

# **PHX Energy Services Corp.**

## **First Quarter Report for the three-month periods ended March 31, 2016 and 2015**

### **Financial Results**

For the three-month period ended March 31, 2016 adjusted EBITDA was \$4.0 million (10 percent of revenue), which is 42 percent lower than the \$6.8 million (7 percent of revenue) reported in the comparable 2015-period. Adjusted EBITDA is defined as earnings before finance expense, income taxes, depreciation and amortization ("EBITDA"), impairment losses on goodwill and intangible assets, provisions for the settlement of litigations, severance costs and other non-cash charges (see Non-GAAP measures section). In the three-month period ended March 31, 2016, PHX Energy generated consolidated revenue of \$40.4 million, 61 percent lower than the \$103.9 million generated in the 2015-period. In the first quarter of 2016, PHX Energy reported a net loss of \$7.4 million compared to a first quarter net loss of \$5.9 million in 2015. The decreased adjusted EBITDA, revenue and increased net loss is mainly due to lower industry activity, pricing pressures in each of the Corporation's operating segments and the devaluation of the Russian ruble.

As at March 31, 2016, PHX Energy had long-term debt of \$50.0 million, which is a reduction of \$10.0 million from December 31, 2015, and working capital of \$55.6 million.

### **Severance**

If the first quarter of 2016, Management continued to align the Corporation's cost structure with the lower activity levels. This resulted in severance payments of \$0.9 million during the 2016 three-month period that are included in direct costs and SG&A.

### **Capital Spending**

The Corporation remained cautious with its capital spending incurring \$0.9 million in capital expenditures in the first quarter of 2016, which is 92 percent less than the \$10.6 million incurred in the comparable 2015-period. As at March 31, 2016, the Corporation has commitments to purchase drilling and other equipment for \$1.1 million; including \$0.7 million of electronic drilling recorder ("EDR") equipment and \$0.3 million of machinery and equipment. Delivery is expected to occur by the end of September 2016. It is anticipated that capital expenditures of \$3.6 million will be incurred in 2016.

## Amendments to Credit Facilities

On March 14, 2016, the Corporation reduced the maximum principal amount available under the Syndicated Credit Facility from CDN\$90 million to CDN\$70 million. The purpose of the decrease is to reduce the standby fees charged on unused balances under the credit facilities.

## Dividends

During the three-month period ended March 31, 2016, the Corporation paid dividends totaling \$0.4 million (2015 - \$7.4 million). On February 24, 2016, the Corporation announced the elimination of its quarterly dividend, which was effective immediately.

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

	Three-month periods ended March 31,		
	2016	2015	% Change
<b>Operating Results</b>	<i>(unaudited)</i>	<i>(unaudited)</i>	
Revenue	40,449	103,928	(61)
Net loss	(7,404)	(5,898)	26
Loss per share – diluted	(0.18)	(0.17)	6
Adjusted EBITDA <sup>(1)</sup>	3,978	6,829	(42)
Adjusted EBITDA per share – diluted <sup>(1)</sup>	0.10	0.19	(47)
Adjusted EBITDA as a percentage of revenue <sup>(1)</sup>	10%	7%	
<b>Cash Flow</b>			
Cash flows from operating activities	758	19,620	(96)
Funds from operations <sup>(1)</sup>	3,584	3,300	9
Funds from operations per share – diluted <sup>(1)</sup>	0.09	0.09	-
Dividends paid	416	7,407	(94)
Dividends per share <sup>(2)</sup>	0.01	0.21	(95)
Capital expenditures	857	10,604	(92)
<b>Financial Position (unaudited)</b>	<b>Mar. 31, '16</b>	Dec 31, '15	
Working capital	55,571	61,041	(9)
Long-term debt	50,000	60,000	(17)
Shareholders' equity	186,699	200,938	(7)
Common shares outstanding	41,573,915	41,567,023	-

<sup>(1)</sup> Refer to non-GAAP measures section that follows the outlook section.

<sup>(2)</sup> Dividends paid by the Corporation on a per share basis in the period.

## Non-GAAP Measures

PHX Energy uses certain performance measures throughout this MD&A that are not recognizable under Canadian generally accepted accounting principles ("GAAP"). These performance measures include adjusted earnings before interest, taxes, depreciation and amortization ("EBITDA"), adjusted EBITDA per share, funds from operations, funds from operations per share, and debt to covenant EBITDA ratio. 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, these may not be comparable. Please refer to the non-GAAP measures section following the Outlook section for applicable definitions and reconciliations.

## Management's Discussion and Analysis

The following 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 2015 annual report, including the MD&A, and audited consolidated financial statements and the accompanying notes contained therein, and the Corporation's 2016 unaudited interim first quarter report, including the unaudited condensed consolidated financial statements and the accompanying notes contained therein. Readers can also obtain additional information on the Corporation including its Information Circular and Annual Information Form ("AIF") filed on SEDAR at [www.sedar.com](http://www.sedar.com). This MD&A has been prepared taking into consideration information available up to and including May 4, 2016.

PHX Energy's Interim Financial Report for the three-month periods ended March 31, 2016 and 2015 has been prepared in accordance with International Financial Reporting Standards ("IFRS"). The MD&A and Interim Financial Report were reviewed by PHX Energy's Audit Committee and approved by PHX Energy's Board on May 4, 2016.

## 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:

- Delivery of the drilling and other equipment that is on order is expected to occur by the end of September 2016.
- It is anticipated that capital expenditures of \$3.6 million will be incurred in 2016.
- Planned expenditures are expected to be financed from a combination of one or more of the following: cash flow from operations, the Corporation's unused credit facilities or equity, if necessary.

The above are stated under the headings: "Overall Performance" and "Capital Resources". 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](http://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 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 centers 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; Fort Worth, Texas; Midland, Texas; Bellaire, Ohio; Pittsburgh, Pennsylvania; and Oklahoma City, Oklahoma. Internationally, PHX Energy has sales offices and service facilities in Russia and Albania, and administrative offices in Nicosia, Cyprus and Luxembourg City, Luxembourg.

