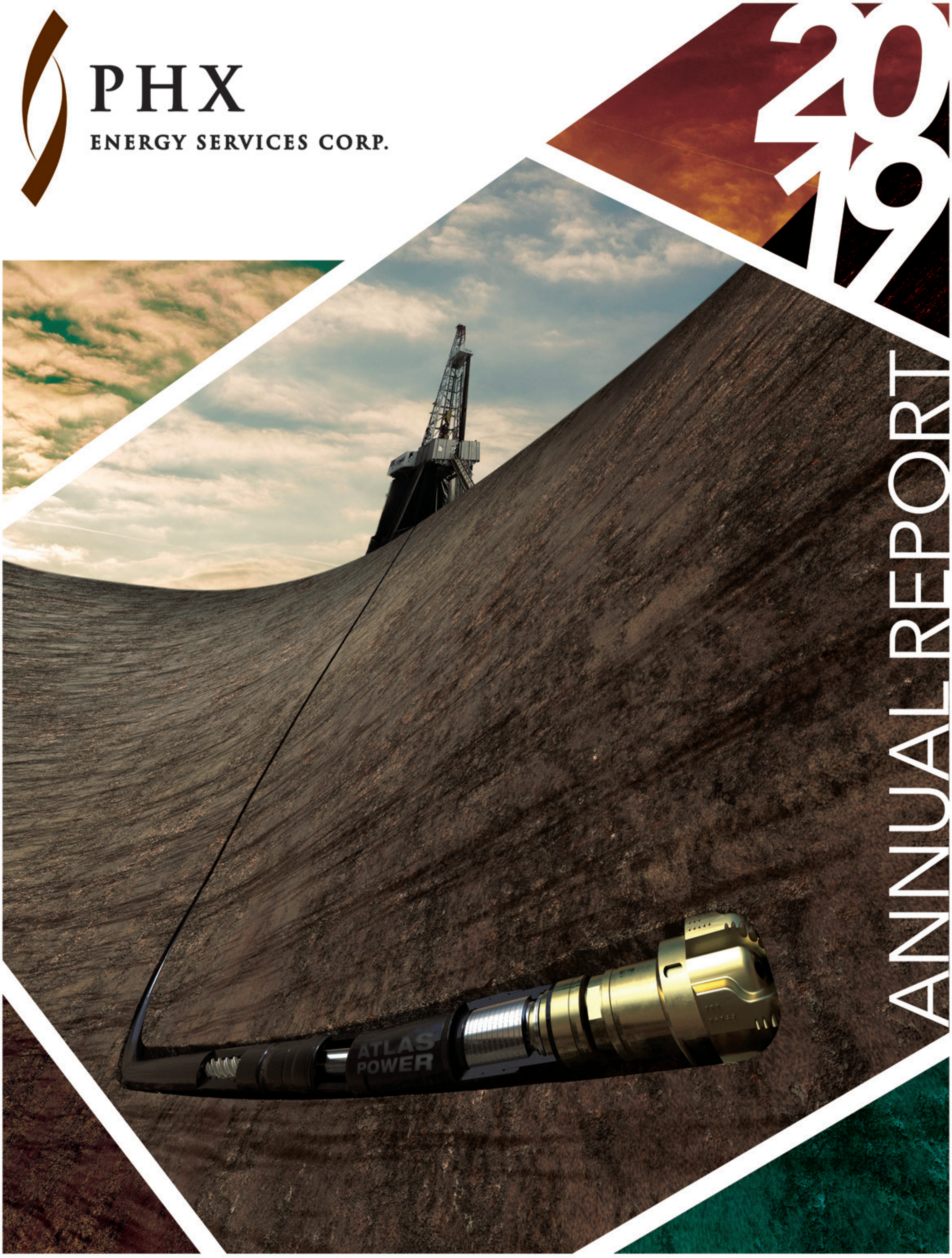
PHX

ENERGY SERVICES CORP.

2019 ANNUAL REPORT



Management's Discussion and Analysis

February 25, 2020

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, 2019 and 2018, and the accompanying notes contained therein, as well as other sections contained within the Corporation's 2019 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 25, 2020.

PHX Energy's audited annual financial statements for the years ended December 31, 2019 and 2018 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 25, 2020.

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:

- Equipment on order as at December 31, 2019 is expected to be delivered within the first half of 2020.
- PHX Energy currently anticipates that $30 million in capital expenditures will be spent in the 2020-year. The 2020 capital expenditure program is anticipated to principally be allocated toward expanding the Corporation's high performance fleets.
- Peters & Co. Limited forecasts that 2020 conventional capital spending to remain relatively flat.
- Capital spending for the most active operators in the US in 2019 was estimated by Peters & Co. Limited to be 8 percent lower than in 2018. They forecast in 2020 capital spending for the most active US operators may decline by an additional 10 percent.
- Planned expenditures are expected to be financed primarily by funds from operations and unused credit facilities. However, if a sustained period of market and commodity price uncertainty and financial market volatility persists in 2020, 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.

The above are stated under the headings: "Overall Performance", "Industry Activity & Statistics", and "Cash Requirements for Capital Expenditures". In addition, all information contained within the Critical Accounting Estimates and Judgments, Financial Instruments, Business Risk Factors and Outlook section of this MD&A contains forward-looking information and 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, 2019, PHX Energy had 835 full-time employees and the Corporation utilized over 150 additional field consultants in 2019.

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,		
	2019	2018	% Change	**2019**	2018	% Change
Operating Results	***(unaudited)***	*(unaudited)*				
Revenue	**93,853**	92,335	2	**362,057**	317,135	14
Net loss	**(1,720)**	(18,355)	(91)	**(2,213)**	(18,947)	(88)
Loss per share – diluted	**(0.03)**	(0.32)	(91)	**(0.04)**	(0.33)	(88)
Adjusted EBITDA [(1)]	**12,399**	14,736	(16)	**50,360**	45,449	11
Adjusted EBITDA [(1)] per share – diluted	**0.22**	0.25	(12)	**0.88**	0.77	14
Adjusted EBITDA [(1)] as a percentage of revenue	**13%**	16%		**14%**	14%	
Cash Flow						
Cash flows from operating activities	**9,508**	(2,541)	n.m.	**50,173**	13,330	n.m.
Funds from operations [(1)]	**11,344**	12,803	(11)	**45,896**	37,178	23
Funds from operations per share – diluted [(1)]	**0.21**	0.22	(5)	**0.80**	0.63	27
Capital expenditures	**5,686**	19,196	(70)	**34,526**	35,027	(1)
Financial Position, December 31,						
Working capital [(1)]				**68,393**	66,315	3
Net Debt [(1)]				**14,710**	21,526	(32)
Shareholders' equity				**148,944**	173,739	(14)
Common shares outstanding				**53,246,420**	57,963,720	(8)

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

Throughout this MD&A, PHX Energy uses 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, working capital and net debt. 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

In the 2019-year, the Corporation achieved its highest adjusted EBITDA since 2014, despite declines in North American industry activity. This is the third consecutive year that the Corporation has produced this result as PHX Energy has progressively strengthened its profitability year-over-year since 2017. Adjusted EBITDA for the year ended December 31, 2019 increased 11 percent to $50.4 million compared to $45.4 million reported in 2018. The Corporation's improved profitability was generally driven by greater capacity of PHX Energy's high performance technologies, which generate higher margins. For the three-month period ended December 31, 2019, adjusted EBITDA was $12.4 million, a 16 percent decrease as compared to the $14.7 million generated in the corresponding 2018-quarter due to slower activity in Canada.

PHX Energy also achieved its highest consolidated revenue since 2014 in the 2019-year. The Corporation's consolidated revenue increased 14 percent to $362.1 million, compared to $317.1 million in 2018. The higher revenue achieved is mainly attributable to increased revenue per day in the US and Canadian divisions and higher activity levels generated by Phoenix USA. The annual average consolidated revenue per day, excluding the motor rental division in the US and the EDR division, for 2019 was $13,495, a 14 percent improvement compared to an annual average of $11,816 in 2018. The higher revenue per day was primarily due to the increased capacity of the Corporation's high performance technology fleets in the US, specifically Velocity Real Time Systems ("Velocity"), PowerDrive Orbit Rotary Steerable Systems ("RSS"), and Atlas High Performance ("Atlas") Motors. For the quarter ended December 31, 2019, the Corporation's consolidated revenue increased slightly (2 percent) to $93.9 million from the $92.3 million realized in the corresponding 2018-quarter.

The Corporation reported a net loss of $2.2 million for the 2019-year, an 88 percent improvement as compared to the $18.9 million reported in the 2018-year. The 2019 net loss includes impairment losses of $0.5 million (2018 - $4.5 million). In 2018, the net loss includes $17.7 million of unrecognized deferred tax assets relating to Canadian jurisdictions.

As at December 31, 2019, PHX Energy had loans and borrowings of $13.9 million as well as operating facility borrowings of $11.4 million. These debt items less cash and cash equivalents of $10.6 million resulted in net debt of $14.7 million (December 31, 2018 - $21.5 million)

Capital Spending

For the year ended December 31, 2019, the Corporation spent $34.5 million in capital expenditures, primarily directed towards its high performance fleets. Of the total capital expenditures, $22.7 million was spent on growing the Corporation's fleet of drilling equipment and the remaining $11.8 million was spent on maintenance of the current fleet of drilling and other equipment. Capital expenditures in the 2019-year were mainly directed towards Atlas Motors and Velocity systems. As at December 31, 2019, $19.5 million of equipment, primarily dedicated to Atlas Motors and Velocity systems, was on order and is expected to be delivered within the first half of 2020.

PHX Energy currently anticipates that $30 million in capital expenditures will be spent in the 2020-year. The 2020 capital expenditure program is anticipated to principally be allocated toward expanding the Corporation's high performance fleets.

Normal Course Issuer Bid

During the third quarter of 2019, 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 3,280,889 common shares, representing 10 percent of the Corporation's public float of Common Shares as at July 31, 2019. The NCIB commenced on August 9, 2019 and will terminate on August 8, 2020. 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 current NCIB, subsequent to August 9, 2019, 2,524,500 common shares were purchased by the Corporation and cancelled as at December 31, 2019.

The Corporation's previous NCIB commenced on August 8, 2018 and terminated on August 7, 2019. Pursuant to the previous NCIB, 357,500 common shares were purchased by the Corporation in the second half of 2018 and cancelled, and in 2019, the Corporation purchased and cancelled 2,237,800 common shares. In total, pursuant to the previous NCIB, 2,595,300 common shares were purchased and cancelled by the Corporation.

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. In 2019, the Corporation purchased and cancelled 8 percent of its total common shares outstanding as at December 31, 2018, representing 31 percent of funds from operations.

Change in Accounting Policy

During the fourth quarter of 2019 to appropriately align with IFRS, the Corporation changed its policy for how accruals relating to repairs and maintenance of drilling equipment are recorded, specifically the timing of when accruals are recorded. Accruals for repairs and maintenance were historically recorded when the drilling equipment arrived at the facility and was identified by the Corporation as requiring repair, but prior to any work having been performed. Accruals for repairs and maintenance are now recorded when repairs are performed by the third party vendor, and expensed as they are incurred. As a result, previously reported trade and other payables were overstated. The effect to net income (loss) for the years ended December 31, 2019 and 2018 is immaterial. The effect of the recast on the January 1 and December 31, 2018 Consolidated Statements of Financial Position is summarized below.

January 1, 2018	As previously reported	Accrual Adjustment	As Recast
Current tax assets	1,353,622	(552,660)	800,962
Trade and other payables	41,629,783	(6,551,428)	35,078,355
Deferred tax liability	378,170	673,793	1,051,963
Retained Earnings	(106,438,399)	5,324,975	(101,113,424)

December 31, 2018	As previously reported	Accrual Adjustment	As Recast
Current tax assets	625,964	(552,660)	73,304
Trade and other payables	64,578,428	(6,551,428)	58,027,000
Deferred tax liability	2,886,606	673,793	3,560,399
Retained Earnings	(125,385,208)	5,324,975	(120,060,233)

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;
- gross profit margin;
- net debt (1),
- the reliability of the Corporation's equipment and ability to provide high quality services in the field, and
- health and safety performance targets.

