which represent the lowest levels within the Corporation at which goodwill is monitored for internal management purposes.

As at December 31, 2018, the full carrying amount of goodwill of $8.9 million (2017 - $8.9 million) was allocated to the Canadian CGU. The recoverable amount was based on its value in use determined by discounting expected future cash flows to be generated from the continuing use of the assets within the CGU. The cash flows used in the calculation were discounted using a discount rate, which was estimated using the weighted-average cost of capital formula and adjusted for risks specific to the CGU. The following key assumptions were used in the discounted cash flow projection:

- 2019 forecasted earnings before interest, taxes, depreciation and amortization (EBITDA) is lower compared to 2018 results due to expected oil production cuts taking effect in 2019. Subsequent to 2019, revenues are expected to rebound and grow on average by 16 percent a year due to a forecasted recovery in commodity prices and improved drilling activity.
- Terminal growth rate of 2.5 percent based on Management's estimate, consistent with the assumptions that a market participant would make.
- A discount rate of 12.5 percent that reflects current market assessments of the time value of money and risks specific to the Canadian CGU.

The values assigned to the key assumptions represent Management's assessment of future trends in the service industry and are based on both external sources and internal sources (historical data).

The estimated recoverable amount of the Canadian CGU exceeded its carrying amount by $18.9 million. There was no impairment of goodwill as at December 31, 2018. Management identified that an increase of 3.9 percent to the discount rate or a reduction of 7 percent to average revenue growth subsequent to 2019 could cause the carrying amount of the Canadian CGU to exceed the recoverable amount.

8. Intangible Assets

During the fourth quarter of 2018 the Corporation determined no further economic benefits are expected from the future use or future disposal of the licenses in the EDR division, Stream Services ("Stream"). The carrying amount of $4.5 million relating to licenses was derecognized.

At year-end, the Corporation determined indicators of impairment exist in Stream due to lower than expected oil production in Canada for 2019 and lower profitability compared to budget in 2018. As such, an impairment test was performed in the Stream CGU. The recoverable amount was based on its value in use determined by discounting expected future cash flows to be generated from the continuing use of the assets within the CGU. The cash flows used in the calculation were discounted using a discount rate, which was estimated using the weighted-average cost of capital formula and adjusted for risks specific to the CGU. The following key assumptions were used in the discounted cash flow projection:

- Estimated revenues are expected to increase yearly on average by 20 percent in the five-year business plan, resulting in improved EBITDA margins in line with increased revenue volumes.
- Terminal growth rate of 2.5 percent based on Management's estimate, consistent with the assumptions that a market participant would make.
- A discount rate of 22.6 percent that reflects current market assessments of the time value of money and risks specific to the Stream CGU.

The values assigned to the key assumptions represent Management's assessment of future trends in the service industry and are based on both external sources and internal sources (historical data).

The estimated recoverable amount of the Stream CGU exceeded its carrying amount by $0.3 million. Management identified that an increase of 0.9 percent to the discount rate or a reduction of 2 percent to average revenue growth in the five-year business plan could cause the carrying amount of the Stream CGU to exceed the recoverable amount.

(Stated in thousands of dollars)

	Technology	License	Development Costs	Systems/ Software	Total
Cost					
At January 1, 2018	3,219	26,000	2,577	1,960	33,756
Additions	28	3,024	-	-	3,052
Impairment	-	(4,498)	-	-	(4,498)
Effect of movement in exchange rate	-	78	-	12	90
At December 31, 2018	3,247	24,604	2,577	1,972	32,400
Accumulated Amortization					
At January 1, 2018	1,401	4,370	-	1,060	6,831
Amortization	425	1,811	859	161	3,256
Effect of movement in exchange rate	-	1	-	10	11
At December 31, 2018	1,826	6,182	859	1,231	10,098
Carrying amount at December 31, 2018	1,421	18,422	1,718	741	22,302

(Stated in thousands of dollars)

	Technology	License	Development Costs	Systems/ Software	Total
Cost					
At January 1, 2017	3,204	24,065	1,649	1,922	30,840
Additions	15	1,935	928	38	2,916
At December 31, 2017	3,219	26,000	2,577	1,960	33,756
Accumulated Amortization					
At January 1, 2017	927	2,721	-	890	4,538
Amortization	474	1,649	-	170	2,293
At December 31, 2017	1,401	4,370	-	1,060	6,831
Carrying amount at December 31, 2017	1,818	21,630	2,577	900	26,925

During the year ended December 31, 2018, the Corporation acquired intangible assets with a total cost of $3.1 million (2017 - $2.9 million).