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

# Results of Operations

Three-Month Period Ended March 31, 2016

## Revenue

*(Stated in thousands of dollars)*

	Three-month periods ended March 31,		
	2016	2015	% Change
Revenue	40,449	103,928	(61)

Industry activity in each of the Corporation's operating segments remained low and pricing pressures continued to mount as depressed oil prices carried through the first quarter of 2016. For the three-month period ended March 31, 2016, consolidated revenue decreased by 61 percent to \$40.4 million compared to \$103.9 million in the comparable 2015-period. US and international revenue as a percentage of total consolidated revenue were 54 and 8 percent, respectively, for the 2016-quarter as compared to 58 and 6 percent in 2015. Consolidated operating days decreased by 49 percent to 4,069 days as compared to 8,002 days in the 2015-quarter. Average consolidated day rates for the three-month period ended March 31, 2016, excluding the motor rental division in the US and the Stream division, decreased by 23 percent to \$9,669 from \$12,541 in the first quarter of 2015.

In the first quarter of 2016, the average rig count in Canada declined 45 percent as compared to the first quarter of the prior year, while the US rig count fell by 61 percent over the same periods. Throughout North America the vast majority of wells continued to be horizontal and directional. In Canada, 89 percent of all wells drilled were horizontal or directional and in the US the average number of horizontal and directional rigs operating per day increased to 88 percent of all rigs running. (Sources: Daily Oil Bulletin and Baker Hughes)

## Operating Costs and Expenses

(Stated in thousands of dollars except percentages)

	Three-month periods ended March 31,		
	2016	2015	% Change
Direct costs	46,011	96,915	(53)
Gross profit (loss) as a percentage of revenue	(14%)	7%	
Depreciation & amortization (included in direct costs)	14,003	9,305	50
Gross profit as percentage of revenue excluding depreciation & amortization	21%	16%	

Direct costs are comprised of field and shop expenses, and include depreciation and amortization on the Corporation's equipment. In the first quarter of 2016, direct costs decreased 53 percent to \$46.0 million from \$96.9 million in the comparable 2015-period. The decrease in costs is consistent with the Corporation's lower operating days experienced in 2016.

The Corporation's gross profit as a percentage of revenue was 7 percent in the first quarter of 2015 compared to a gross loss percentage of 14 percent in 2016. The declining gross profit as a percentage of revenue in 2016 was primarily due to significantly higher depreciation and amortization expenses and lower activity levels and day rates.

The increase in depreciation and amortization expenses in the three-month period ended March 31, 2016 was mainly the result of PHX Energy's review of the residual values of its drilling equipment completed in the third quarter of 2015. Depreciation expenses increased by approximately \$4.0 million in the first quarter of 2016 as compared to the 2015-quarter due to the residual values of drilling equipment being removed.

Excluding depreciation and amortization, gross profit as a percentage of revenue increased to 21 percent for the three-month period ended March 31, 2016 from 16 percent in the comparable 2015-period. The improved margin experienced in the three-month period ended March 31, 2016 is a result of the Corporation's realignment and control of its cost structure in relation to the lower activity level.

(Stated in thousands of dollars except percentages)

	Three-month periods ended March 31,		
	2016	2015	% Change
Selling, general & administrative ("SG&A") costs	6,679	12,569	(47)
Equity-settled share-based payments (included in SG&A costs)	286	200	43
SG&A costs excluding equity-settled share-based payments as a percentage of revenue	16%	12%	

SG&A costs for the three-month period ended March 31, 2016 decreased by 47 percent to \$6.7 million as compared to \$12.6 million in 2015. Included in SG&A costs for the 2016 and 2015-quarters are equity-settled share-based payments of \$0.3 million and \$0.2 million, respectively. Excluding these costs, SG&A costs as a percentage of consolidated revenue for the three-month periods ended March 31, 2016 and 2015 were 16 percent and 12 percent, respectively. Also included in SG&A costs for the three-month period ended March 31, 2016 were severance costs of \$0.2 million.

In the 2016-period, the Corporation continued to implement initiatives to reduce SG&A costs across all regions. These initiatives included reductions to personnel, travel, entertainment and marketing related costs. In addition, during the first quarter of 2016, the SG&A costs were less than the comparable period as a result of lower compensation expenses related to the cash-settled share-based retention awards, primarily due to the declining price of PHX Energy's shares.

Equity-settled share-based payments relate to the amortization of the fair values of issued options of the Corporation using the Black-Scholes model. In the three-month period ended March 31, 2016, equity-settled share-based payments increased by 43 percent, as compared to the corresponding 2015-period, generally due to compensation expenses related to options that were granted in March 2016.

Cash-settled share-based retention awards, which are included in SG&A costs, are measured at fair value, and in the 2016-quarter, the related compensation expense recognized by PHX Energy decreased to a recovery of \$0.1 million as compared to an expense of \$0.5 million in the 2015-quarter. The decrease is primarily due to the re-valuation of the retention awards based on the decrease in PHX Energy's stock price.

(Stated in thousands of dollars)

	Three-month periods ended March 31,		
	2016	2015	% Change
Research & development expense	525	859	(39)

Research and development ("R&D") expenditures charged to net earnings during the three-month period ended March 31, 2016 and 2015 were \$0.5 million and \$0.9 million, respectively. The decrease in R&D expenditures in 2016 was primarily due to the reduction of personnel related costs in the R&D department.

(Stated in thousands of dollars)

	Three-month periods ended March 31,		
	2016	2015	% Change
Finance expense	571	1,129	(49)

Finance expenses relate to interest charges on the Corporation's long-term and short-term bank facilities. As expected, finance charges decreased to \$0.6 million in the first quarter of 2016 from \$1.1 million in 2015. The decrease was primarily due to the lower amount of borrowings outstanding during the 2016-period resulting from significant repayments made subsequent to March 31, 2015.