(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 2019, the North American industry's activity declined with both the US and Canadian rig counts regressing as compared to 2018. In Canada the sharp decrease began in the first quarter and remained throughout the year, whereas in the US the rig count began to weaken in the second quarter and the drop steepened as the year progressed.

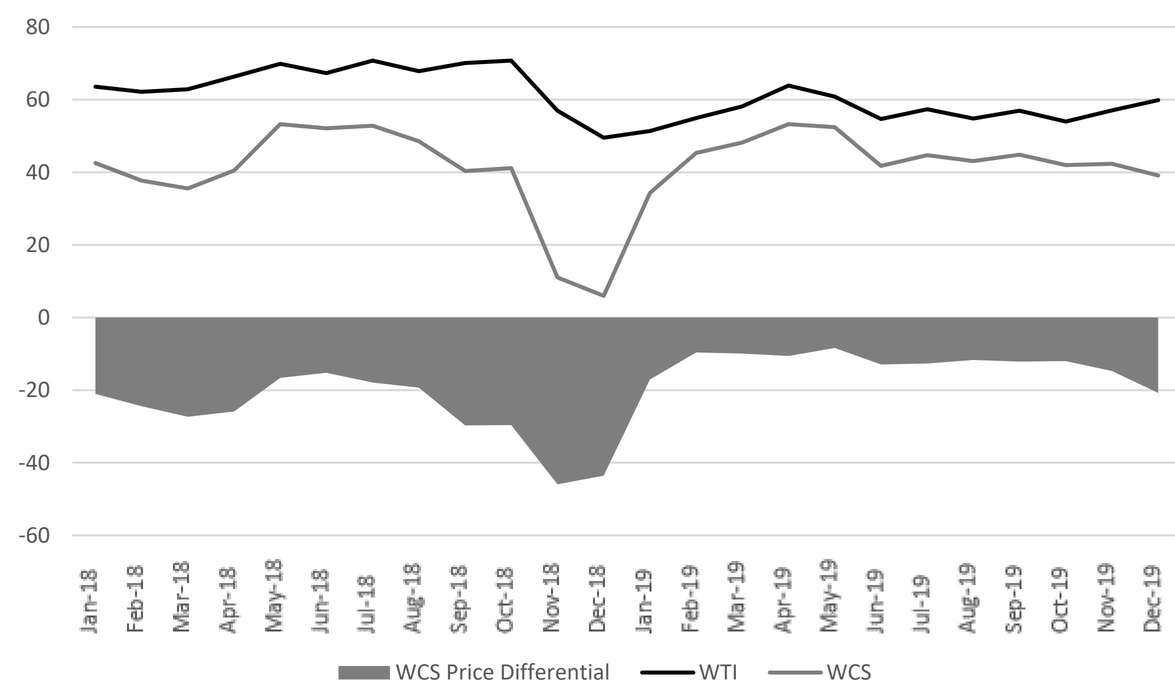
Commodity Price Trends

The commodity price environment has been weak in historical terms over the last five years, mainly as a result of supply growth in the US.

The price of crude oil remained relatively low in 2019 and the average Western Texas Intermediate ("WTI") price was approximately USD $57 for the year (2018 – USD $65). As a result of the Alberta government's curtailments, the price of Western Canadian Select ("WCS") improved in 2019 as compared to 2018 and the differential between WTI and WCS narrowed. The average price of WCS was USD $44 in 2019 (2018 – USD $38) and the average differential between WTI and WCS was USD$12 (2018 – USD $26). However in December and the start of 2020 the differential widened to approximately USD $20 as inventories built. (Source: Peters & Co. Limited, Energy Overview 2020, 01-13-20 and Alberta Government Economic Dashboard - https://economicdashboard.alberta.ca/OilPrice).

WTI and WCS Crude Oil and WCS Differential ($US/bbl)

Source: Alberta Government Economic Dashboard - https://economicdashboard.alberta.ca/OilPrice

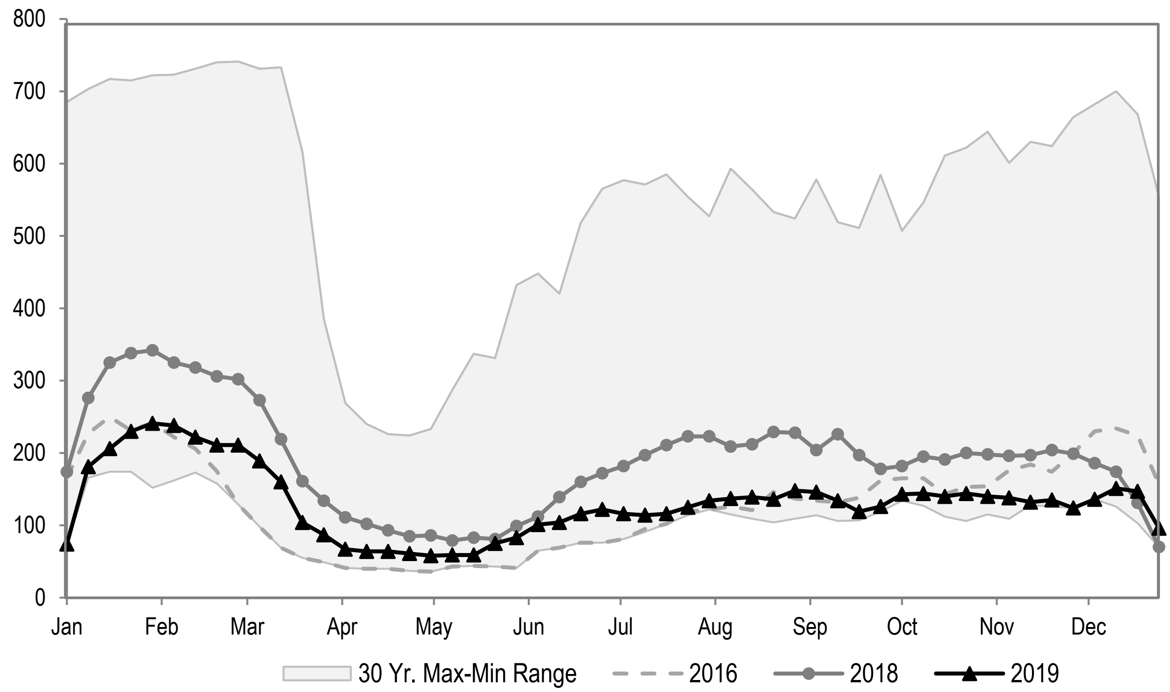


The natural gas commodity prices also remained relatively low in 2019, but as is the case with oil commodities, the Canadian gas prices (AECO strip) was one of the top performing commodities over 2019 narrowing the differential. The Henry Hub spot price in 2019 averaged USD $2.57 in 2019 (2018 – USD $2.84) while AECO-C spot averaged CAD $1.78 in 2019 (2018 – CAD $1.65). (Source: Peters & Co. Limited, Energy Overview 2020, 01-13-20 and Peters & Co. Limited, Energy Statistics, 12-31-2019).

Canadian Industry

WCSB Active Drilling Rig Count

Source: Baker Hughes, North American Rotary Rig Count, 01-24-20



Despite the narrowing WCS and WTI differential, activity levels in Canada were one of the weakest in the last 30 years as the industry continued to faces challenges related to market access. In 2019, there were 31 percent fewer rigs operating on average as compared to the 2018-year and the rig count hovered around the levels experienced in 2016, the trough of the downturn. Horizontal and directional drilling continues to be the norm in the industry, and combined, horizontal and directional wells represented 95 percent of the total 2019 industry drilling days (2018 – 96 percent). Oil well drilling represented 62 percent of the Canadian industry's average active rig count in 2019 which is on par with 2018. (Source: Daily Oil Bulletin, hz-dir days 191231, 01-09-2020 and Baker Hughes, North American Rotary Rig Count, 01-24-20).

Canadian producers' conventional capital spending also declined approximately 30 percent year-over-year according to Peters & Co. Limited, and they forecast that 2020 conventional capital spending to remain relatively flat. (Source: Peters & Co. Limited, Energy Overview 2020, 01-13-20).

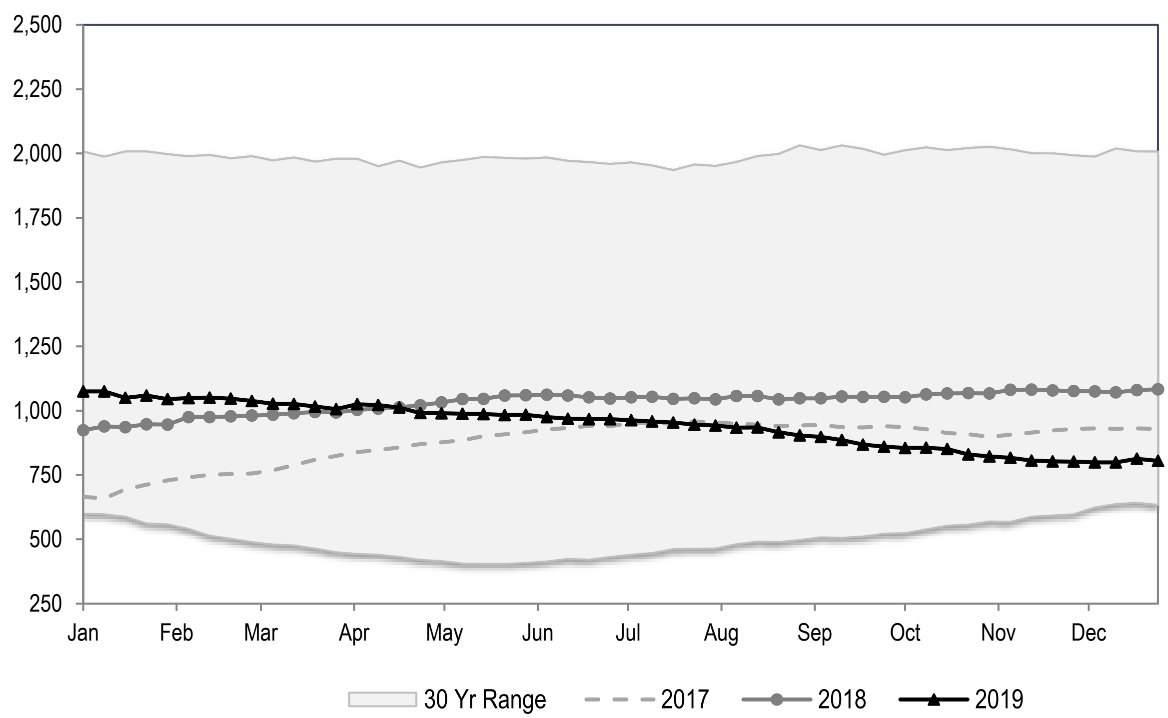
US Industry

The volume of US drilling activity weakened after two years of improved activity with the average number of active rigs in the year decreasing 9 percent. By the fourth quarter of the year the rig count had declined to the lowest level since the first quarter of 2017. The average rig count in 2019 was 943 rigs, as compared to an average of 1,032 rigs in 2018. The Permian basin continued to be the largest area of activity in the US, representing 47 percent of the average active rigs in 2019 (2018 - 45 percent) and the Permian was more resilient compared to the overall industry with a year-over-year decline of 5 percent. The dominance of horizontal and directional drilling continued representing 94 percent of active rigs (2018 - 94 percent). (Source: Peters & Co. Limited, Energy Overview 2020, 01-13-20 and Baker Hughes, North American Rotary Rig Count, 01-24-20).