As at December 31, 2018, the Corporation has contingent liabilities arising from existing development agreements of $0.4 million expected to be paid in 2019.

9. Loans and Borrowings

(Stated in thousands of dollars)

	Currency	Amount of Facility	Date of Maturity	Currency	Carrying Amount at December 31, 2018	Currency	Carrying Amount at December 31, 2017
Operating Facility	CAD	15,000	Due on demand	CAD	**13,349**	CAD	5,620
Syndicated Facility	CAD	48,000	December 11, 2020	CAD	**5,000**	CAD	14,000
US Operating Facility	USD	5,000	December 11, 2020	USD	**5,000**	USD	-

Under the syndicated loan agreement, the Corporation is required to maintain certain financial covenants. As at December 31, 2018 the Corporation was in compliance with all its financial covenants as follows:

Ratio	Covenant	As at December 31, 2018
Debt to covenant EBITDA	<3.0x	**0.55**
Interest coverage ratio	>3.0x	**37.80**
Net capital expenditures and intangible asset acquisitions, net of proceeds from asset dispositions	<$30 million	**$23.5 million**

The Corporation has approximately CAD$44.7 million available to be drawn from its credit facilities as at December 31, 2018.

The credit facilities are secured by substantially all of the Corporation's assets.

10. Deferred Tax Assets and Liabilities

a) Unrecognized Deferred Tax Assets and Liabilities

The Corporation has unrecognized deferred tax assets relating to international segments of $3.6 million (2017 - $3.4 million) in relation to $15.1 million (2017 - $14.0 million) of non-capital tax losses that can be carried forward against future taxable income of the entities in which the losses arose. Deferred tax assets have not been recognized in respect of the losses as they may not be used to offset taxable profits elsewhere in the Corporation, and they have arisen in subsidiaries that have not established indicators demonstrating that it is probable that future taxable profits will be available to utilize those loss carry-forwards. These unrecognized deferred tax assets expire starting in 2019. There are no other deductible temporary differences that have not been recognized at the reporting date.

As at December 31, 2018, the Corporation has unrecognized deferred tax assets of $17.7 million (2017 - nil) with respect to deductible temporary differences in the Canadian jurisdiction. Deferred tax assets have not been recognized in respect of deductible temporary differences due to a recent history of taxable losses in Canada. Of the unrecognized deductible temporary differences in Canada, $45.6 million (2017 - nil) pertains to federal non-capital losses that expire between 2029 and 2038 and $13.8 million (2017 - nil) pertains to other deductible temporary differences that do not expire. The benefit associated with $3.1 million (2017 - nil) of unused investment tax credits and foreign tax credits are also not being recognized and expire between 2023 and 2036.

b) Recognized Deferred Tax Assets and Liabilities

Deferred tax assets and liabilities are attributable to the following:

Years ended December 31,		**2018**		2017
Deferred income tax assets:				
Non-capital income tax losses	**$**	**5,382,327**	$	17,214,755
Partnership loss		**-**		229,377
Deferred income and provision for onerous contracts		**-**		931,051
Other (including other equipment, intangible assets, foreign and other tax credits)		**609,646**		6,603,366
	$	**5,991,973**	$	24,978,549
Deferred income tax liabilities:				
Drilling and other equipment	**$**	**(8,250,905)**	$	(6,707,344)
Intangible assets		-		(2,685,705)
Investment tax credits		-		(731,270)
Other		**(33,625)**		(25,516)
		(8,284,530)		(10,149,835)
Net deferred income tax asset (liability)	**$**	**(2,292,557)**	$	14,828,714

Included in deferred income tax assets is $0.6 million (2017 - $0.7 million) relating to the Corporation's international segments' other (including other equipment, intangible assets, foreign and other tax credits) and non-capital income tax losses, aforementioned amounts are disclosed separately on the Consolidated Statements of Financial Position. The non-capital losses expire between 2020 and 2034. Deferred tax assets are recognized only to the extent it is considered probable that those assets will be recoverable. The determination involves an assessment of when those deferred tax assets are likely to reverse and a judgment of whether there will be sufficient taxable profits available to utilize the tax assets when they do reverse. Assumptions regarding future profitability have been made and used as the basis for recognizing the deferred tax asset. Deferred tax movements are included in net loss.