(Stated in thousands of dollars)

	Three-month periods ended March 31,	
	2016	2015
Gain (Loss) on disposition of drilling equipment	1,205	(105)
Foreign exchange gains	351	440
Provision for bad debts	(30)	-
Other Income	1,526	335

For the three-month period ended March 31, 2016, other income is primarily comprised of the gain on the disposition of drilling equipment of \$1.2 million (2015 - loss of \$0.1 million). Gains 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. Losses typically result from any asset retirements that were made before the end of the equipment's useful life and self-insured down hole equipment losses. In the 2016-period, the gain on disposition of drilling equipment resulted from primarily from insured down hole equipment losses.

During the period ended March 31, 2016, the Corporation recognized foreign exchange gains of \$0.4 million (2015 - \$0.4 million), mainly from the settlement of Canadian-denominated payables in the US.

*(Stated in thousands of dollars, except percentages)*

	Three-month periods ended March 31,	
	2016	2015
Provision for (Recovery of) income taxes	(4,407)	(1,312)
Effective tax rates	37%	18%

The recovery of income taxes for the three-month period ended March 31, 2016 was \$4.4 million as compared to \$1.3 million in the 2015-quarter. The expected combined Canadian federal and provincial tax rate for 2015 was 26 percent and for 2016 it is 27 percent. The effective tax rate in the 2016-period was higher than the expected rates primarily due to the effect of higher tax rates in foreign jurisdictions.

## 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, in Russia and Albania.

### Canada

*(Stated in thousands of dollars)*

	Three-month periods ended March 31,		
	2016	2015	% Change
Revenue	15,620	37,503	(58)
Reportable segment loss before tax	(3,262)	(3,937)	(17)
Reportable segment loss before tax as a percentage of revenue	(21%)	(10%)	

PHX Energy's Canadian revenue for the three-month period ended March 31, 2016 decreased by 58 percent to \$15.6 million from \$37.5 million in the corresponding 2015-period. The decrease was generally due to weak industry activity and lower day rates realized in the 2016-quarter. In the first quarter of 2016, the Canadian segment reported 1,951 operating days, a 45 percent decrease from the 3,536 days in the 2015-period. In comparison, total industry horizontal and directional drilling activity, as measured by drilling days, declined by 49 percent in the 2016-quarter to 12,441 days from 24,202 days in the 2015-quarter. (Source: Daily Oil Bulletin) Average day rates also continued to decline in 2016, decreasing by 24 percent to \$7,870 from \$10,415 in the 2015-quarter (excluding Stream revenue of \$0.3 million).

Despite lower activity levels, the Canadian division maintained its healthy market share and a well-diversified client base. During the 2016-quarter, the Canadian operations' activity was evenly divided between oil and natural gas drilling and PHX Energy was active in the Montney, Wilrich, Bakken, Shaunavon, and Viking areas.

The Canadian operations' reportable segment loss before tax for the first quarter of 2016 was \$3.3 million as compared to losses of \$3.9 million in the 2015-quarter. Included in the Canadian segment's losses in the three-month period ended March 31, 2016 were losses of \$1.7 million (2015 - \$2.8 million) from the Stream division. The Stream division's losses in the 2016-period pertain mostly to depreciation expenses of \$1.2 million and lower activity.

## United States

*(Stated in thousands of dollars)*

	Three-month periods ended March 31,		
	2016	2015	% Change
Revenue	21,739	60,236	(64)
Reportable segment loss before tax	(7,783)	(1,262)	n.m.
Reportable segment loss before tax as a percentage of revenue	(36%)	(2%)	

n.m. – not meaningful

In the first quarter of 2016, revenue from PHX Energy's US operations decreased by 64 percent to \$21.7 million from \$60.2 million in the 2015-quarter. The decrease mainly resulted from the significantly reduced industry rig count. In the first quarter of 2016, the number of horizontal and directional rigs running per day decreased by 59 percent from an average of 1,186 horizontal and directional rigs running per day during the 2015-quarter to 487 in the 2016-quarter. (Source: Baker Hughes) In comparison, the Corporation's US activity levels also weakened as operating days decreased by 58 percent from 3,757 days in the 2015-quarter to 1,564 days in the 2016-quarter. Average day rates slightly decreased during the 2016 three-month period generally due to pricing pressures from customers, however, this was offset by the positive impact of a stronger US dollar. Average day rates, excluding the motor rental division in Midland, Texas and the Rocky Mountain region, decreased to \$13,361 in the 2016-quarter compared to \$15,259 in the 2015-period. Excluding the effects of foreign exchange, the average day rates decreased by 12 percent to \$11,943 in the 2016-quarter.

Horizontal and directional drilling represented 88 percent of the industry's average number of rigs running on a daily basis in the first quarter of 2016, which was 3 percent greater than the percentage in 2015. For the three-month period ended March 31, 2016, 83 percent of the US operating division's activity was oil well drilling, as measured by wells drilled and excluding the motor rental and gyro surveying divisions. During the first quarter of 2016, Phoenix USA remained active in the Permian, Eagle Ford, Bakken, Mississippian/Woodford, Marcellus, Niobrara and Utica basins.

Reportable segment loss before tax for the three-month period ended March 31, 2016 was \$7.8 million compared to losses of \$1.3 million in the 2015-quarter. The increased segment losses experienced in 2016 were largely the result of weaker activity levels and lower average day rates.

## International

*(Stated in thousands of dollars, except percentages)*

	Three-month periods ended March 31,		
	2016	2015	% Change
Revenue	3,090	6,189	(50)
Reportable segment profit (loss) before tax	(692)	1,183	n.m.
Reportable segment profit (loss) before tax as a percentage of revenue	(22%)	19%	

n.m. – not meaningful

For the three-month period ended March 31, 2016, the Corporation's international revenue decreased by 50 percent to \$3.1 million from the \$6.2 million generated in the 2015-period. International operating days declined by 22 percent from 709 days in the 2015-quarter to 554 days in the 2016-quarter. The Corporation generated 8 percent of its consolidated revenue from its international operations in the 2016-quarter as compared to 6 percent in the comparable 2015-period.