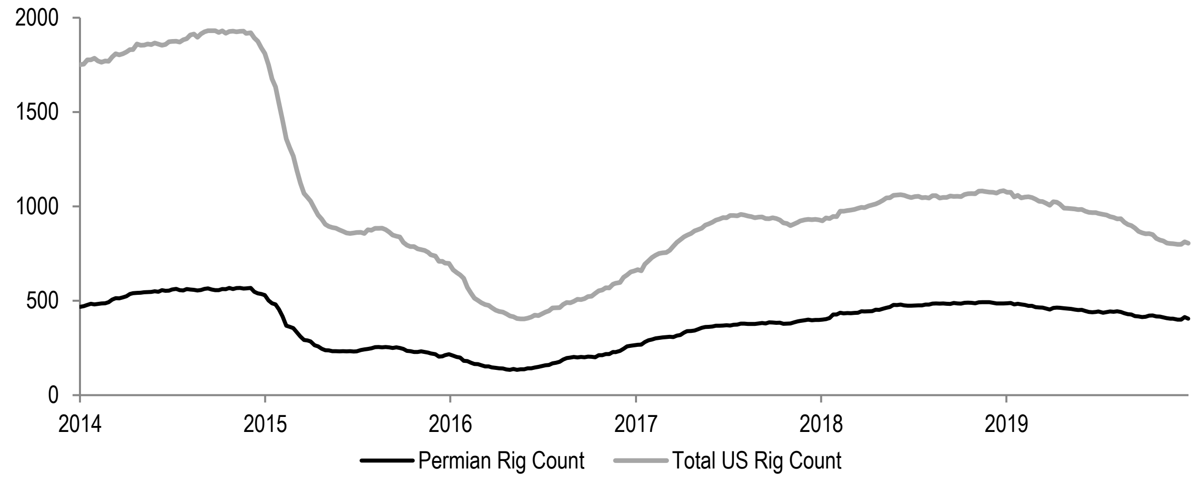
Capital spending for the most active operators in the US in 2019 was estimated by Peters & Co. Limited to be 8 percent lower than in 2018 in line with the weakening of the US activity. They forecast in 2020 capital spending for the most active US operators may decline by an additional 10 percent. (Source: Peters & Co. Limited, Energy Overview 2020, 01-13-20).

US Active Drilling Rig Count

Baker Hughes, North American Rotary Rig Count, 01-24-20



US Total Rig Count and Permian Basin Rig Count
Source: Baker Hughes, North American Rotary Rig Count, 01-04-2020



Results of Operations

Three-Month Period and Year Ended December 31, 2019

Revenue

(Stated in thousands of dollars)

	Three-month periods ended December 31,			Years ended December 31,		
	2019	2018	% Change	**2019**	2018	% Change
Revenue	**93,853**	92,335	2	**362,057**	317,135	14

PHX Energy achieved the highest quarterly revenue since the first quarter of 2015, despite weaker drilling activity seen in both the Canadian and US industry. For the three-month period ended December 31, 2019, consolidated revenue increased 2 percent to $93.9 million compared to $92.3 million in the corresponding 2018-quarter. Higher revenue in the quarter was primarily driven by increased revenue associated with PHX Energy's high performance technologies as the Corporation continued to expand capacity during the quarter to address growing demand. Average consolidated revenue per day, excluding the motor rental division in the US and the EDR division, for the three-month period ended December 31, 2019 was $14,117 an increase of 9 percent as compared to $12,929 in the 2018-quarter. The impact of the higher average revenue per day on consolidated revenue was partially offset by lower drilling activity in Canada. In the 2019-quarter consolidated operating days decreased by 8 percent to 6,349 days compared to 6,920 days in the corresponding 2018-quarter. US and international revenue were 76 percent and 5 percent of total consolidated revenue, respectively, for the 2019-quarter relative to 70 percent and 4 percent, respectively, for the 2018-quarter.

In the fourth quarter of 2019, the US and Canadian rig counts dropped by 24 percent when compared to the number of rigs operating in the comparable quarter of 2018. In Canada the quarter-over-quarter decrease was similar to the decline experienced in prior 2019 quarters, whereas in the US the quarter-over-quarter decline was much sharper in the fourth quarter compared to earlier quarters of the year. In Canada there was an average of 136 active rigs per day in the fourth quarter of 2019 (2018 - 179 rigs) and in the US there was an average of 820 active rigs per day in the fourth quarter of 2019 (2018 - 1,073 rigs). The Permian basin remained the most active play in North America representing 43 percent of the North American rig count. There was an average of 410 active Permian rigs in the fourth quarter of 2019, which is 16 percent lower than in the fourth quarter of 2018. Horizontal and directional drilling continues to dominate the market representing approximately 95 percent of the drilling activity in North America (Source: Daily Oil Bulletin and Baker Hughes).

For the year ended December 31, 2019, consolidated revenue was $362.1, an increase of 14 percent, compared to $317.1 million in 2018. Higher revenue in 2019 was mainly driven by the US division. US and international revenue, as a percentage of total consolidated revenue, were 75 percent (2018 – 66 percent) and 6 percent (2018 – 6 percent), respectively. The annual average consolidated revenue per day, excluding the motor rental division in the US and the EDR division, in 2019 was $13,495 relative to $11,816 in 2018. In the 2019-year, consolidated operating days were down 2 percent to 25,570 days versus 26,140 days in the same 2018-period, due to lower drilling activity in Canada.

Operating Costs and Expenses

(Stated in thousands of dollars except percentages)

	Three-month periods ended December 31,			Years ended December 31,		
	2019	2018	% Change	**2019**	2018	% Change
Direct costs	**81,468**	78,454	4	**309,608**	276,250	12
Gross profit as a percentage of revenue	**13%**	15%		**14%**	13%	
Depreciation & amortization (included in direct costs)	**9,668**	10,126	(5)	**39,846**	39,738	-
Depreciation & amortization right-of-use asset (included in direct costs)	**898**	-	n.m.	**3,539**	-	n.m.
Gross profit as percentage of revenue excluding depreciation & amortization	**24%**	26%		**26%**	25%	

n.m. – not meaningful

Direct costs are comprised of field and shop expenses, and include depreciation and amortization of the Corporation's equipment and right-of-use assets. Depreciation on right-of-use assets relates to the impact of adopting IFRS 16 Leases as at January 1, 2019, which required capitalizing the Corporation's office, shop and vehicle leases.

For the three-month period ended December 31, 2019, direct costs increased 4 percent to $81.5 million compared to $78.5 million in the 2018-quarter, primarily due to greater volume of equipment repair expenses and equipment rentals. For the year ended December 31, 2019, direct costs increased 12 percent to $309.6 million from $276.3 million in the 2018-year, as a result of Phoenix USA's increased activity. In the 2019-year, the Corporation incurred higher overall labour costs, a greater number of equipment repair expenses, and more equipment rentals.

For the fourth quarter of 2019, gross profit as a percent of revenue, excluding depreciation and amortization, was 24 percent as compared to 26 percent in the 2018-quarter. The lower percentage in the 2019-quarter was primarily due to weaker drilling activity in Canada that resulted in a decline in the division's profitability. For the 2019-year, gross profit as a percent of revenue, excluding depreciation and amortization, was 26 percent in comparison to 25 percent in 2018. Improved profitability for the 2019-year is primarily due to increased activity and revenue per day in PHX Energy's US division.

(Stated in thousands of dollars except percentages)

	Three-month periods ended December 31,			Years ended December 31,		
	2019	2018	% Change	**2019**	2018	% Change
Selling, general and administrative ("SG&A") costs	**10,544**	10,707	(2)	**45,756**	41,472	10
Equity-settled share-based payments (included in SG&A costs)	**52**	168	(69)	**612**	1,369	(55)
Cash-settled share-based payments (included in SG&A costs)	**1,751**	44	n.m.	**6,859**	4,120	66
Onerous contract rent expense (included in SG&A costs)	**-**	(44)	n.m.	**-**	(314)	n.m.
SG&A costs excluding share- based payments and onerous expenses as a percentage of revenue	**9%**	11%		**11%**	11%	

n.m. – not meaningful

For the three-month period ended December 31, 2019, SG&A costs decreased slightly by 2 percent to $10.5 million from $10.7 million in the 2018-quarter. This decrease was mainly due to lower personnel costs and lower facilities expenses as a result of adopting IFRS 16 Leases in 2019, which were partially offset by higher cash-settled share-based payments in the 2019-quarter. Annual SG&A costs in 2019 increased 10 percent to $45.8 million from $41.5 million in 2018 primarily due to higher cash-settled share-based payments and higher overall personnel costs associated with Phoenix USA's increased activity.

Cash-settled share-based payments relate to the Corporation's Retention Award Plan and are measured at fair value. For the three-month period and year ended December 31, 2019 the Corporation's cash-settled share-based payments increased to $1.8 million and $6.9 million, respectively, as compared to $44 thousand and $4.1 million in the corresponding 2018-periods.

Changes in cash-settled share-based payments in the 2019-periods are mainly attributable to fluctuations in the Corporation's share price period-over-period.

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, 2019, equity-settled share-based payments decreased to $0.1 million and $0.6 million, respectively, compared to $0.2 million and $1.4 million in the same 2018-periods. The lower equity-settled share-based payments are due to previously granted options that fully vested in the 2018 and 2019-years.

Due to adoption of IFRS 16 Leases as of January 1, 2019, onerous contract lease payments are no longer recorded.

(Stated in thousands of dollars)

	Three-month periods ended December 31,			Years ended December 31,		
	2019	2018	% Change	**2019**	2018	% Change
Research and development expense	**896**	847	6	**3,869**	3,354	15

Research and development ("R&D") expenditures during the quarter and year ended December 31, 2019 were $0.9 million and $3.9 million, respectively, compared to $0.8 million and $3.4 million in the corresponding 2018-periods. PHX Energy's R&D focus continues to be on developing new technologies, improving reliability of equipment, and reducing costs to operations. Higher R&D costs in both 2019-periods are attributable to prototype expenses to further enhance Velocity's operational performance.

(Stated in thousands of dollars)

	Three-month periods ended December 31,			Years ended December 31,		
	2019	2018	% Change	**2019**	2018	% Change
Finance expense	**337**	279	21	**1,426**	1,208	18
Finance expense lease liability	**612**	-	n.m.	**2,509**	-	n.m.

n.m. – not meaningful

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, 2019, the Corporation's finance expense grew by 21 percent and 18 percent, respectively, relative to the same 2018-periods. Higher finance expenses in the respective periods are primarily due to higher average long-term borrowings as a result of increased capital expenditures and common share repurchases relative to the same 2018-periods.

Finance expense lease liability relates to interest expenses incurred on lease liabilities, as a result of the adoption of IFRS 16 Leases in 2019.

(Stated in thousands of dollars)

	Three-month periods ended December 31,		Years ended December 31,	
	2019	2018	**2019**	2018
Net gain on disposition of drilling equipment	**(1,039)**	(2,168)	**(4,429)**	(8,377)
Foreign exchange loss	**322**	503	**879**	199
Provision for bad debts	**-**	24	**388**	9
Other income	**(717)**	(1,641)	**(3,162)**	(8,169)

Net gain 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 asset retirements that were made before the end of the equipment's useful life and self-insured downhole equipment losses. During the quarter and year ended December 31, 2019, the Corporation recognized $1 million and $4.4 million gain on dispositions, respectively, compared to $2.2 million and $8.4 million gain on dispositions in the corresponding 2018-periods. In both 2019-periods, the Corporation noted fewer instances of high value downhole equipment losses and more occurrences of asset retirements relative to the same 2018-periods.

Foreign exchange losses relate to unrealized and realized exchange losses in the period. For the three-month period and year ended December 31, 2019, the Corporation recognized $0.3 million and $0.9 million in losses, respectively, as compared to $0.5 million and $0.2 million losses in the relative 2018-periods. Losses in the 2019-periods were primarily due to settlement of US-denominated intercompany payables in the international segment.

(Stated in thousands of dollars except percentages)

	Three-month periods ended December 31,		Years ended December 31,	
	2019	2018	**2019**	2018
Provision for income taxes	**1,934**	17,546	**3,764**	17,469
Effective tax rates	**n.m.**	n.m.	**n.m.**	n.m.

n.m. – not meaningful

The provision for income taxes for the three-month period and year ended December 31, 2019 was $1.9 million (2018 - $17.5 million) and $3.8 million (2018 - $17.5 million), respectively. The effective tax rates for the three-month period and year ended December 31, 2019 were higher than expected as a result of unrecognized deferred tax assets of $3.3 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,		
	2019	2018	% Change	**2019**	2018	% Change
Net loss	**(1,720)**	(18,355)	(91)	**(2,213)**	(18,947)	(88)
Loss per share – diluted	**(0.03)**	(0.32)	(91)	**(0.04)**	(0.33)	(88)
Adjusted EBITDA[(1)]	**12,399**	14,736	(16)	**50,360**	45,449	11
Adjusted EBITDA[(1)] per share – diluted	**0.22**	0.25	(12)	**0.88**	0.77	14
Adjusted EBITDA[(1)] as a percentage of revenue	**13%**	16%		**14%**	14%	

[(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 2019-quarter, mainly due to lower margins in the Canadian division and lower net gain on disposition of drilling equipment, the Corporation's adjusted EBITDA as a percentage of revenue decreased to 13 percent compared to 16 percent in the corresponding 2018-quarter. Net loss in the 2019-quarter decreased to $1.7 million as compared to $18.4 million in the 2018-quarter. Net loss for the 2019-quarter includes impairment losses of $0.5 million (2018 - $4.5 million). The 2018-quarter net loss included $17.7 million of derecognized deferred tax assets due to a recent history of tax losses in the Corporation's entities under Canadian jurisdiction. Adjusted EBITDA as a percent of revenue for the year ended December 31, 2019 was 14 percent (2018 – 14 percent).