11. Share Capital

a) Authorized and Issued Shares

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

	Number		Amount
Balance as at January 1, 2017	50,810,721	$	237,539,242
Issued shares pursuant to equity financing and private placement	7,687,500		30,750,000
Transaction costs	-		(1,737,500)
Tax effect of transaction costs	-		469,125
Issued shares pursuant to share option plan	91,666		243,630
Common shares repurchased	(192,000)		(426,461)
Balance as at December 31, 2017	58,397,887	$	266,838,036
Common shares repurchased	**(482,500)**		**(1,207,324)**
Issued shares pursuant to share option plan	**48,333**		**129,679**
Balance as at December 31, 2018	**57,963,720**	**$**	**265,760,391**

On February 2, 2017, PHX Energy closed a bought deal short-term prospectus for aggregate proceeds of $28.8 million. An aggregate of 7,187,500 common shares of the Corporation were issued at a price of $4.00 per common share. Concurrent with the closing of the public offering, certain directors, officers, employees and consultants of PHX Energy purchased a total of 500,000 common shares at a price of $4.00 per share on a private placement basis. The gross proceeds from the public offering and concurrent private placement totaled to approximately $30.8 million.

b) Weighted-Average Number of Shares

	2018	2017
Issued common shares at January 1,	**58,397,887**	50,810,721
Effect of shares pursuant to Normal Course Issuer Bid	**(189,089)**	(16,590)
Effect of share options exercised	**21,475**	75,844
Effect of shares issued pursuant to equity financing and private placement	**-**	6,992,466
Weighted-average number of common shares at December 31,	**58,230,273**	57,862,441

c) Basic and Diluted Loss per Share

2018		**Loss (numerator)**	**Shares (denominator)**		**Per Share Amount**
Basic loss per share:	**$**	**(18,946,809)**	**58,230,273**	**$**	**(0.33)**
Diluted loss per share:					
Dilutive effect of share option conversions		-	-		
	$	**(18,946,809)**	**58,230,273**	**$**	**(0.33)**

2017		Loss (numerator)	Shares (denominator)		Per Share Amount
Basic loss per share:	$	(23,527,974)	57,862,441	$	(0.41)
Diluted loss per share:					
Dilutive effect of share option conversions		-	-		
	$	(23,527,974)	57,862,441	$	(0.41)

As at December 31, 2018, as the Corporation was in a loss position, for the calculation of diluted earnings per share, all options were determined to be anti-dilutive and were excluded. The number of excluded options was 5,291,101 (2017 – 5,499,468) of which 2,478,601 options (2017 – 2,293,601) had exercise prices below the Corporation share price as at December 31, 2018.

d) Normal Course Issuer Bid ("NCIB")

During the third quarter of 2018, the Toronto Stock Exchange ("TSX") approved the renewal of PHX Energy's NCIB to purchase for cancellation, from time-to-time, up to a maximum of 2,915,311 common shares, representing 5 percent of the outstanding common shares at the time the NCIB was renewed. The NCIB commenced on August 8, 2018 and will terminate on August 7, 2019. Purchases of common shares are to be made on the open market through the facilities of the TSX and through alternative trading systems. The price which PHX Energy is to pay for any common shares purchased is to be at the prevailing market price on the TSX or alternate trading systems at the time of such purchase. Pursuant to the NCIB, 357,500 common shares were purchased by the Corporation in the second half of 2018 and cancelled.

The Corporation's previous NCIB commenced on June 26, 2017 and terminated on June 25, 2018. Pursuant to the prior NCIB, 125,000 common shares were purchased by the Corporation in the first six months of 2018 and cancelled.

In the 2018 year, the Corporation has purchased and cancelled 482,500 common shares.

12. Share-Based Payments

a) Share Option Program (Equity-Settled)

PHX Energy has a share option program that entitles key management personnel and other employees to purchase common shares in the Corporation. Grants under the plan vest as to one-third 6 months from the grant date, one-third 18 months from grant date and one-third 30 months from grant date. In accordance with these programs, options are exercisable using the five-day weighted-average trading price of the common shares ending immediately prior to the date of grant, or in the case of a US option holder, the trading price of the common shares ending immediately prior to the date of grant. The options have a term of five years.