PHX Energy's Russian operations continued to benefit from its long term initiatives to diversify its client base and in the first quarter of 2016, the division reported a 19 percent increase in activity to 554 operating days compared to 464 days in the 2015-period. The continued downward pressure on pricing and devaluation of the Russian ruble against the Canadian dollar caused a negative impact in both the revenue and profitability of the division.

The Albania division was idle for the first quarter of 2016, recording zero days of activity, down from 245 days in the same quarter of the previous year. With the reduction in activity, the division reduced its fixed and overhead costs while retaining the ability to recommence operations with little start up time required.

Reportable segment loss from international operations for the three-month period March 31, 2016 was \$0.7 million, which is \$1.9 million lower than the profit \$1.2 million (19 percent of revenue) reported in 2015. The decrease in the international operations' profitability in 2016 was mainly due to no Albania activity in the quarter and the lower ruble.

## Summary of Quarterly Results

(Stated in thousands of dollars except per share amounts)

	Mar-16	Dec-15	Sept-15	Jun-15	Mar-15	Dec-14	Sept-14	Jun-14
Revenue	40,449	56,138	68,227	58,487	103,928	152,881	138,971	100,484
Net earnings (loss)	(7,404)	(3,782)	(24,515)	(8,294)	(5,898)	1,220	13,024	(1,062)
Earnings (Loss) per share – basic	(0.18)	(0.09)	(0.59)	(0.23)	(0.17)	0.03	0.37	(0.03)
Earnings (Loss) per share – diluted	(0.18)	(0.09)	(0.59)	(0.23)	(0.17)	0.03	0.37	(0.03)
Adjusted EBITDA	3,978	9,674	4,627	1,930	6,829	29,899	26,496	8,624
Funds from operations	3,584	9,529	677	340	3,300	28,543	26,703	6,503

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 at the same level during this Canadian spring break-up period.

## Liquidity

(Stated in thousands of dollars)

	Three-month periods ended March 31,	
	2016	2015
Funds from operations	3,584	3,300

  

	Mar. 31, '16	Dec. 31, '15
Working capital	55,571	61,041

Although the Corporation experienced significant pricing pressures and low activity, funds from operations increased slightly from \$3.3 million in the three-month period ended March 31, 2015 to \$3.6 million in 2016. The increase is attributable to Management's implementation of a realigned cost structure.

As at March 31, 2016, the Corporation had working capital of \$55.6 million, which is \$5.4 million lower than the \$61.0 million reported at December 31, 2015. The decrease in working capital at March 31, 2016 was largely due to the lower level of cash and cash equivalents from the repayment of loans during the quarter and the lower level of trade and other receivables.

## Investing Activities

Net cash generated in investing activities for the three-month period ended March 31, 2016 was \$1.4 million as compared to cash used of \$9.1 million in 2015. During the 2016-quarter, PHX Energy received proceeds of \$2.6 million (2015 - \$1.1 million) from the disposition of capital equipment, primarily related to the involuntary disposal of drilling equipment in well bores, recognizing a gain on disposition of \$1.2 million (2015 - \$0.1 million loss). Additionally, the Corporation spent \$0.9 million on capital expenditures in 2016 (2015 - \$10.6 million). These expenditures included:

- \$0.3 million in MWD systems and spare components;
- \$0.4 million in machinery and equipment; and
- \$0.1 million in down hole performance drilling motors and leasehold improvements.

The capital expenditure program undertaken in the period was financed generally from working capital and cash flow.

During the 2016-quarter, the Corporation spent \$0.2 million in intangible assets, consisting primarily of additions related to development costs.

The change in non-cash working capital balances of \$0.1 million (use of cash) for the three-month period ended March 31, 2016, relates to the net change in the Corporation's trade payables that are associated with the acquisition of capital assets. This compares to a \$1.4 million source of cash for the three-month period ended March 31, 2015.

## Financing Activities

The Corporation reported cash flows used in financing activities of \$9.7 million in the three-month period ended March 31, 2016 as compared to \$4.9 million in the 2015-period. In the 2016-quarter:

- through its DRIP program, the Corporation received cash proceeds of \$11,000 from reinvested dividends to acquire 6,892 common shares of the Corporation;
- the Corporation paid dividends of \$0.4 million to shareholders, or \$0.01 per share; and
- the Corporation made aggregate net repayments of \$9.3 million on its operating and syndicated facilities.

## Capital Resources

On March 14, 2016, the Corporation reduced the maximum principal amount available under the Syndicated Credit Facility from CDN\$90 million to CDN\$70 million. The purpose of the decrease is to reduce the standby fees charged on unused balances under the credit facilities.

As of March 31, 2016, the Corporation had \$50.0 million drawn on its syndicated facility, \$0.7 million drawn on its operating facility, and nil drawn on its US operating facility. At March 31, 2016, the Corporation had approximately CAD\$34.3 million and US\$2.5 million available to be drawn from its credit facilities.

As at March 31, 2016, the Corporation was in compliance with all its financial covenants.

## Cash Requirements for Capital Expenditures

Historically, the Corporation has financed its capital expenditures and acquisitions through cash flows from operating activities, debt and equity. In order to continue preserving cash flows, the 2016 capital budget remains at \$3.6 million. These planned expenditures are expected to be financed from a combination of one or more of the following: cash flow from operations, the Corporation's unused credit facilities or equity, if necessary. However, if a sustained period of market uncertainty and financial market volatility persists in 2016, the Corporation's activity levels, cash flows and access to credit may be negatively impacted, and the expenditure level would be reduced accordingly. Conversely, if future growth opportunities present themselves, the Corporation would look at expanding this planned capital expenditure amount.