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,		
	2019	2018	% Change	**2019**	2018	% Change
Revenue	**17,273**	24,302	(29)	**71,923**	90,610	(21)
Reportable segment profit (loss) before tax [(1)]	**(1,587)**	1,061	n.m.	**(5,917)**	(4,078)	45

[(1)] Includes adjustments to intercompany transactions.
n.m. - not meaningful

Throughout 2019 the Canadian oil and gas industry experienced challenges resulting in one of the lowest volumes of drilling activity in the last 30 years. Despite these challenges, PHX Energy continued to focus on maintaining profit margins and controlling costs, while delivering superior operational performance.

For the three-month period ended December 31, 2019, PHX Energy's Canadian revenue was $17.3 million in comparison to $24.3 million in the corresponding 2018-quarter, a decrease of 29 percent. Lower revenue in the 2019-quarter was primarily due to declining drilling activity. For the fourth quarter of 2019, PHX Energy's Canadian segment operating days declined 35 percent to 1,810 days compared to 2,768 days in the 2018-quarter. In comparison, the number of horizontal and directional drilling days in the industry decreased by 29 percent quarter-over-quarter from 16,253 days in the 2018-quarter to 11,459 days in the 2019-quarter (Source: Daily Oil Bulletin) and the overall rig count in the Canadian industry declined by 24 percent quarter-over-quarter (Source: Baker Hughes). The decrease in PHX Energy's Canadian segment revenue was partially offset by slightly higher average revenue per day. For the three-month period ended December 31, 2019, average revenue per day was $8,968, a 6 percent increase in comparison to an average of $8,452 in the 2018-quarter. Due to lower operating days, PHX Energy's Canadian reportable segment loss before tax was $1.6 million in the 2019-quarter.

During the fourth quarter of 2019, oil drilling, as measured by drilling days, represented approximately 43 percent of PHX Energy's Canadian activity. The Corporation remained active in the Montney, Wilrich, Bakken, Shaunavon, Duvernay, Cardium and Viking areas.

For the year ended December 31, 2019, lower drilling activity resulted in PHX Energy's Canadian revenue declining 21 percent to $71.9 million as compared to $90.6 million in 2018. PHX Energy's Canadian division recorded 7,700 operating days in 2019, a 26 percent decrease compared to the 10,462 days in 2018, which is in line with industry decline. In 2019, there were 45,414 horizontal and directional drilling days in the Canadian industry, which is a 32 percent decline as compared to the 66,398 days in 2018 (Sources: Daily Oil Bulletin). The overall rig count in the Canadian industry also fell 31 percent year-over-year. For the year ended December 31, 2019, average revenue per day increased 5 percent to $8,720 in comparison to an average of $8,287 in the 2018-year.

United States

(Stated in thousands of dollars)

	Three-month periods ended December 31,			Years ended December 31,		
	2019	2018	% Change	**2019**	2018	% Change
Revenue	**71,629**	64,270	11	**270,028**	208,112	30
Reportable segment profit before tax (1)	**5,153**	4,775	8	**20,899**	11,382	84

(1) Includes adjustments to intercompany transactions.

PHX Energy's US division continued to capitalize on the advantages of its high performance technologies throughout 2019. Despite sharp declines in US rig counts in the fourth quarter of 2019, Phoenix USA's activity once again outperformed the industry as a result of greater capacity in its high performance technology fleets, superior operational performance of personnel and equipment, and concentrated marketing efforts of the Corporation.

For the three-month period ended December 31, 2019, Phoenix USA's revenue grew 11 percent to $71.6 million as compared to $64.3 million in the corresponding 2018-quarter. Average revenue per day, excluding the Corporation's motor rental division, increased by 8 percent to $17,793 as compared to $16,508 in the 2018-quarter. The increase in average revenue per day was mainly due to the premiums and surcharges for the Corporation's high performance technologies, especially those resulting from increased RSS activity. In the face of declining US rig counts, the US division's operating days rose 2 percent in the fourth quarter of 2019 to 3,847 days from 3,765 days in the corresponding 2018-quarter. In comparison, the industry activity continued its downward trend that began in the second quarter of 2019, and the number of horizontal and directional rigs running per day declined 23 percent from 1,003 in the fourth quarter of 2018 to 768 rigs in the 2019-quarter. This is the lowest quarterly average rig count in the US industry since the first quarter of 2017 (Source: Baker Hughes). Reportable segment profit in the 2019-quarter increased by 8 percent to $5.2 million from $4.8 million in the 2018-quarter, mainly as a result of higher average revenue per day realized in the 2019-quarter.

In the fourth quarter of 2019, horizontal and directional drilling continued to represent a large majority of the industry rig count, averaging 94 percent of the rigs running on a daily basis. The vast majority of PHX Energy's activity was related to oil well drilling in the fourth quarter, excluding the motor rental division, as approximately half of the industry's drilling activity remained concentrated in Texas, specifically the Permian basin. During the fourth quarter of 2019, Phoenix USA remained active in the Permian, Mississippian/Woodford, Marcellus, Utica, Niobrara and Bakken basins.

Phoenix USA's annual revenue increased to $270 million in 2019, 30 percent higher as compared to the $208.1 million recorded in 2018. In the 2019-year, even with declining US rig counts, PHX Energy's US division grew its operating days by 14 percent to 15,348 from 13,506 days in the 2018-year. The US industry activity, as measured by the average number of horizontal and directional rigs running on a daily basis, declined by 8 percent to 889 rigs in 2019 compared from 969 rigs in 2018 (Source: Baker Hughes). Average revenue per day, excluding the Corporation's motor rental division, for the year ended December 31, 2019 rose to $16,798, an 11 percent increase when compared to the average of $15,074 in 2018. In the 2019-year, reportable segment profit increased 84 percent to $20.9 million as compared to $11.4 million recognized in the 2018-year. Higher profitability in the 2019-year is mainly attributable to greater revenue per day and operating days resulting from the increased capacity of the Corporation's high performance technology fleets.

International

(Stated in thousands of dollars)

	Three-month periods ended December 31,			Years ended December 31,		
	2019	2018	% Change	**2019**	2018	% Change
Revenue	**4,952**	3,763	32	**20,106**	18,413	9
Reportable segment profit (loss) before tax	**(413)**	(306)	35	**(43)**	525	n.m.

n.m. - not meaningful

For the three-month period ended December 31, 2019, the international segment's revenue was $5 million as compared to $3.8 million in the 2018-quarter, an increase of 32 percent. For the year ended December 31, 2019, the international segment's revenue was $20.1 million as compared to $18.4 million, an increase of 9 percent. Higher revenue in the 2019-quarter primarily relates to increased activity in PHX Energy's Russia division, while the higher annual revenue relates to increased activity in the Albanian division.

For the three-month period ended December 31, 2019, PHX Energy's Russia division's revenue was $3.8 million, 81 percent higher than the $2.1 million of revenue in the corresponding 2018-quarter. The division achieved 560 operating days in the 2019-quarter, which is 227 percent greater than the 171 days in the 2018-quarter. For the year ended December 31, 2019, Russian revenue was $12.3 million, 12 percent lower compared to the $13.9 million of annual revenue in 2018. The Russia division generated 1,618 operating days in the 2019-year, which is 1 percent lower than the 1,639 days in 2018. PHX Energy operated on a higher share of lower priced services and experienced a general decline in the Russian market's day rates in 2019 relative to the 2018-year.

For the three-month period ended December 31, 2019, PHX Energy's Albania division's revenue was $1.2 million, 29 percent lower compared to the $1.7 million of revenue record in the same 2018-quarter. The Albania division realized 133 operating days in the 2019-quarter, 38 percent lower relative to 216 days generated in the corresponding 2018-quarter. The decline in activity and revenue was due to drilling operations being temporarily suspended in the latter half of the 2019-quarter. For the year ended December 31, 2019, PHX Energy's Albania division's revenue was $7.8 million, 73 percent higher compared to $4.5 million of annual revenue in 2018. The Albania division realized 905 operating days in the 2019-year which is a 70 percent increase relative to the 533 days generated in 2018. Albania grew its operations to 3 rigs during 2019, however, in the latter half of the fourth quarter all operations were suspend and at December 31 there were no rigs operating.

For the three-month period and year ended December 31, 2019, the international reportable segment loss before tax was $0.4 million (2018- $0.3 million loss) and $43 thousand (2018 - $0.5 million profit), respectively. Lower margins in the respective 2019-periods were primarily due to the general decline in the market day rates in Russia.

Liquidity

(Stated in thousands of dollars)

	Three-month periods ended December 31,		Years ended December 31,	
	2019	2018	**2019**	2018
Funds from operations(1)	**11,344**	12,803	**45,896**	37,178

(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.

	Dec. 31, '19	Dec. 31, '18
Working capital(1)	**68,393**	66,315

(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 three-month period ended December 31, 2019, lower funds from operations of $11.3 million (2018 - $12.8 million) was mainly due to decreased profitability in the Corporation's Canadian division. For the year ended December 31, 2019, funds from operations rose to $45.9 million (2018- $37.2 million) primarily due to greater activity in the US segment and increased overall profitability.

As at December 31, 2019, the Corporation had working capital of $68.4 million, an increase of $2.1 million compared to $66.3 million reported at December 31, 2018, mainly due to higher cash and cash equivalents and lower operating facility borrowings in the fourth quarter of 2019. In the fourth quarter of 2019, the Corporation recognized a recast adjustment relating to prior period accruals for repairs and maintenance. For the year ended December 31, 2019, trade and other payables were reduced by $6.6 million (2018- $6.6 million).

Investing Activities

Net cash used in investing activities for the year ended December 31, 2019 was $26.2 million as compared to $18.2 million in the 2018. During 2019, the Corporation spent $34.5 million on capital expenditures directed towards drilling and other equipment (2018 - $35 million) and received proceeds of $15.3 million primarily from involuntary disposal of drilling equipment in well bores (2018 - $14.6 million). The 2019 expenditures were comprised of:

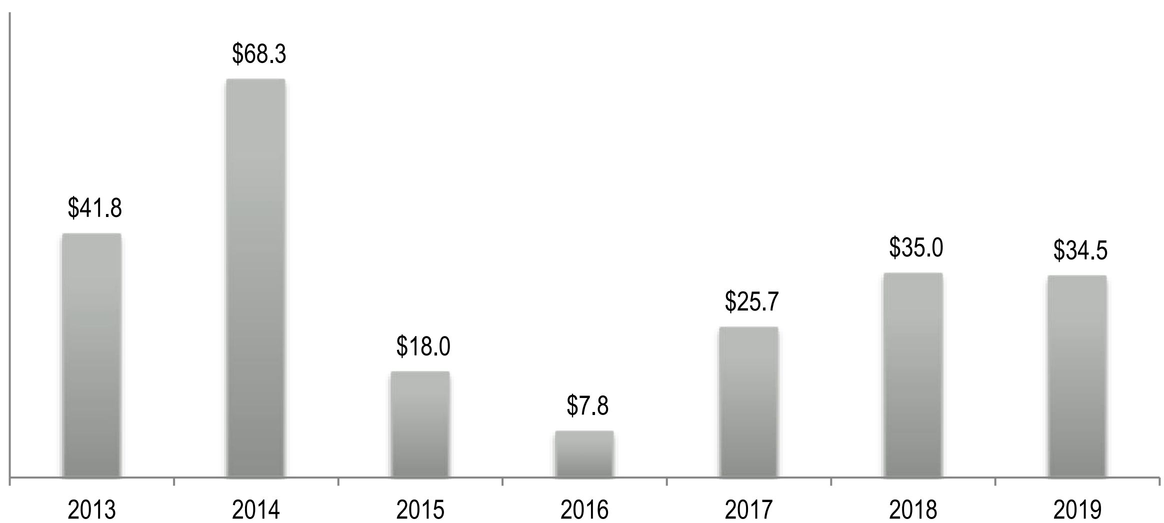
- $16.1 million in downhole performance drilling motors;
- $14.1 million in measurement while drilling (" MWD") systems and spare components; and
- $4.3 million in RSS tools, machining and equipment, and other assets.