Summary of option grants in 2018

Number	Exercise Price		Expiration Date	Fair Value	
200,000	$	2.00	March 9, 2023	$	0.83
50,000		1.95	March 9, 2023		0.85
250,000					

During the year ended December 31, 2018, a total of 48,333 options (2017 – 91,666) were exercised at exercise price of $1.59, a total of 33,334 options were forfeited (2017 – 230,755), 8,333 options were cancelled (2017 – 62,579), and 368,367 options expired (2017 – 168,335).

As at December 31, 2018, the Corporation had a total of 5,291,101 (2017 – 5,499,468) options outstanding which expire over a period of 1 year to 5 years.

The fair value of options that were exercised for the year ended December 31, 2018 in the amount of $52,763 has been added to share capital.

The Corporation values all of its share options using the Black-Scholes model. The Corporation's determination of fair value of options on the date of grant is affected by the Corporation's share price as well as assumptions regarding a number of variables. For the options granted during 2018 these variables include, but are not limited to, the Corporation's expected share price volatility over the term of the options of 60 percent, forfeiture rate of nil, and a risk free interest rate of 1.81 percent. The amounts computed according to the Black-Scholes model method may not be indicative of the actual values realized upon the exercise of these options by the holders.

During 2018, the Corporation recognized a total compensation expense of $1,368,819 (2017 - $2,600,015) for share options granted between 2016 and 2018.

A summary of the status of the plan as at December 31, 2018, is presented below:

	2018		2017	
	Options	**Weighted-Average Exercise Price**	Options	Weighted-Average Exercise Price
Outstanding, beginning of year	**5,499,468**	**$ 4.41**	3,462,803	$ 5.27
Granted	**250,000**	**1.99**	2,590,000	3.41
Exercised	**(48,333)**	**1.59**	(91,666)	1.55
Forfeited / cancelled	**(41,667)**	**3.06**	(293,334)	3.88
Expired	**(368,367)**	**10.78**	(168,335)	9.18
Outstanding, end of year	**5,291,101**	**$ 3.89**	5,499,468	$ 4.41
Options exercisable, end of year	**4,042,758**	**$ 4.20**	3,006,123	$ 5.73

The range of exercise prices for options outstanding at December 31, 2018 are as follows:

Options Outstanding				Options Exercisable	
Original Exercise Price	Number	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number	Weighted-Average Exercise Price
$ 1.55	**1,318,334**	**2.18 yrs**	**$ 1.55**	**1,318,334**	**$ 1.55**
1.71	**175,000**	**3.63 yrs**	**1.71**	**58,333**	**1.71**
1.79	**575,000**	**3.63 yrs**	**1.79**	**191,665**	**1.79**
1.95	**210,267**	**2.91 yrs**	**1.95**	**176,933**	**1.95**
2.00	**200,000**	**4.19 yrs**	**2.00**	**66,664**	**2.00**
3.41	**25,000**	**2.89 yrs**	**3.41**	**16,666**	**3.41**
4.06	**1,305,000**	**3.17 yrs**	**4.06**	**869,997**	**4.06**
4.15	**415,000**	**3.17 yrs**	**4.15**	**276,666**	**4.15**
6.87 - 15.81	**1,067,500**	**0.99 yrs**	**8.71**	**1,067,500**	**8.71**
	5,291,101	**2.56 yrs**	**$ 3.89**	**4,042,758**	**$ 4.20**

b) Retention Award Plan

The retention award plan results in eligible participants receiving cash compensation in relation to the value of a specified number of underlying notional retention awards. The retention award plan has two types of awards Restricted Awards (RAs) and Performance Awards (PAs). RAs vest evenly over a period of three-years. Upon vesting and subsequent exercise, the holder is entitled to receive a cash payment based on the fair value of the underlying shares determined using the five-day weighted-average trading price of the shares ending immediately prior to the exercise date plus accrued re-invested dividends.

PAs vesting and subsequent exercise is similar to RAs, except a payout multiplier is applied to the final payout. The payout multiplier is linked solely to total shareholder return on the Corporation's common shares relative to returns on securities of members of the Corporation's peer comparison group over the applicable vesting period and can range from a payout of zero percent to 200 percent. The Corporation's use of PAs commenced in 2017. In 2018, 750,000 PAs were granted (2017 - 200,000), 66,664 PAs settled at a zero percent payout multiplier (2017 - nil), no PAs were forfeited (2017 - nil), and, as at December 31, 2018 883,336 PAs were outstanding (2017 - 200,000).