## Contractual Obligations

The following table reflects the Corporation's anticipated payment of contractual obligations related to continuing operations as at March 31, 2016.

*(Stated in thousands of dollars)*

	2016	2017	2018	2019	2020
Trade and other payables	19,139	-	-	-	-
Operating leases	6,887	6,547	6,286	5,886	5,695
Drilling and other equipment	1,062	-	-	-	-
Operating facility	713	-	-	-	-
Loans and borrowings	-	-	50,000	-	-
<b>Total</b>	<b>27,801</b>	<b>6,547</b>	<b>56,286</b>	<b>5,886</b>	<b>5,695</b>

## Off-Balance Sheet Arrangements

The Corporation had no off-balance sheet arrangements as at March 31, 2016 and 2015, other than operating leases.

## Proposed Transactions

The Corporation reviews and evaluates any material business acquisitions or capital asset divestitures in the normal course of its operations.

## Critical Accounting Estimates

The consolidated interim financial statements have been prepared in accordance with IAS 34 Interim Financial Reporting. The Corporation's significant accounting policies are described in its annual audited consolidated financial statements for the year ended December 31, 2015. Management, in preparing these financial statements, is required to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses. These estimates and judgments are based upon assumptions that are considered reasonable under the circumstances. Actual results could differ from such estimates and judgments by a material amount. The significant judgments made by Management in applying the Corporation's accounting policies and the key sources of estimation uncertainty have not changed significantly since December 31, 2015.

## Changes in Accounting Policies

The condensed consolidated interim financial statements have been prepared utilizing the same accounting policies and methods as the consolidated financial statements of the Corporation for the year ended December 31, 2015.

## Business Risk Factors

The business risk factors applicable to the Corporation have not materially changed since December 31, 2015. Refer to the "Business Risk Factors" section of the MD&A in the PHX Energy's 2015 annual report.

## 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 Directors of the Corporation. Additional information relating to the Corporation's Corporate Governance can be found in the Corporation's Annual Information Form and Information Circular in respect of its annual meeting of shareholders, each of which are annually filed on SEDAR at [www.sedar.com](http://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 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 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 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.

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 January 1, 2016 and ending on March 31, 2016 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

<i>(In thousands of shares)</i>	<b>As at May 4, 2016</b>
Common shares outstanding	41,573,915
Dilutive securities:	
Options	-
Corporation shares – diluted	41,573,915

## Outlook

PHX Energy maintained its focus on delivering superior performance and prudent balance sheet management through strict cost controls and capital spending during the first quarter of 2016.

Although the industry experienced the worst decline in commodity prices in a generation, the Corporation delivered on key strategies during the quarter. Long term debt was reduced to \$50.0 million, and profitability, as measured by adjusted EBITDA as a percentage of revenue, was positive given the reduced activity levels. Additionally, PHX Energy proudly protected its market share throughout all operating regions and continued to develop and deploy new technology without extensive capital expenditures.

During the quarter, the global oilfield services sector continued to experience the deterioration of market conditions, with rig counts dropping even further. The Canadian rig count peaked in late January at less than 300 active rigs per day and saw a steady decline through to the end of the quarter when there were fewer than 40 active rigs per day. Similarly, the US industry's rig count slid from 660 active rigs per day at the start of the year to 430 active rigs per day at the end of March. Compared to the first quarter of 2015, the average active rig count in the 2016-quarter was 45 percent lower in Canada and 61 percent lower in the US.

In contrast, the market for directional drilling services in Russia remained strong relative to the North American market, however, the weakness in the value of the Russian ruble persisted and this lowered profitability. PHX Energy's client base is diversifying in Russia and as a result this division is gaining momentum. The Corporation believes this growth will be ongoing through the 2016-year.

The Corporation expects that in the second quarter of 2016 the North American drilling market will shrink to the smallest it has been in the last 3 decades, as a result of the US rig count continuing to fall and the seasonal effects of spring break-up in Canada. This obviously creates challenges for oilfield service companies one of which is the increased pressure on day rates as competition for the limited active rigs intensifies. However, PHX Energy has proven its ability to maintain its position as a market leader in a contracting market and over the past 18 months the Corporation has executed the necessary strategies to create a stable financial position. These combined will put PHX Energy in a position to not only survive the mounting challenges of the extended downturn, but to be poised to thrive when industry conditions improve.

PHX Energy has not sacrificed its long-term growth initiatives despite the pains created by the economic and market conditions. Rather the Corporation has adapted to deliver on these objectives within the confines of the current environment. The Corporation is cautiously optimistic for the future. New technology recently commercialized is already creating a competitive advantage for operating divisions in all areas and development is progressing on various other initiatives.

Additionally, despite the necessity to reduce the size of its workforce and the unfortunate loss of the associated personnel, PHX Energy is proud of its talented personnel who diligently work each and every day toward ensuring the quality of service our clients expect is delivered. These people are vital to the Corporation.

The Corporation believes that due to the severity and volatility of this downward cycle there will be some directional drilling capacity exiting the market, and when the industry does turn, PHX Energy will be in a very enviable position to grow as a result of improved market dynamics and the Corporation's strengths. PHX Energy is now creating a strategy designed to guide the growth of the Corporation as the market shifts to stable activity levels and ultimately grows again. At the same time, as the Corporation waits for improved market conditions PHX Energy will remain focused on balance sheet strength and generating positive cash flow and EBITDA.

Michael Buker  
President  
May 4, 2016

## Non-GAAP Measures

### 1) Adjusted EBITDA

Adjusted EBITDA, defined as earnings before finance expense, income taxes, depreciation and amortization, impairment losses on goodwill and intangible assets, provisions for the settlement of litigations, severance costs and other non-cash charges, 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 other non-recurring 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 net earnings to adjusted EBITDA:

*(Stated in thousands of dollars)*

	Three-month periods ended March 31,	
	2016	2015
Net Loss	(7,404)	(5,898)
Add:		
Depreciation and amortization	14,003	9,305
Provision for (Recovery of) income taxes	(4,407)	(1,312)
Finance expense	571	1,129
Provision for settlement of litigation	-	978
Severance costs	915	2,627
Other non-cash charges	300	-
Adjusted EBITDA as reported	3,978	6,829

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.