The capital expenditure program undertaken in the year was financed generally from cash flow from operating activities. Of the total capital expenditures in the 2019-year, $22.7 million was used to grow the Corporation's fleet of drilling equipment and the remaining $11.8 million was used to maintain the current fleet of drilling and other equipment.

The change in non-cash working capital balances of $6.8 million (use of cash) for the year ended December 31, 2019, relates to the net change in the Corporation's trade payables that are associated with the acquisition of capital assets. This compares to a $5.3 million (source of cash) for the year ended December 31, 2018.

Capital Expenditures

(In millions of dollars)



In 2019, the Corporation continued to preserve cash flows, however, with increased activity in the US segment, capital spending was increased primarily to expand the Corporation's fleet of high performance technologies including its Atlas Motors, Velocity systems, and PowerDrive Orbit RSS tools.

Financing Activities

For the year ended December 31, 2019, net cash used in financing activities was $17.1 million as compared to $4.4 million source of cash in 2018. In the 2019-year, the Corporation:

- repurchased 4,762,300 shares for $14.1 million under its NCIB program;
- made payments of $3.2 million towards its lease liability in line with the newly adopted IFRS 16 Lease standard;
- received net proceeds of $0.1 million from its syndicated and operating facilities; and
- 45,000 common shares were issued for proceeds of $0.1 million upon the exercise of share options.

Capital Resources

As of December 31, 2019, the Corporation had $10 million drawn on its Syndicated Facility, $11.4 million drawn on its Canadian Operating Facility and USD $3 million drawn on its US Operating Facility.

As at December 31, 2019, the Corporation was in compliance with all its financial covenants as follows:

Ratio	Covenant	**As at December 31, 2019**
Debt to covenant EBITDA (1)	<3.0x	**0.57**
Interest coverage ratio	>3.0x	**31.29**

(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 January 2019, the Corporation amended its syndicated loan agreement in connection with the effect of IFRS 16 Leases. 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 Leases.

On July 29, 2019, the Corporation extended the maturity date of the syndicated loan agreement to December 11, 2022. The Corporation also increased the borrowing amounts in the syndicated facility from CAD $48 million to CAD $50 million and in the US operating facility from USD $5 million to USD $15 million.

The Corporation had approximately CAD $43.6 million and USD $12 million available to be drawn from its credit facilities as at December 31, 2019.

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 2020 capital budget has been set at $30 million subject to quarterly review of the Board. These planned expenditures are expected to be financed primarily by funds from operations and unused credit facilities. However, if a sustained period of market and commodity price uncertainty and financial market volatility persists in 2020, 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, 2019 and 2018, other than short-term or low value operating leases.

Proposed Transactions

The Corporation regularly reviews and evaluates possible strategic material business or asset acquisitions or capital asset divestitures in the normal course of its operations. In 2020, the Corporation has currently budgeted to spend $30 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,
- valuation of equity-settled and cash-settled share-based payments, and
- key assumptions used in the estimate of leases including valuation of right-of-use assets and lease liabilities.

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.

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, 2019, one customer comprised 7 percent of the total revenue (2018 - 6 percent of revenue). The customer's revenue is reported within the US operating segment.

As at December 31, 2019, the ageing of trade and other receivables that were not impaired was as follows:

(Stated in thousands of dollars)		2019
Neither past due nor impaired	$	50,299
Past due 1-30 days		28,315
Past due 31-60 days		7,129
Past due 61-90 days		3,181
Past due over 90 days		4,718
	$	93,642

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 represented 5 percent or approximately $4.7 million of total receivables on the statement of financial position at December 31, 2019. 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 $0.8 million for all amounts it considers uncollectable at December 31, 2019 (2018 - $0.5 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, 2019:

(Stated in thousands of dollars)	2020	2021	2022	2023	2024
Loans and borrowings	11,396	-	13,896	-	-
Drilling and other equipment purchase commitments	19,531	-	-	-	-
Trade and other payables	54,892	-	-	-	-
	85,819	-	13,896	-	-

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 $152,070 for the year ended December 31, 2019.

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, 2019, foreign exchange losses of $0.9 million (2018 – $0.2 million) resulted mainly from fluctuations in the CAD-RUB 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, 2019	**CAD**	**USD**	**RUB**
Cash and cash equivalents	**-**	**331,511**	**66,997,623**
Trade and other receivables	**-**	**3,900**	**178,608,038**
Trade and other payables	**-**	**(4,551,623)**	**(29,865,292)**
Intercompany receivables	**700,392**	**-**	**-**
Intercompany payables	**(13,207,293)**	**-**	**-**
Statement of financial position exposure	**(12,506,901)**	**(4,216,212)**	**215,740,369**

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

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

	Average Rate		December 31, Close Rate	
	2019	2018	**2019**	2018
USD	**1.3268**	1.2961	**1.2988**	1.3642
RUB	**48.7454**	48.4518	**47.3611**	50.9614

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)		**2019**		2018
CAD (10% strengthening)	**$**	**(962,958)**	$	(237,063)
USD (10% strengthening)		**(547,602)**		(275,116)
RUB (10% strengthening)		**414,111**		620,914

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 these risk factors and additional risk factors that could affect the Corporation 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. Market events and conditions, including global excess oil and natural gas supply, recent actions taken by the Organization of the Petroleum Exporting Countries, sanctions against Iran and Venezuela, slowing growth in China and emerging economies, weakening global relationships, conflict between the US and Iran, isolationist and punitive trade policies, US shale production, sovereign debt levels, world health emergencies and political upheavals in various countries including growing anti-fossil fuel sentiment, have caused significant volatility in commodity prices. These events and conditions have caused a significant reduction in the valuation of companies involved in the oil and natural gas industry and a decrease in confidence in the industry as a whole. These difficulties have been exacerbated in Canada by political and other actions resulting in uncertainty surrounding regulatory, tax, royalty changes and environmental regulation. As a result, there continues to be significant uncertainty and volatility in the oil and natural 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, 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. Additionally, the failure to obtain adequate financing on a timely basis could cause the Corporation to miss certain strategic opportunities and reduce or terminate certain of its operations. The current conditions in the oil and natural gas industry have negatively impacted the ability of, and the cost to, companies involved in the oil and natural gas industry to access additional financing. The inability of the Corporation to access sufficient and acceptable capital for its operations in a timely manner 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 to the 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, and other market factors 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 natural 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 a customer's ability to satisfy their obligations to the Corporation and therefore could materially adversely effect the Corporation's business, financial condition, results of operations, receivable and prospects.

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, state 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

Climate change policy is evolving at regional, national and international levels, and political and economic events may significantly affect the scope and timing of climate change measures that are ultimately put in place to slow the rate of climate change or mitigate its effects. The direct or indirect costs of compliance with greenhouse gas-related regulations may have an adverse effect on the Corporation's and its customer's business, financial condition, results of operations and prospects. Concerns about climate change have resulted in a number of environmental activists and members of the public opposing the continued exploitation and development of fossil fuels which has influenced investors' willingness to invest in the oil and natural gas industry. Historically, political and legal opposition to the fossil fuel industry focused on public opinion and the regulatory process. More recently, however, there has been a movement to more directly hold governments and participants in the oil and natural gas industry responsible for climate change through climate litigation. Given the evolving nature of climate change policy and the control of greenhouse gases and resulting requirements, it is expected that current and future climate change regulations will have the effect of increasing the Corporation's operating expenses as well as third party credit risk, and, in the long-term, potentially reducing the demand for oil and natural gas production, resulting in a material impact on the Corporation's customers and in turn potentially resulting in a decrease in the demand for the Corporation's services, as well as its profitability, the value of its assets or requiring asset impairments for financial statement purposes.

The majority of countries across the globe have agreed to reduce their carbon emissions in accordance with the Paris Agreement. In Canada, the federal government implemented legislation aimed at incentivizing the use of alternative fuels and in turn reducing carbon emissions. The federal system currently applies in provinces and territories without their own system that meets federal standards. Any taxes placed on carbon emissions may 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. Further, the imposition of carbon taxes puts the Corporation at a disadvantage with its counterparts who operate in jurisdictions where there are less costly carbon regulations

Reliance on a Skilled Workforce and Key Personnel

The success of the Corporation will be dependent upon the recruitment and retention of a skilled workforce and 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. Competition for qualified personnel in certain sectors of the oil and natural gas services industry is intense and there can be no assurance that the Corporation will be able to continue to attract and retain all personnel necessary for the 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 equipment and specialized components at a reasonable cost, as well as upon its ability to develop or acquire new competitive technology. There can be no assurance that the Corporation will be able to respond to the competitive pressures of those companies with greater financial and technical resources and implement new technologies on a timely basis, at an acceptable cost, or at all. The Corporation purchases equipment and materials from various suppliers in the oil and natural gas drilling service industry. There can be no assurance that these sources for equipment and materials 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 or may not have the option of insuring. 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, which prevents, delays or makes operations more difficult. 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

In the last several years, the United States and certain European and Middle Eastern 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 has withdrawn the United States from the Trans-Pacific Partnership and the United States Congress has passed sweeping tax reform, which, among other things, significantly reduces US corporate tax rates. This has affected the competitiveness of other jurisdictions, including Canada. In addition, the North American Free Trade Agreement ("NAFTA") has been renegotiated and on November 30, 2018, Canada, the US and Mexico signed the Canada–United States–Mexico Agreement ("USMCA") which will replace NAFTA once ratified by the three signatory countries. The USMCA was ratified by Mexico's Senate in June 2019 and by the United States' Senate in January 2020. The Canadian Parliament has not yet passed legislation to implement the USMCA. The US administration has also taken action with respect to reduction of regulation, which may also affect relative competitiveness of other jurisdictions. It is 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 natural gas industry. Any actions taken by the current US administration may have a negative impact on the Canadian economy and on the businesses, financial conditions, results of operations and the valuation of Canadian oil and natural gas services companies, including the Corporation.

In addition to the political disruption in the United States, the impact of the United Kingdom's exit from the European Union 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. Conflict and political uncertainty also continues to progress in the Middle East. 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 the Corporation's common shares.

A change in federal, provincial or municipal governments in Canada may have an impact on the directions taken by such governments on matters that may impact the oil and natural gas industry including the balance between economic development and environmental policy. Alberta elected a new government in 2019 that is supportive of the Trans Mountain Pipeline expansion project while a minority government in British Columbia remains opposed to the project and has attempted to regulate the transport of heavy oil products into and through British Columbia. Though the Supreme Court of Canada unanimously rejected the government of British Columbia's proposed regulation of the transport of heavy oil products into and through British Columbia in January, 2020 and the Federal Court of Appeal dismissed a challenge by British Columbia first nations groups to the Trans Mountain Pipeline expansion project in February 2020, continued uncertainty and delays have led to decreased investor confidence, increased capital costs and operational delays for producers and service providers operating in the industry.

The federal Government was re-elected in 2019, but in a minority position. The ability of the minority federal government to pass legislation will be subject to whether it is able to come to agreement with, and garner the support of, the other elected parties, most of whom are opposed to the development of the oil and natural gas industry. The minority federal government will also be required to rely on the support of the other elected parties to remain in power, which provides less stability and may lead to an earlier subsequent federal election. Political instability, at both the federal and provincial level, continues to create regulatory uncertainty, the effects of which become apparent on an ongoing basis, particularly with respect to carbon pricing regimes, curtailment of crude oil production and transportation and export capacity, and may affect the business of participants in the oil and natural gas industry.