The Corporation recorded a total of $4.1 million compensation expense relating to these plans for the year ended December 31, 2018 (2017 - $1.3 million). The expense is included in selling, general and administrative expense and has a corresponding liability included in trade and other payables. There were 3,443,456 RAs and PAs outstanding as at December 31, 2018 (2017 – 2,103,040).

A summary of the status of the plan as at December 31, 2018, is presented below:

	2018	2017
RAs and PAs Outstanding, beginning of year	**2,103,040**	**1,789,522**
Granted	**2,469,292**	**1,199,962**
Settled	**(879,504)**	**(712,604)**
Forfeited / cancelled	**(249,372)**	**(173,840)**
RAs and PAs Outstanding, end of year	**3,443,456**	**2,103,040**

13. Expenses by Nature

(Stated in thousands of dollars)

Years ended December 31,	**2018**	2017
Salaries and employee benefits	**117,600**	78,025
Share-based payments	**5,489**	3,915
Personnel expenses	**123,089**	81,940
Depreciation and amortization	**39,738**	41,621
Equipment expenses	**60,570**	50,206
Consumed repair parts	**33,823**	24,828
Contract labour	**24,015**	36,464
Facility and office expenses	**10,274**	10,734
Field and freight expenses	**12,297**	12,082
Insurance and business and sales taxes	**8,893**	4,100
Travel and entertainment	**4,863**	4,389
Provisions for inventory	**543**	1,073
Provision for onerous contracts	**(314)**	(437)
Legal and audit fees	**1,257**	1,350
Other	**2,027**	2,261
	321,075	270,611

The total amount of expenses represents the aggregate of direct costs, selling, general and administrative expenses, and research and development expenses in the statements of comprehensive income (loss).

14. Other Income

Years ended December 31,		**2018**		2017
Net gain on disposition of drilling equipment (Note 6)	**$**	**8,376,711**	$	6,061,340
Foreign exchange loss		**(198,576)**		(246,436)
Provision for bad debts		**(9,458)**		(478,707)
	$	**8,168,677**	$	5,336,197

15. Income Taxes

Years ended December 31,		2018		2017
Current tax expense (recovery):				
Current period	$	193,563	$	449,535
Adjustment for prior periods		(15,737)		(37,770)
		177,826		411,765
Deferred tax recovery:				
Origination and reversal of temporary differences		17,243,611		(3,250,510)
Adjustment for prior periods		47,840		82,099
		17,291,451		(3,168,411)
Total income tax expense (recovery)	$	17,469,277	$	(2,756,646)

Reconciliation of effective tax rate

Years ended December 31,		2018			2017	
Net loss	$	(18,946,809)		$	(23,527,974)	
Total income tax recovery		17,469,277			(2,756,646)	
Loss before income taxes		(1,477,532)			(26,284,620)	
Income tax using the Corporation's domestic tax rate		(398,939)	27.0%		(7,096,850)	27.0%
Non-taxable portion of gains on disposal of assets		(295,825)	20.0%		(276,195)	1.1%
Change in unrecognized deductible temporary differences		18,076,755	n.m.		593,455	(2.2%)
Effect of tax rates in foreign jurisdictions		(812,911)	55.0%		3,120,583	(11.9%)
Non-deductible share-based payments and other expenses		598,126	(40.5%)		940,286	(3.6%)
Effect of change in U.S. tax rate		-	-		(220,182)	0.8%
Other		302,071	(20.4%)		182,257	(0.7%)
	$	17,469,277	n.m.	$	(2,756,646)	10.5%

n.m. – not meaningful

16. Operating Segments

The Corporation provides directional and horizontal oil and natural gas well drilling services. PHX Energy's reportable segments have been aligned geographically as follows:

Information about reportable segments

(Stated in thousands of dollars)