## 2) Funds from Operations

Funds from operations is defined as cash flows generated from operating activities before changes in non-cash working capital, interest paid, and income taxes paid. This is not a 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 cash flows from operating activities to funds from operations:

*(Stated in thousands of dollars)*

	Three-month periods ended March 31,	
	2016	2015
Net cash flows from operating activities	758	19,620
Add (deduct):		
Changes in non-cash working capital	2,332	(18,630)
Interest paid	438	984
Income taxes paid	56	1,326
Funds from operations	3,584	3,300

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.

### 3) 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, unrealized foreign exchange losses, impairment losses on goodwill and intangible assets, loss on disposition of drilling equipment, severance costs, provision for inventory obsolescence and provision for the settlement of litigations, subject to the restrictions provided in the amended credit agreement.

### 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 day rate is calculated by dividing revenue by the number of operating days. Average consolidated day rate is calculated by dividing consolidated revenue by the consolidated number of operating days.

## Condensed Consolidated Statements of Financial Position

(unaudited)

	March 31, 2016	December 31, 2015
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 1,500,283	\$ 9,007,808
Trade and other receivables	32,579,072	44,694,812
Inventories	28,653,684	30,261,260
Prepaid expenses	3,692,578	2,869,018
Current tax assets	8,997,688	4,996,279
Total current assets	75,423,305	91,829,177
Non-current assets:		
Drilling and other equipment (Note 6)	147,889,318	166,113,852
Goodwill	8,876,351	8,876,351
Intangible assets	24,394,257	25,025,202
Deferred tax assets	3,134,710	1,581,847
Total non-current assets	184,294,636	201,597,252
Total assets	\$ 259,717,941	\$ 293,426,429
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Operating facility (Note 8)	\$ 713,363	\$ -
Trade and other payables	19,138,970	30,373,003
Dividends payable (Note 9b)	-	415,670
Total current liabilities	19,852,333	30,788,673
Non-current liabilities:		
Loans and borrowings (Note 8)	50,000,000	60,000,000
Deferred tax liabilities	1,499,574	-
Deferred income	1,666,670	1,700,003
Total non-current liabilities	53,166,244	61,700,003
Equity:		
Share capital (Note 9a)	213,614,980	213,604,045
Contributed surplus	5,676,505	5,390,124
Retained earnings	(43,797,607)	(36,393,629)
Accumulated other comprehensive income	11,205,486	18,337,213
Total equity	186,699,364	200,937,753
Total liabilities and equity	\$ 259,717,941	\$ 293,426,429

See accompanying notes to unaudited condensed consolidated interim financial statements.

## Condensed Consolidated Statements of Comprehensive Income

(unaudited)

	Three-month periods ended March 31,	
	2016	2015
Revenue	\$ 40,449,234	\$ 103,927,689
Direct costs	46,010,788	96,915,381
Gross profit (loss)	(5,561,554)	7,012,308
Expenses:		
Selling, general and administrative expenses	6,678,977	12,569,222
Research and development expenses	525,311	858,582
Finance expense	571,410	1,129,179
Other income (Note 10)	(1,526,441)	(335,117)
	6,249,257	14,221,866
Loss before income taxes	(11,810,811)	(7,209,558)
Provision for (Recovery of) income taxes		
Current	(4,230,905)	422,049
Deferred	(175,928)	(1,734,062)
	(4,406,833)	(1,312,013)
Net loss	(7,403,978)	(5,897,545)
Other comprehensive income (loss)		
Foreign currency translation	(7,131,727)	10,834,073
Total comprehensive income (loss) for the period	\$ (14,535,705)	\$ 4,936,528
Loss per share – basic	\$ (0.18)	\$ (0.17)
Loss per share – diluted	\$ (0.18)	\$ (0.17)

See accompanying notes to unaudited condensed consolidated interim financial statements.

## Condensed Consolidated Statements of Changes in Equity

(unaudited)

Three-month period ended March 31, 2016	Share Capital		Contributed Surplus	Accumulated Other Comprehensive Income	Retained Earnings	Total Equity
	Number	Amount (\$)				
Balance, December 31, 2015	41,567,023	\$ 213,604,045	\$ 5,390,124	\$ 18,337,213	\$ (36,393,629)	\$ 200,937,753
Issuance of share capital	6,892	10,935	-	-	-	10,935
Share-based payments	-	-	286,381	-	-	286,381
Net loss	-	-	-	-	(7,403,978)	(7,403,978)
Foreign currency translation	-	-	-	(7,131,727)	-	(7,131,727)
<b>Balance, March 31, 2016</b>	<b>41,573,915</b>	<b>\$ 213,614,980</b>	<b>\$ 5,676,505</b>	<b>\$ 11,205,486</b>	<b>\$ (43,797,607)</b>	<b>\$ 186,699,364</b>

Three-month period ended March 31, 2015	Share Capital		Contributed Surplus	Accumulated Other Comprehensive Income	Retained Earnings	Total Equity
	Number	Amount (\$)				
Balance, December 31, 2014	35,237,839	\$ 178,650,340	\$ 4,513,265	\$ (64,479)	\$ 16,861,918	\$ 199,961,044
Issuance of share capital	87,692	563,715	-	-	-	563,715
Share-based payments	-	-	200,399	-	-	200,399
Net loss	-	-	-	-	(5,897,545)	(5,897,545)
Foreign currency translation	-	-	-	10,834,073	-	10,834,073
Dividends	-	-	-	-	(6,176,996)	(6,176,996)
<b>Balance, March 31, 2015</b>	<b>35,325,531</b>	<b>\$ 179,214,055</b>	<b>\$ 4,713,664</b>	<b>\$ 10,769,594</b>	<b>\$ 4,787,377</b>	<b>\$ 199,484,690</b>

See accompanying notes to unaudited condensed consolidated interim financial statements.