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 foreign currency exchange rate fluctuations, changes of laws affecting foreign ownership, government participation, taxation, royalties, duties, inflation, repatriation of earnings, social unrest or civil war, corruption, acts of terrorism, extortion or armed conflict and uncertain political and economic conditions resulting in unfavourable government actions such as sanctions and unfavourable legislation or regulation. 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. While the impact of these factors cannot be accurately predicted, if any of the risks materialize, they could have a material adverse effect on the Corporation's business, financial condition, results of operations and cash flows.

Changing Investor Sentiment

A number of factors, including the effects of the use of fossil fuels on climate change, the impact of oil and natural gas operations on the environment, environmental damage relating to spills of petroleum products during production and transportation, Indigenous rights and gender balance, have affected certain investors' sentiments towards investing in the oil and natural gas industry and certain corporations generally. Any reduction in the investor base interested or willing to invest in the oil and natural gas industry and more specifically, the Corporation, may result in limiting the Corporation's access to capital, increasing the cost of capital, and decreasing the price and liquidity of the Corporation's securities even if the Corporation's operating results, underlying asset values or prospects have not changed. Additionally, these factors, as well as other related factors, may cause a decrease in the value of the Corporation's assets which may result in an impairment charge.

Alternatives to and Changing Demand for Petroleum & Petroleum Based Products

Fuel conservation measures, alternative fuel requirements, increasing consumer demand for alternatives to oil and natural gas and technological advances in fuel economy and renewable energy generation systems could reduce the demand for oil, natural gas and liquid hydrocarbons. Recently, certain jurisdictions have implemented policies or incentives to decrease the use of fossil fuels and encourage the use of renewable fuel alternatives, which may lessen the demand for petroleum and petroleum based products and put downward pressure on commodity prices. Advancements in energy efficient products have a similar effect on the demand for oil and natural gas products. The Corporation cannot predict the impact of changing demand for oil and natural gas products, and any major changes may have a material adverse effect the Corporation's customers and therefore in turn have a material adverse effect on the Corporation's business, financial condition, results of operations and cash flow.

Reputational Risk

The Corporation's business, financial condition, operations or prospects may be negatively impacted as a result of any negative public opinion toward the Corporation or as a result of any negative sentiment toward or in respect of Corporation's reputation with stakeholders, special interest groups, political leadership, the media or other entities. Public opinion may be influenced by certain media and special interest groups' negative portrayal of the industry in which the Corporation operates as well as their opposition to certain oil and natural gas projects. Potential impacts of negative public opinion or reputational issues may include, with respect to both the Corporation and its customers which would indirectly affect the Corporation, the following: delays or interruptions in operations, legal or regulatory actions or challenges, blockades, increased regulatory oversight, reduced support for, delays in, challenges to, or the revocation of regulatory approvals, permits and/or licences and increased costs and/or cost overruns. Any environmental damage, loss of life, injury or damage to property caused by the Corporation's operations could damage the reputation of the Corporation. The Corporation's reputation could be affected by actions and activities of other corporations operating in the oil and natural gas industry, over which the Corporation has no control. Opposition from special interest groups opposed to oil and natural gas development and the possibility of climate related litigation against fossil fuel companies may indirectly harm the Corporation's reputation.

Reputational risk cannot be managed in isolation from other forms of risk. Credit, market, operational, insurance, regulatory and legal risks, among others, must all be managed effectively to safeguard the Corporation's reputation. Damage to the Corporation's reputation could result in in negative investor sentiment towards the Corporation, which may result in limiting the Corporation's access to capital, increasing the cost of capital, and decreasing the price and liquidity of the Corporation's securities.

Information Technology Systems, Cyber-Security and Social Media

The Corporation has become increasingly dependent upon the availability, capacity, reliability and security of its information technology infrastructure and its ability to expand and continually update this infrastructure, to conduct daily operations. The Corporation depends on various information technology systems to process and record financial data, manage financial resources, administer contracts with customers and communicate with employees and third-party partners.

Further, the Corporation is subject to a variety of information technology and system risks as a 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. Unauthorized access to these systems by employees or third parties could lead to corruption or exposure of confidential, fiduciary or proprietary information, interruption to communications or operations or disruption to business activities or the Corporation's competitive position. In addition, cyber phishing attempts, in which a malicious party attempts to obtain sensitive information such as usernames, passwords, and credit card details (and money) by disguising as a trustworthy entity in an electronic communication, have become more widespread and sophisticated in recent years. The Corporation applies technical and process controls in line with industry-accepted standards to protect its information, assets and systems. However, these controls may not adequately prevent cyber-security breaches. Disruption of critical information technology services, or breaches of information security, could have a negative effect on the Corporation's performance and earnings, as well as its reputation, and any damages sustained may not be adequately covered by the Corporation's current insurance coverage, or at all. The significance of any such event is difficult to quantify, but may in certain circumstances be material and could have a material adverse effect on the Corporation’s business, financial condition and results of operations.

Additionally, social media is increasingly used as a vehicle to carry out cyber phishing attacks. Information posted on social media sites, for business or personal purposes, may be used by attackers to gain entry into the Corporation's systems and obtain confidential information. While the Corporation takes steps to alleviate such risks, despite its efforts,, as social media continues to grow in influence and access to social media platforms becomes increasingly prevalent, there are significant risks that the Corporation may not be able to properly regulate social media use and preserve adequate records of business activities and client communications conducted through the use of social media platforms.

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 (the "Certifying Officers") have designed, or caused to be designed under their supervision, disclosure controls and procedures ("DC&P"), as defined in National Instrument 52-109 Certification of Disclosure in Issuers' Annual and Interim Filings ("NI 52-109"), to provide reasonable assurance that 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 periods specified in the securities legislation and include controls and procedures designed to ensure that information required to be so disclosed is accumulated and communicated to the Corporation's management, including the Certifying Officers, as appropriate to allow timely decisions regarding required disclosure.

The Certifying Officers have evaluated, or caused to be evaluated under their supervision, the effectiveness of the Corporation's DC&P. Based on that evaluation, the Certifying Officers have concluded that the Corporation's DC&P were effective as at December 31, 2019.

Internal Controls Over Financial Reporting

The Corporation's Certifying Officers have designed, or caused to be designed under their supervision, internal controls over financial reporting ("ICFR"), as defined in NI 52-109, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles applicable to the Corporation. ICFR includes those policies and procedures that (i) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Corporation; (ii) are designed to provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and that receipts and expenditures of the Corporation are being made only in accordance with authorizations of management and directors of the Corporation; and (iii) are designed to provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Corporation's assets that could have a material effect on the annual financial statements or interim financial reports.

The control framework used to design and evaluate the Corporation's ICFR is "Internal Control - Integrated Framework (2013)" published by The Committee of Sponsoring Organizations of the Treadway Commission (COSO).

The Certifying Officers have evaluated, or caused to be evaluated under their supervision, the effectiveness of the Corporation's ICFR and have concluded that the Corporation's ICFR were effective as at December 31, 2019.

There were no changes in the Corporation's ICFR that occurred during the period beginning on October 1, 2019 and ended on December 31, 2019 that have materially affected, or are reasonably likely to materially affect, the Corporation's ICFR.

While the Certifying Officers believe that the Corporation's ICFR provide a reasonable level of assurance and are effective, they do not expect that the ICFR will prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

Outstanding Corporation Share Data

	As at February 25, 2020
Common shares outstanding	53,251,420
Dilutive securities:	
Options	4,728,601
Corporation shares – diluted	57,980,021

Selected Annual Financial Information

The following selected annual financial information was obtained from the audited consolidated financial statements prepared in accordance with IFRS, with the exception of net debt.

(Stated in thousands of dollars except per share amounts)

Years ended December 31,	**2019**	2018	2017
Revenue	**362,057**	317,135	241,001
Net loss	**(2,213)**	(18,947)	(23,528)
Loss per share – basic	**(0.04)**	(0.33)	(0.41)
Loss per share – diluted	**(0.04)**	(0.33)	(0.41)
Net Debt [1]	**14,710**	21,526	15,498
Total assets	**277,253**	263,628	246,062

(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 2019, the Corporation increased drilling activity and revenue per day in its US segment, resulting in improved profitability in the year. Despite higher revenue in the US, the Corporation has recorded a net loss the past three years, due to continued historically low industry activity in Canada. However net loss has decreased year-over-year. In the 2019-year, the Corporation recorded an impairment losses of $0.5 million relating to its EDR division (2018 - $4.5 million). The Corporation has maintained a disciplined cost approach and is focused on increasing capacity of its high performance technologies to sustain continued growth. The Corporation is also committed to maintaining a stable financial position while returning value to investors in the form of share repurchases. Cash flows were and will continue to be preserved wherever possible. The Corporation's net debt as at December 31, 2019 was $14.7 million a decrease of 32 percent from $21.5 million net debt in 2018. As at December 31, 2019, PHX Energy's total assets increased to $277.3 million primarily due to inclusion of right-of-use assets as part of adopting IFRS 16 Leases as at January 1, 2019.

Summary of Quarterly Results

(Stated in thousands of dollars except per share amounts)

	Dec-19	**Sept-19**	**Jun-19**	**Mar-19**	Dec-18	Sept-18	Jun-18	Mar-18
Revenue	**93,853**	**93,099**	**82,984**	**92,121**	92,335	85,033	69,009	70,759
Net income (loss)	**(1,720)**	**2,594**	**(2,020)**	**(1,067)**	(18,355)	3,743	(84)	(4,251)
Income (loss) per share – basic	**(0.03)**	**0.05**	**(0.04)**	**(0.02)**	(0.32)	0.06	-	(0.07)
Income (loss) per share – diluted	**(0.03)**	**0.05**	**(0.04)**	**(0.02)**	(0.32)	0.06	-	(0.07)
Adjusted EBITDA(1)	**12,399**	**15,536**	**10,995**	**11,431**	14,736	13,934	10,013	6,768
Funds from operations(1)	**11,344**	**14,669**	**9,785**	**10,100**	12,803	11,461	7,158	5,757

(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. 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 typically the slowest time for activity in Canada, 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. See Business Risk Factors section of this MD&A.

Outlook

PHX Energy finished 2019 strong and achieved its highest annual revenue and adjusted EBITDA since 2014. Additionally, in the fourth quarter PHX Energy achieved its highest quarterly revenue since the first quarter of 2015. These records were achieved despite declining North American rig counts. Phoenix USA represented 75 percent of revenue in 2019, and this trend is expected to continue throughout 2020. The Corporation has aligned its strategy to take advantage of the larger US market and the growth opportunities it presents.

Currently the global market is volatile due to the uncertainty around how severely the Coronavirus outbreak will affect global energy consumption. The global economy is reliant on the manufacturing and trade of products and the movement of people, and any slowdown in this process has a chain reaction that impacts energy consumption by both manufacturers and consumers. As a result of the outbreak's impact on the global economy, commodity prices have already declined and there may be a further weakening as the effects move through the supply chain. North American producers' cash flow may decrease and this could impact the already weak rig activity forecasted for North America.

In the fourth quarter, Phoenix USA continued to build upon the positive momentum of prior quarters. This performance is a testament to the growing reputation of Phoenix USA, particularly given that the industry rig counts began to decline in the second quarter of 2019. It is forecasted that a weaker rig count will persist in 2020, but despite this forecast, the Corporation is optimistic that the US division will continue to capture additional market share. PHX Energy has dedicated its 2019 and 2020 capital expenditures towards expanding its high performance fleets and believes the demand for Velocity, Atlas Motors and PowerDrive Orbit RSS will continue to propel growth and profitability of the US division.

In Canada, the difficult industry environment persisted, with new challenges arising in the recent months. In 2019 there was near record low drilling activity, with the fourth quarter being particularly slow. The decline in the Corporation's Canadian operations can be directly related to the industry decline, however, the Corporation continued to be one of the most active competitors in its sector and the Corporation remains focused on preserving profit margins. Entering 2020, PHX Energy's Canadian operations experienced a considerable uptick in activity and today the division is more active than was anticipated. This increase in activity and stable market share can be attributed to our high performance technology as well as our strong marketing relationships.