	Canada		United States		International		Total	
Years ended December 31,	**2018**	2017	**2018**	2017	**2018**	2017	**2018**	2017
Drilling services revenue	**86,698**	80,464	**208,112**	137,625	**18,413**	18,971	**313,223**	237,060
EDR rental revenue	**3,912**	3,941	**-**	-	**-**	-	**3,912**	3,941
Total revenue	**90,610**	84,405	**208,112**	137,625	**18,413**	18,971	**317,135**	241,001
Reportable segment profit (loss) before income taxes	**2,513**	(5,162)	**4,791**	(14,928)	**525**	(959)	**7,829**	(21,049)

(Stated in thousands of dollars)

	Canada		United States		International		Total	
As at December 31,	**2018**	2017	**2018**	2017	**2018**	2017	**2018**	2017
Drilling and other equipment	**27,863**	44,236	**59,996**	44,415	**6,306**	9,919	**94,165**	98,570
Goodwill	**8,876**	8,876	**-**	-	**-**	-	**8,876**	8,876

Reconciliation of reportable segment loss and other material items

(Stated in thousands of dollars)

Years ended December 31,		**2018**		2017
Reportable segment income (loss) before income taxes	**$**	**7,829**	$	(21,049)
Corporate:				
Selling, general and administrative expenses		**8,416**		6,098
Research and development expenses		**3,354**		2,463
Finance expense		**1,208**		2,011
Impairment loss on intangible assets		**4,498**		-
Other income		**(8,169)**		(5,336)
Loss before income taxes	**$**	**(1,478)**	$	(26,285)

17. Changes in Non-Cash Working Capital

(Stated in thousands of dollars)

Years ended December 31,		2018		2017
Trade and other receivables	$	(37,352)	$	(25,083)
Inventories		(5,549)		2,979
Prepaid expenses		488		(302)
Investment and foreign tax credits		4,557		(607)
Trade and other payables		22,949		10,435
Impact of foreign exchange rate changes in working capital		(3,214)		(3,886)
	$	(18,121)	$	(16,464)

18. Financial Instruments

a) Credit Risk

The Corporation is exposed to normal credit risks of its customers that exist within the oil and natural gas exploration and development industry. The Corporation's credit risk associated with these customers can be directly impacted by a decline in economic conditions, which would impair the customers' ability to satisfy their obligations to the Corporation. During the year ended December 31, 2018, one customer comprised 6 percent of the total revenue (2017 - 8 percent of revenue). The customer's revenue is reported within the US operating segment.

As at December 31, 2018, the ageing of trade and other receivables that were not impaired was as follows:

(Stated in thousands of dollars)		2018
Neither past due nor impaired	$	49,160
Past due 1-30 days		27,023
Past due 31-60 days		17,803
Past due 61-90 days		4,985
Past due over 90 days		5,017
	$	103,988

The Corporation's standard customer payment terms are 30 days after job completion or invoice issuance date, after which, the balance becomes past due. The Corporation will assess for impairment once the receivable becomes past due. All accounts receivable balances that are past due for more than 90 days and were not impaired represent 5 percent or approximately $5.0 million of total receivables on the statement of financial position at December 31, 2018. Management believes that the unimpaired amounts that are past due are still collectible in full, based on historic payment behavior and extensive analysis of customer credit risk. Management has provided an allowance of $0.5 million for all amounts it considers uncollectable at December 31, 2018 (2017 - $0.8 million).

The Corporation has a credit management program to assist in managing this risk, which consists of conducting financial and other assessments to establish and monitor a customer's creditworthiness. The Corporation monitors and manages its credit risk on an ongoing basis.

b) Liquidity Risk

Liquidity risk is the risk that the Corporation will not be able to meet its financial obligations as they fall due. The Corporation has financial liabilities, thus, is exposed to liquidity risk. The Corporation's approach to managing liquidity risk is to ensure that it always has sufficient cash and credit facilities to meet its obligations when due. Management typically forecasts cash flows for a period of twelve months to identify financing requirements. These requirements are then addressed through a combination of demand credit facilities and access to capital markets. The Corporation believes that future cash flows generated by the operations and access to additional liquidity through capital and banking markets will be adequate to meet its financial obligations.