## Condensed Consolidated Statements of Cash Flows

(unaudited)

	Three-month periods ended March 31,	
	2016	2015
Cash flows from operating activities:		
Net loss	\$ (7,403,978)	\$ (5,897,545)
Adjustments for:		
Depreciation and amortization	14,002,745	9,304,570
Provision for (Recovery of) income taxes	(4,406,833)	(1,312,013)
Unrealized foreign exchange loss (gain)	1,442,188	(1,175,152)
Loss (Gain) on disposition of drilling equipment	(1,205,107)	105,023
Equity-settled share-based payments	286,381	200,399
Finance expense	571,410	1,129,179
Other non-cash charges	300,000	977,973
Amortization of deferred income	(33,333)	(33,333)
Provision for bad debts	30,418	-
Change in non-cash working capital	(2,331,682)	18,629,819
Cash generated from operating activities	1,252,209	21,928,920
Interest paid	(438,245)	(983,533)
Income taxes paid	(56,396)	(1,325,863)
Net cash generated from operating activities	757,568	19,619,524
Cash flows from investing activities:		
Proceeds on disposition of drilling equipment	2,576,187	1,065,836
Acquisition of drilling and other equipment	(856,696)	(10,603,554)
Acquisition of intangible assets	(176,543)	(969,203)
Change in non-cash working capital	(116,669)	1,423,338
Net cash generated from (used in) investing activities	1,426,279	(9,083,583)
Cash flows from financing activities:		
Proceeds from issuance of share capital	10,935	563,715
Dividends paid to shareholders	(415,670)	(7,407,252)
Proceeds on (Repayment of) loans and borrowings	(10,000,000)	7,500,600
Payments under finance leases	-	(43,655)
Proceeds on (Repayment) of operating facility	713,363	(5,503,176)
Net cash used in financing activities	(9,691,372)	(4,889,768)
Net increase (decrease) in cash and cash equivalents	(7,507,525)	5,646,173
Cash and cash equivalents, beginning of period	9,007,808	3,018,445
Cash and cash equivalents, end of period	\$ 1,500,283	\$ 8,664,618

See accompanying notes to unaudited condensed consolidated interim financial statements.

# Notes to the Condensed Consolidated Financial Statements

For the three-month periods ended March 31, 2016 and 2015

In Canadian dollars (*unaudited*)

## 1. Reporting Entity:

PHX Energy is a publicly-traded Corporation listed on the Toronto Stock Exchange under the symbol "PHX".

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, Albania, and Russia. The Corporation also develops and manufactures technologies that are made available for internal operational use.

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

## 2. Basis of Preparation:

### a) Statement of Compliance

These condensed consolidated interim financial statements have been prepared in accordance with IAS 34 Interim Financial Reporting. The condensed consolidated interim financial statements do not include all of the information required for full annual financial statements and should be read in conjunction with the consolidated financial statements of the Corporation as at and for the year ended December 31, 2015.

These condensed consolidated interim financial statements were authorized by the Board of Directors on May 4, 2016.

### b) Basis of Measurement

The condensed consolidated interim financial statements have been prepared on a going concern basis and 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 condensed consolidated interim financial statements are presented in Canadian dollars, which is the Corporation's functional currency.

### d) Use of Estimates and Judgments

The preparation of the condensed consolidated interim financial statements in conformity with International Financial Reporting Standards ("IFRS") requires Management to make judgments, 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.

In preparing these condensed consolidated interim financial statements, the significant judgments made by Management in applying the Corporation's accounting policies and the key sources of estimation uncertainty have not changed significantly since December 31, 2015.

## 3. Significant Accounting Policies:

These condensed consolidated interim financial statements have been prepared utilizing the same accounting policies and methods as the consolidated financial statements of the Corporation for the year ended December 31, 2015.

## 4. Operating Segments:

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

### Information about reportable segments

*(Stated in thousands of dollars)*

Three-month periods ended March 31,	Canada		United States		International		Total	
	2016	2015	2016	2015	2016	2015	2016	2015
Revenue	15,620	37,503	21,739	60,236	3,090	6,189	40,449	103,928
Reportable segment loss before income taxes	(3,262)	(3,937)	(7,783)	(1,262)	(692)	1,183	(11,737)	(4,016)

*(Stated in thousands of dollars)*

As at March 31,	Canada		United States		International		Total	
	2016	2015	2016	2015	2016	2015	2016	2015
Drilling and other equipment	122,085	167,077	12,516	14,397	13,288	17,012	147,889	198,486
Goodwill	8,876	16,230	-	-	-	-	8,876	16,230

### Reconciliation of reportable segment loss and other material items

*(Stated in thousands of dollars)*

	Three-month periods ended March 31,	
	2016	2015
Reportable segment loss before income taxes	(11,737)	(4,016)
Corporate:		
Selling, general and administrative expenses	504	1,541
Research and development expenses	525	859
Finance expense	571	1,129
Other income	(1,526)	(335)
Loss before income taxes	(11,811)	(7,210)

## 5. Seasonality of Operations:

A significant portion of the Corporation's operations are carried out in western Canada. 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. In addition, many exploration and production areas in northern Canada are accessible only in winter months when the ground is frozen enough to support equipment. The timing of freeze-up and spring break-up affects the ability to move equipment in and out of these areas. As a result, late March through May is traditionally the Corporation's least active time, and as such the operating results of the Corporation will vary on a quarterly basis.

## 6. Drilling and Other Equipment:

### a) Acquisitions and Disposals

During the three-month period ended March 31, 2016, the Corporation acquired assets with a cost of \$0.9 million (2015 - \$10.6 million).