International operations recorded increases in revenue in the 2019-year and in the fourth quarter, however, profitability declined period-over-period. In Russia, although PHX Energy continued to show improved activity and revenue over 2018, profitability declined as there was a larger portion of lower priced services and there were overall pricing pressures in the industry. The Corporation is implementing strategies to improve profitability and remains focused on achieving higher margins in this region. In the 2019-year, Albanian operations grew to 3 rigs which resulted in year-over-year improvements, however, in the fourth quarter operations were temporarily suspended and currently PHX Energy is not active in the country. The Corporation has downsized its Albania footprint, but remains in a position to resume operations quickly if opportunities arise.

Technology Update

PHX Energy continues to focus on growing its fleet of high performance technology and has dedicated its anticipated $30 million capital expenditure program to growing and maintaining the higher margin fleets. As a result of increased demand for these technologies, PHX Energy has committed the majority of the anticipated 2020 capital expenditures to ensure delivery of new equipment occurs within the year. PHX Energy has recently received additional Atlas and RSS capacity, and as a result, the Corporation is the largest independent provider of the PowerDrive Orbit RSS in the US market. Demand for RSS technology is growing in the US market and the new systems allow PHX Energy to deploy its own equipment to replace systems presently being rented, which has a significant improvement on margins. In addition, the growth in the RSS fleet is expected to aide market share growth in the US.

Despite the strong results generated by the Corporation, PHX Energy's valuations remain low due to the general sentiment towards the energy sector. The Corporation is committed to enhancing long-term shareholder returns in this difficult environment and it will continue to achieve this by leveraging its NCIB. Over the past two years, PHX Energy has improved profitability and maintained low debt levels, creating a favorable financial position. Looking forward, the Corporation will continue with this focus, while investing in high performance technology that is unmatched in the industry.

Michael Buker, President
February 25, 2020

Non-GAAP Measures

Adjusted EBITDA

Adjusted EBITDA, defined as earnings before finance expense and finance expense lease liability, income taxes, depreciation and amortization, impairment losses on goodwill and intangible assets, equity 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 net earnings to adjusted EBITDA:

(Stated in thousands of dollars)

	Three-month periods ended December 31,		Years ended December 31,	
	2019	2018	**2019**	2018
Net loss	**(1,720)**	(18,355)	**(2,213)**	(18,947)
Add:				
Depreciation and amortization drilling and other equipment	**9,668**	10,126	**39,846**	39,738
Depreciation and amortization right-of-use asset [1]	**898**	-	**3,539**	-
Provision for income taxes	**1,934**	17,546	**3,764**	17,469
Finance expense	**337**	279	**1,426**	1,208
Finance expense lease liability	**612**	-	**2,509**	-
Impairment loss	**500**	4,498	**500**	4,498
Equity-settled share-based payments	**52**	168	**612**	1,369
Unrealized foreign exchange (gain) loss	**118**	474	**377**	114
Adjusted EBITDA as reported	**12,399**	14,736	**50,360**	45,449

[1] Cash payment on leases included in IFRS 16 Leases for the three-month period and year ended December 31, 2019 was $1.5 million and $5.7 million, respectively. These were recorded as rental expenses in direct costs and SG&A in the 2018-periods.

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 generated 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 cash flows from operating activities to funds from operations:

(Stated in thousands of dollars)

	Three-month periods ended December 31,		Years ended December 31,	
	2019	2018	**2019**	2018
Cash flows from operating activities	**9,508**	(2,541)	**50,173**	13,330
Add (deduct):				
Changes in non-cash working capital	**1,251**	15,454	**(5,506)**	23,388
Interest paid	**140**	84	**808**	526
Income taxes paid (received)	**445**	(194)	**421**	(66)
Funds from operations	**11,344**	12,803	**45,896**	37,178

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 and finance expense lease liability, provision for income taxes, depreciation and amortization, equity-settled share-based payments, impairment losses on goodwill and intangible assets, onerous contracts, and IFRS 16 Leases adjustment to restate cash payments to expense, subject to the restrictions provided in the amended credit agreement.

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.

Net Debt

Net debt is defined as the Corporation's loans and borrowings and operating facility borrowings less cash and cash equivalents. 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.

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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, 2019 and December 31, 2018;
- the consolidated statements of comprehensive 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, 2019 and December 31, 2018, 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.

Emphasis of Matter – Prospective Change in Accounting Policy

We draw attention to Note 3 to the financial statements which indicates that the Entity has changed its accounting policy for leases and has applied that change prospectively.

Our opinion is not modified in respect to this matter.

Other Information

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

- the information included in Management's Discussion and Analysis filed with the relevant Canadian Securities Commissions.
- the information, other than the financial statements and the auditor's report thereon, included in a document titled "2019 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 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 "2019 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 25, 2020

Consolidated Statements of Financial Position

	December 31, 2019	December 31, 2018
ASSETS		
Current assets:		
Cash and cash equivalents	**$ 10,582,296**	$ 3,643,418
Trade and other receivables (Note 18a)	**93,641,885**	103,987,716
Inventories (Note 5)	**30,826,700**	27,558,003
Prepaid expenses	**2,569,046**	2,428,221
Current tax assets (Note 4)	**-**	73,304
Total current assets	**137,619,927**	137,690,662
Non-current assets:		
Drilling and other long-term assets (Note 6)	**78,416,229**	94,164,880
Right-of-use asset (Note 20)	**32,825,964**	-
Intangible assets (Note 8)	**18,901,559**	22,301,680
Goodwill (Note 7)	**8,876,351**	8,876,351
Deferred tax assets (Note 10)	**613,355**	594,049
Total non-current assets	**139,633,458**	125,936,960
Total assets	**$ 277,253,385**	$ 263,627,622
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Lease Liability (Note 20)	**$ 2,765,633**	-
Operating facility (Note 9)	**11,395,835**	$ 13,348,562
Trade and other payables (Note 4)	**54,892,277**	58,027,000
Current tax liability	**172,766**	-
Total current liabilities	**69,226,511**	71,375,562
Non-current liabilities:		
Lease Liability (Note 20)	**39,753,860**	-
Loans and borrowings (Note 9)	**13,896,400**	11,821,000
Deferred tax liability (Note 4 and Note 10)	**5,432,527**	3,560,399
Provision for onerous contracts (Note 3)	**-**	1,832,000
Deferred income (Note 3)	**-**	1,300,007
Total non-current liabilities	**59,082,787**	18,513,406
Equity:		
Share capital (Note 11a)	**251,815,183**	265,760,391
Contributed surplus	**10,854,650**	10,631,982
Retained earnings (Note 4)	**(127,902,593)**	(120,060,233)
Accumulated other comprehensive income	**14,176,847**	17,406,514
Total equity	**148,944,087**	173,738,654
Total liabilities and equity	**$ 277,253,385**	$ 263,627,622

See accompanying notes to consolidated financial statements.

Consolidated Statements of Comprehensive Loss

Years ended December 31,		2019		2018
Revenue (Note 16)	$	**362,056,761**	$	317,135,411
Direct costs (Note 13)		**309,608,296**		276,249,509
Gross profit		**52,448,465**		40,885,902
Expenses:				
Selling, general and administrative expenses (Note 13)		**45,756,152**		41,471,955
Research and development expenses (Note 13)		**3,868,779**		3,353,746
Finance expense		**1,426,382**		1,208,344
Finance expense lease liability (Note 20)		**2,508,691**		-
Impairment loss (Note 6 and Note 8)		**500,000**		4,498,066
Other income (Note 14)		**(3,162,661)**		(8,168,677)
		50,897,343		42,363,434
Earnings (loss) before income taxes		**1,551,122**		(1,477,532)
Provision for income taxes (Note 15)				
Current		**699,186**		177,826
Deferred		**3,065,056**		17,291,451
		3,764,242		17,469,277
Net loss		**(2,213,120)**		(18,946,809)
Other comprehensive loss				
Foreign currency translation		**(3,229,667)**		5,584,125
Total comprehensive loss for the period	**$**	**(5,442,787)**	$	(13,362,684)
Loss per share – basic (Note 11c)	**$**	**(0.04)**	$	(0.33)
Loss per share – diluted (Note 11c)	**$**	**(0.04)**	$	(0.33)

See accompanying notes to consolidated financial statements.

Consolidated Statements of Changes in Equity

Year Ended December 31, 2019	**Share Capital Number**		**Share Capital Amount ($)**		**Contributed Surplus**		**Accumulated Other Comprehensive Income**		**Retained Earnings**		**Total Equity**
Balance, December 31, 2018 (Note 4)	**57,963,720**	**$**	**265,760,391**	**$**	**10,631,982**	**$**	**17,406,514**	**$**	**(120,060,233)**	**$**	**173,738,654**
Adjustment initial application of IFRS 16 (Note 3)	**-**		**-**		**-**		**-**		**(5,629,240)**		**(5,629,240)**
Issuance of share capital (Note 11a)	**45,000**		**87,750**		**-**		**-**		**-**		**87,750**
Common shares repurchased (Note 11a)	**(4,762,300)**		**(14,071,163)**		**-**		**-**		**-**		**(14,071,163)**
Share-based payments	**-**		**-**		**611,681**		**-**		**-**		**611,681**
Surrender value share exercise (Note 11a)	**-**		**(350,808)**		**-**		**-**		**-**		**(350,808)**
Fair value of options exercised	**-**		**389,013**		**(389,013)**		**-**		**-**		**-**
Net loss	**-**		**-**		**-**		**-**		**(2,213,120)**		**(2,213,120)**
Foreign currency translation	**-**		**-**		**-**		**(3,229,667)**		**-**		**(3,229,667)**
Balance, December 31, 2019	**53,246,420**	**$**	**251,815,183**	**$**	**10,854,650**	**$**	**14,176,847**	**$**	**(127,902,593)**	**$**	**148,944,087**

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 (Note 4)	58,397,887	$	266,838,036	$	9,315,926	$	11,822,389	$	(101,113,424)	$	186,862,927
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	$	(120,060,233)	$	173,738,654

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

Years ended December 31,		2019		2018
Cash flows from operating activities:				
Net loss	$	**(2,213,120)**	$	(18,946,809)
Adjustments for:				
Depreciation and amortization (Note 13)		**39,846,248**		39,738,406
Depreciation and amortization right-of-use asset (Note 13)		**3,539,039**		-
Provision for income taxes (Note 15)		**3,764,242**		17,469,277
Impairment loss (Note 6 and Note 8)		**500,000**		4,498,066
Unrealized foreign exchange loss		**377,345**		114,325
Gain on disposition of drilling equipment (Note 14)		**(4,429,047)**		(8,376,711)
Equity-settled share-based payments (Note 12a)		**611,681**		1,368,819
Finance expense		**1,426,382**		1,208,344
Provision for bad debts (Note 14)		**387,728**		9,458
Provisions for inventory obsolescence (Note 5 and Note13)		**2,086,242**		542,941
Provision for onerous contracts (Note 3 and Note 13)		**-**		(314,000)
Amortization of deferred income (Note 3)		**-**		(133,332)
Interest paid		**(807,997)**		(525,741)
Income taxes paid (recovered)		**(421,260)**		65,611
Change in non-cash working capital (Note 17)		**5,505,861**		(23,388,445)
Net cash from operating activities		**50,173,344**		13,330,209
Cash flows from investing activities:				
Proceeds on disposition of drilling equipment		**15,275,908**		14,583,922
Acquisition of drilling and other equipment (Note 6)		**(34,526,264)**		(35,027,380)
Acquisition of intangible assets (Note 8)		**(66,180)**		(3,052,146)
Change in non-cash working capital (Note 17)		**(6,837,332)**		5,267,584
Net cash used in investing activities		**(26,153,868)**		(18,228,020)
Cash flows from financing activities:				
Repurchase of common shares under the NCIB (Note 11a)		**(14,071,163)**		(1,207,324)
Payments of lease liability		**(3,219,858)**		-
Proceeds from (Repayment of) operating facility		**(1,952,727)**		7,728,098
Proceeds from (Repayment of) loans and borrowings		**2,075,400**		(2,179,000)
Proceeds from issuance of share capital (Note 11a)		**87,750**		76,916
Net cash from (used) in financing activities		**(17,080,598)**		4,418,690
Net increase (decrease) in cash and cash equivalents		**6,938,878**		(479,121)
Cash and cash equivalents, beginning of year		**3,643,418**		4,122,539
Cash and cash equivalents, end of year	$	**10,582,296**	$	3,643,418

See accompanying notes to consolidated financial statements.