The following table reflects the Corporation's anticipated payment of contractual obligations related to continuing operations as at December 31, 2018:

(Stated in thousands of dollars)

	2019	2020	2021	2022	2023
Loans and borrowings	13,349	11,821	-	-	-
Drilling and other equipment purchase commitments	7,954	-	-	-	-
Trade and other payables	64,578	-	-	-	-
	85,881	11,821	-	-	-

c) Fair Values of Financial Instruments

The Corporation has designated its trade and other payables as other financial liabilities carried at amortized cost. Accounts receivable are designated as loans and receivables, measured at amortized cost. The Corporation's carrying values of these items approximate their fair value due to the relatively short periods to maturity of the instruments. Loans and borrowings have been designated as an other financial liability, and are measured at amortized cost. The fair value of loans and borrowings included in the consolidated statement of financial position approximates carrying values as the indebtedness is subject to floating rates of interest.

d) Interest Rate Risk

Interest rate risk is created by fluctuations in the fair values of financial instruments due to changes in the market interest rates. The Corporation has variable interest long-term debt which exposes it to fluctuations in cash interest payment amounts.

A one percent change in interest rates would have increased or decreased the Corporation's profit by $103,642 for the year ended December 31, 2018.

e) Foreign Exchange Risk

Foreign exchange risk is created by fluctuations in the fair values of financial instruments due to changes in foreign exchange rates. Due to operations of the Corporation's subsidiaries in the US and Russia, the Corporation has an exposure to foreign currency exchange rates. The carrying values of Canadian dollar, US dollar and Russian ruble ("RUB") denominated monetary assets and liabilities and earnings are subject to foreign exchange risk. For the year ended December 31, 2018, foreign exchange losses of $0.2 million (2017 – $0.2 million) resulted mainly from fluctuations in the USD-CAD exchange rates. The Corporation reviews options with respect to managing its foreign exchange risk periodically.

The following chart represents the Corporation's exposure to foreign currency risk:

As at December 31, 2018	**CAD**	**USD**	**RUB**
Cash and cash equivalents	**-**	**404,362**	**98,377,373**
Trade and other receivables	**-**	**4,919**	**258,474,591**
Trade and other payables	**-**	**(2,425,966)**	**(8,783,015)**
Intercompany receivables	**2,815,843**	**-**	**-**
Intercompany payables	**(6,049,850)**	**-**	**-**
Statement of financial position exposure	**(3,234,007)**	**(2,016,685)**	**348,068,949**

As at December 31, 2017	CAD	USD	RUB
Cash and cash equivalents	-	(22,376)	90,149,327
Trade and other receivables	-	79,230	223,816,391
Trade and other payables	-	(2,245,877)	(216,501)
Intercompany receivables	6,004,858	-	-
Intercompany payables	(8,460,819)	-	-
Statement of financial position exposure	(2,455,961)	(2,189,023)	313,749,217

The following significant exchange rates applied during the year ended December 31:

	Average Rate		December 31, Close Rate	
	2018	2017	**2018**	2017
USD	**1.2961**	1.2980	**1.3642**	1.2545
RUB	**48.4518**	44.9743	**50.9614**	45.9258

A strengthening of the Canadian dollar, US dollar, and Russian ruble against all other currencies as at December 31 would have affected the measurement of financial instruments denominated in a foreign currency and affected profit or loss by the amounts shown below. The analysis assumes that all other variables remain constant.

Gain (Loss)	**2018**	2017
CAD (10% strengthening)	**$ (237,063)**	$ (195,772)
USD (10% strengthening)	**(275,116)**	(274,613)
RUB (10% strengthening)	**620,914**	621,060

19. Capital Management

The Corporation's primary objective of capital management is to maintain a strong capital base, in conjunction with conservative long-term debt levels so as to maintain investor, creditor and market confidence, and to sustain future development of the business. The Corporation seeks to maintain a balance between higher returns that might be possible with higher levels of borrowings and the advantages and security created by a strong equity position.

The Corporation's Management considers the capital structure to consist of long-term debt, including any current portion of long-term debt, and shareholders' equity. As at December 31, 2018, the Corporation had $25.2 million (2017 – $19.6 million) in loans and borrowings and $168.4 million (2017 – $181.5 million) in shareholders' equity. The Corporation's resulting long-term debt to equity ratio was 0.15 as at December 31, 2018 (2017 – 0.11).

The Corporation prepares annual and quarterly operating and capital expenditure budgets, and forecasts to assist with the management of its capital. The Corporation intends to maintain a flexible capital structure and it may alter its dividend levels, raise new equity or issue new debt in response to a change in economic conditions.