Assets with a carrying amount of \$1.4 million (2015 - \$1.2 million) were disposed of as a result of tools lost down hole and scrapped assets, resulting in a net gain on disposition of \$1.2 million (2015 - \$0.1 million net loss), which is included in other income in the condensed consolidated statement of comprehensive income.

### b) Capital Commitments

As at March 31, 2016, the Corporation has commitments to purchase drilling and other equipment for \$1.1 million; delivery is expected to occur by the end of September 2016.

## 7. Intangible Assets:

During the three-month period ended March 31, 2016, the Corporation acquired intangible assets with a total cost of \$0.2 million (2015 - \$1.0 million), most of which related to development costs. An additional \$5.0 million is estimated to be paid, contingent on the licensor's successful completion of performance criteria set under the license agreement.

As at March 31, 2016, the contingent liabilities arising from the agreements are as follows:

*(Stated in thousands of dollars)*

	2016	2017	Total
License	1,000	4,000	5,000

## 8. Loans and Borrowings:

*(Stated in thousands of dollars)*

	Currency	Amount of Facility	Date of Maturity	Currency	Carrying Amount at March 31, 2016	Currency	Carrying Amount at December 31, 2015
Operating Facility	CAD	15,000	Due on demand	CAD	713	CAD	-
Syndicated Facility	CAD	70,000	December 12, 2018	CAD	50,000	CAD	60,000
US Operating Facility	USD	2,500	December 12, 2018	USD	-	USD	-

On March 14, 2016, the Corporation reduced the maximum principal amount available under the Syndicated Credit Facility from CDN\$90 million to CDN\$70 million. The purpose of the decrease was to reduce the standby fees charged on unused balances under the credit facilities.

Under the syndicated loan agreement, the Corporation is required to maintain certain financial covenants. As at March 31, 2016 the Corporation was in compliance with all its financial covenants as follows:

Ratio	Covenant	As at March 31, 2016
Debt to covenant EBITDA	< or = 5.00:1.00	1.95
Interest coverage ratio	> or = 3.00:1.00	8.93

## 9. Share Capital:

### a) Authorized and Issued Shares

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

	Number		Amount
Balance as at January 1, 2015	35,237,839	\$	178,650,340
Issued shares pursuant to equity financing and private placement	6,191,700		35,602,275
Transaction costs	-		(2,052,433)
Tax effect of transaction costs	-		573,993
Issued shares pursuant to DRIP	137,484		829,870
Balance as at December 31, 2015	41,567,023	\$	213,604,045
Issued shares pursuant to DRIP	6,892		10,935
Balance as at March 31, 2016	41,573,915		213,614,980

### b) Dividends

During the three-month period ended March 31, 2016, the Corporation paid dividends totaling \$0.4 million (2015 - \$7.4 million). On February 24, 2016, the Corporation announced the elimination of its quarterly dividend, which was effective immediately.

### c) Share Option Program (Equity-Settled)

PHX Energy has a share option program that entitles key management personnel and other employees to purchase 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 shares ending immediately prior to the date of grant, or in the case of a US option holder, the trading price of the shares ending immediately prior to the date of grant. The options have a term of five years.

Summary of option grants in 2016

Number	Exercise Price	Expiration Date	Fair Value
1,535,000	\$ 1.55	March 4, 2021	\$ 1.11
340,000	1.95	March 4, 2021	0.95
1,875,000			

During the period ended March 31, 2016, there were no options exercised (2015 - nil) and a total of 215,835 options were forfeited/cancelled (2015 - 5,000). As at March 31, 2016, the Corporation had a total of 4,021,458 options outstanding (2015 - 2,777,030) which expire over a period of less than 1 year to 5 years.

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 in 2016 these variables include, but are not limited to, the Corporation's expected share price volatility over the term of the options of 45 percent, forfeiture rate of 1 percent, and a risk free interest rate of 0.52 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 2016, the Corporation recognized a total compensation expense of \$286,381 (2015 - \$200,399) for share options granted between 2012 and 2016.

A summary of the status of the plan as at March 31, 2016, is presented below:

	2016		2015	
	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price
Outstanding, beginning of period	2,362,293	\$ 9.41	1,852,030	\$ 10.74
Granted	1,875,000	1.62	930,000	6.92
Forfeited / cancelled	(215,835)	8.20	(5,000)	11.07
Outstanding, end of period	4,021,458	5.84	2,777,030	7.98
Options exercisable, end of period	1,451,454	10.30	1,322,020	10.73

The range of exercise prices for options outstanding at March 31, 2016 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	1,535,000	4.88 yrs	\$ 1.55	-	\$ -	
1.95	340,000	4.88 yrs	1.95	-	-	
6.87 - 15.81	2,146,458	2.59 yrs	9.53	1,451,454	10.30	
	4,021,458	3.66 yrs	\$ 5.84	1,451,454	\$ 10.30	

## 10. Other Income:

*(Stated in thousands of dollars)*

	Three-month periods ended March 31,	
	2016	2015
Gain (Loss) on disposition of drilling equipment	1,205	(105)
Foreign exchange gains	351	440
Provision for bad debts	(30)	-
Other Income	1,526	335

## 11. Fair Values of Financial Instruments:

The Corporation has designated its trade and other payables and dividends payable as other financial liabilities carried at amortized cost. Trade and other receivables 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 other financial liability, and are measured at amortized cost. The fair value of loans and borrowings included in the condensed consolidated statement of financial position approximates fair values as the indebtedness is subject to floating rates of interest.

# Corporate Information

## Board of Directors

John Hooks  
Randolph ("Randy") M. Charron  
J. Cameron Bailey  
Myron Tétreault  
Judith Athaide  
Lawrence Hibbard  
Roger Thomas

## 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  
Daniel Blanchard  
Vice President Executive Sales  
Jeffery Shafer  
Vice President Sales and Marketing

## 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