The Corporation is subject to capital requirements relating to debt covenants on debt facilities held. As at December 31, 2018, the Corporation was in compliance with all debt covenants.

There were no changes to the Corporation's approach to capital management during the year ended December 31, 2018.

20. Operating Leases

The Corporation is committed to the following minimum payments under operating leases for equipment, vehicles, and premises:

	2018	2017
2019	$ **7,902**	$ 7,191
2020	**7,077**	6,660
2021	**6,644**	6,270
2022	**5,932**	5,962
2023 and after	**4,661**	5,325

During 2018, $6.8 million was recognized as an expense in the statement of comprehensive income in respect of operating leases (2017 – $6.9 million).

21. Related Parties

Transactions with Key Management Personnel

Key management personnel compensation

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Corporation as a whole. The Corporation determined that key management personnel consists of members of the Board, the Chief Executive Officer, President, Senior Vice Presidents and Vice Presidents reporting directly to the Chief Executive Officer.

In addition to their salaries, the Corporation also provides its executive officers with annual incentives which consist of bonuses and commissions that the Compensation Committee considers comparable to benefits provided to executives of other publicly traded oil and natural gas service companies.

Executive officers also participate in the Corporation's share option program and retention award plan.

The Corporation, either directly or indirectly through its subsidiaries, has entered into executive employment agreements with certain executive officers that provide for termination payments. These agreements continue indefinitely until terminated in accordance with the terms thereof and the base salary payable thereunder is subject to annual review.

Key management personnel compensation comprised:

Years ended December 31,	2018	2017
Base salaries, benefits, and directors' remuneration	**$ 2,344,262**	$ 1,912,224
Short-term bonuses and commissions	**3,680,737**	588,310
Share-based compensation	**2,655,734**	3,983,425
	$ 8,680,733	$ 6,483,959

Key management personnel and director transactions

Directors of the Corporation control 16 percent of the common shares of the Corporation.

Directors are entitled to receive an annual retainer as well as a fee for each meeting of the Board or Committee of the Board attended. The Chairman of the Board and the Lead Director receive an additional annual retainer, as do the Chairs of the Audit Committee, Compensation Committee, and Nomination and Corporate Governance Committee. Directors are also entitled to participate in the retention award plan (see Note 12) and can elect to receive certain percentages of these fees as RAs under the retention award plan. As at December 31, 2018, the directors have 742,283 of RAs outstanding (2017 – 607,480).

From time-to-time, Directors of the Corporation, or their related entities, may purchase goods or services from the Corporation. These purchases are on the same terms and conditions as those entered into by other Corporation employees or customers. For the year ended December 31, 2018, no purchase of goods or services from or to a related party occurred (2017 – nil).

22. Significant Subsidiaries

		Ownership Interest	
	Country of Incorporation	**2018**	2017
Phoenix Technology Services Inc.	Canada	**100%**	100%
Phoenix Technology Services LP	Canada	**100%**	100%
Phoenix Technology Services USA Inc.	USA	**100%**	100%
Phoenix Technology Services Luxembourg Sarl.	Luxembourg	**100%**	100%
Phoenix Technology Services International Ltd.[1]	Cyprus	**100%**	100%
Phoenix TSR LLC	Russia	**100%**	100%

[1] *Entity holds a branch in Albania.*

23. Subsequent Events

Subsidiaries of the Corporation have commenced and served an action against a supplier. Having received legal advice, Management believes a favourable outcome is probable. A contingent asset was not recognized as a receivable at December 31, 2018 because receipt of the amount claimed is dependent on the outcome of litigation.

Corporate Information

Board of Directors

John Hooks

Randolph ("Randy") M. Charron

Myron Tétreault

Judith Athaide

Lawrence Hibbard

Roger Thomas

Terry Freeman

Officers

John Hooks
CEO

Michael Buker
President

Cameron Ritchie
Sr. Vice President Finance and CFO
Corporate Secretary

Craig Brown
Sr. Vice President International Operations and Technology

Jeffery Shafer
Sr. Vice President Sales and Marketing

Daniel Blanchard
Vice President Executive Sales

Legal Counsel

Burnet, Duckworth & Palmer LLP
Calgary, Alberta

Auditors

KPMG LLP
Calgary, Alberta

Bankers

HSBC Bank Canada
Calgary, Alberta

Transfer Agent

Computershare Trust Company of Canada
Calgary, Alberta