Notes to the Consolidated Financial Statements

For the years ended December 31, 2019 and 2018

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) 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.

b) Functional and Presentation Currency

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

c) 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,
- valuation of equity-settled and cash-settled share-based payments, and
- key assumptions used in the estimate of leases including valuation of right of use assets and lease liabilities.

d) 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, except IFRS 16 Leases. The Corporation transitioned to IFRS 16 in accordance with the modified retrospective approach. Impacts of IFRS 16 prior to January 1, 2019 were not adjusted.

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 (loss) 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 (loss) 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 (loss), 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 2019 and 2018.

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-today 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	2 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 recognized in profit or loss. Goodwill is not amortized.

The estimated useful lives are as follows:

Licenses	10 to 15 years
Development Costs	3 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) 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 25, 2020.

j) Leases

i. Definition of a Lease

Previously, the Corporation determined whether an arrangement or an agreement contained a lease under IFRIC 4 *Determining Whether an Arrangement contains a Lease*. Beginning January 1, 2019, the Corporation determines whether an arrangement or an agreement contains a lease based on the new definition of a lease. Under IFRS 16, a contract is, or contains, a lease if the contract conveys a right to control the use of an identified asset for a period of time in exchange for consideration.

At inception of a contract, the Corporation assesses whether a contract is, or contains, a lease. To assess whether a contract conveys the right to control the use of an identified asset, the Corporation assesses whether:

- The contract involves the use of an identified asset, which may be specifically or implicitly stated, and the identified asset should be physically distinct or represents substantially all of the capacity of the asset. If the supplier has the substantive right to substitute the asset throughout the term of the contract, then the asset is not identified;
- The Corporation has the right to obtain substantially all of the economic benefits from use of the asset throughout the contract; and
- The Corporation has the right to direct the use of the identified asset throughout the contract. The Corporation has this right to direct how and for what purpose the asset is used. In addition, the Corporation has the right to operate the asset without the lessor or supplier having the right to change those operation instructions, or the Corporation designed the asset in a way that predetermines how and for what purpose it will be used.

On transition to IFRS 16, the Corporation elected to apply the practical expedient to grandfather the assessment of which transactions are leases. The Corporation applied IFRS 16 only to contracts that were previously identified as leases. Contracts that were not identified as leases under IAS 17 and IFRIC 4 were not reassessed. Therefore, the definition of a lease under IFRS 16 has been applied only to contracts entered into or changed on or after January 1, 2019.

At inception or on reassessment of a contract that contains a lease component, the Corporation allocates the consideration in the contract to each lease and non-lease component on the basis of their relative stand-alone prices. However, for leases of properties in which it is a lessee, the Corporation has elected not to separate non-lease components and will instead account for the lease and non-lease components as a single lease component.

ii. As a Lessee

The Corporation historically has leased assets such as properties, vehicles and office equipment.

As a lessee, the Corporation previously classified leases as operating or finance leases based on its assessment of whether the lease transferred substantially all of the risks and rewards of ownership. Historically all previous lease arrangements were classified as operating leases. Under IFRS 16, the Corporation recognizes right-of-use assets and lease liabilities for most leases, which is currently reflected on the Consolidated Statement of Financial Position.

However, the Corporation has elected to apply recognition exemptions to right-of-use assets and lease liabilities for some leases of low-value assets (e.g. office equipment), as well as for short-term leases or leases with terms less than twelve months or entered into on a month-to-month basis. The Corporation recognizes the lease payments associated with these leases as an expense on a straight-line basis over the lease term.

For leases that do not qualify for the exemptions previously noted, the Corporation has recognized right-of-use asset and lease liability, respectively, on the Consolidated Statement of Financial Position.

The Corporation recognizes the right-of-use asset and lease liability at the lease commencement date. Lease liabilities were measured at the present value of the remaining lease payments, discounted at the incremental borrowing rate as at the lease commencement date. Right-of-use assets are measured at an amount equal to the lease-liability, adjusted for any lease payments made at or before commencement date, and initial directs costs incurred by the Corporation.

The Corporation used the following transitional practical expedients when applying IFRS 16 to leases previously classified as operating leases under IAS 17:

- 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 and shall adjust the right-of-use asset at the date of the initial application by the amount of any provision for onerous leases recognized immediately before date of initial application.
- For leases previously classified as operating leases the Corporation has elected to measure the right-of-use asset as if IFRS 16 had always been applied since the commencement date of the lease, but discounted using the incremental borrowing rate at the date of initial application.
- Initial direct costs are excluded from the measurement of right-of-use assets at the date of initial application.
- When determining the lease term of contracts prior to January 1, 2019 the Corporation used 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 twelve 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 for which the lease term ends within twelve months of the date of initial application are 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.

iii. As a Lessor

The Corporation is not required to make any adjustments on transition to IFRS 16 for leases in which it acts as a lessor except for a sub-lease. The Corporation accounted for it leases in accordance with IFRS 16 from the date of initial application.

The Corporation sub-leases some of its properties. Under IAS 17, the head lease and sub-lease contracts were classified as operating leases. The Corporation is required to assess the classification of a sub-lease with reference to the right-of-use asset, not the underlying asset. On transition, the Corporation reassessed the classification of its sub-leases and concluded that they qualify as a finance lease under IFRS 16.

iv. Impacts on Financial Statements

Impacts on transition

On transition to IFRS 16, as at January 1, 2019 the Corporation recognized additional right-of-use assets of $36.2 million and lease liabilities of $45.7 million. The impact of the transition on the Consolidated Statements of Financial Position is summarized below:

	January 1, 2019
Right-of-use assets (1)	36,244
Deferred tax assets	700
Lease liabilities (2)	45,705
Deferred income	(1,300)
Provision for onerous contracts	(1,832)
Retained earnings	(5,629)

(1) Included in the right-of-use assets is a net investment in subleases of $0.5 million.
(2) Includes current and non-current lease liabilities.

When measuring lease liabilities, the Corporation discounted lease payments using the incremental borrowing rate at the commencement date of the lease. The weighted average rate applied was 6 percent.

	January 1, 2019
Operating lease commitments as at December 31, 2018	32,216
Discount using incremental borrowing rate as at January 1, 2019	(9,379)
Adjustments[1]	22,868
Lease liabilities recognized as at January 1, 2019	45,705

[1] Includes the impact of judgement applied with regard to lease terms in which the Corporation is a lessee that include renewals options; and includes exemptions including those for short-term and low-dollar value lease.

k) 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.

l) 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.

m) 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.

n) 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. Recast of Prior Period Amounts

During the fourth quarter of 2019 to appropriately align with IFRS, the Corporation changed its policy for how accruals relating to repairs and maintenance of drilling equipment are recorded, specifically the timing of when accruals are recorded. Accruals for repairs and maintenance were historically recorded when the drilling equipment arrived at the facility and was identified by the Corporation as requiring repair, but prior to any work having been performed. Accruals for repairs and maintenance are now recorded when repairs are performed by the third party vendor, and expensed as they are incurred. As a result, previously reported trade and other payables were overstated, while the effect to net income (loss) for the years ended December 31, 2019 and 2018 is immaterial. The effect of the recast on the January 1 and December 31, 2018 Consolidated Statements of Financial Position is summarized below.

January 1, 2018	As previously reported	Accrual Adjustment	As Recast
Current tax assets	1,353,622	(552,660)	800,962
Trade and other payables	41,629,783	(6,551,428)	35,078,355
Deferred tax liability	378,170	673,793	1,051,963
Retained Earnings	(106,438,399)	5,324,975	(101,113,424)

December 31, 2018	As previously reported	Accrual Adjustment	As Recast
Current tax assets	625,964	(552,660)	73,304
Trade and other payables	64,578,428	(6,551,428)	58,027,000
Deferred tax liability	2,886,606	673,793	3,560,399
Retained Earnings	(125,385,208)	5,324,975	(120,060,233)

5. Inventories

Inventories are mainly comprised of drilling and other equipment repair parts. In 2019, consumed repair parts, which are included in direct costs, amounted to $34.5 million (2018 - $33.8 million). For the year ended December 31, 2019, the Corporation recognized a provision for obsolete inventory of $2.1 million (2018 - $0.5 million).

6. Drilling and Other Long-Term Assets

During the fourth quarter of 2019, the Corporation determined no further economic benefits are expected from the future use or future disposal of a portion of EDR equipment in the Stream Services division ("Stream"), as a result EDR equipment with a carrying amount of $0.5 million was derecognized.

At year end, the Corporation determined indicators of impairment existed in Stream due to lower profitability recorded as compared to the budget in 2019 and continued challenges in the Canadian oil and gas industry. As such, an impairment test was performed in the Stream CGU. The recoverable amount was based on Stream's value in use determined by discounting expected future cash flows to be generated from the continued 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:

- Subsequent to the 2020-year, estimated revenues are expected to increase annually on average by 5 percent in the five-year business plan, which is lower than expected growth rate in prior years due to ongoing challenges and uncertainty in the Canadian oil and gas industry.
- Terminal growth rate of 2.5 percent based on management's estimate, which is consistent with the assumptions that a market participant would make.
- The after-tax discount rate derived from the weighted average cost of capital is 22.5 percent, which reflects the 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 $0.1 million. Management identified that an increase of 0.5 percent to the discount rate or a reduction of 1 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)

	Directional Drilling Equipment	EDR Equipment	Machinery and Equipment	Office and Computer Equipment	Development Costs	Vehicles	Building	Land	Total
Cost									
At January 1, 2019	280,853	8,688	18,991	16,764	3,791	1,325	3,413	178	334,003
Additions	32,282	12	1,430	648	-	154	-	-	34,526
Disposals	(30,265)	(83)	(289)	(1)	-	(147)	(3,279)	(171)	(34,235)
Impairment	-	(500)	-	-	-	-	-	-	(500)
Effect of movement in exchange rate	(8,716)	7	(280)	(321)	-	(73)	(134)	(7)	(9,524)
At December 31, 2019	274,154	8,124	19,852	17,090	3,791	1,259	-	-	324,270
Accumulated Depreciation									
At January 1, 2019	200,064	5,389	14,946	13,725	3,741	787	1,186	-	239,838
Depreciation	31,832	1,273	1,949	1,154	44	194	74	-	36,520
Disposals	(21,757)	(76)	(197)	-	-	(145)	(1,212)	-	(23,387)
Effect of movement in exchange rate	(6,539)	27	(219)	(290)	-	(48)	(48)	-	(7,117)
At December 31, 2019	203,600	6,613	16,479	14,589	3,785	788	-	-	245,854
Carrying amount at December 31, 2019	70,554	1,511	3,373	2,501	6	471	-	-	78,416

(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

Assets with a carrying amount of $10.8 million (2018 - $6.5 million) were disposed of as a result of tools lost downhole and scrapped assets, resulting in a net gain on disposition of $4.4 million (2018 - $8.4 million), which is included in other income in the consolidated statement of comprehensive loss.

a) Capital Commitments

As at December 31, 2019, the Corporation has entered into commitments to purchase drilling and other equipment for $19.5 million (2018 - $8.0 million); delivery is expected to occur within the first half of 2020.

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, 2019, the full carrying amount of goodwill of $8.9 million (2018 - $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:

- 2020 forecasted earnings before interest, taxes, depreciation and amortization (EBITDA) is in line with 2019 results. Average revenue growth for the five years subsequent to 2020 is 15 percent.
- Terminal revenue forecasted is the average revenue from the year 2020 to 2025, which reflects the cyclical nature of revenues in the oil and gas industry.
- Terminal growth rate of 2.5 percent based on management's estimate, which is consistent with the assumptions that a market participant would make.
- The after-tax discount rate derived from the weighted average cost of capital is 14.2 percent, which 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 $4.0 million. There was no impairment of goodwill as at December 31, 2019. Management identified that an increase of 1 percent to the discount rate or a reduction of 2 percent to average revenue growth subsequent to 2020, could cause the carrying amount of the Canadian CGU to exceed the recoverable amount.

8. Intangible Assets

(Stated in thousands of dollars)

	Technology	**License**	**Development Costs**	**Systems/ Software**	**Total**
Cost					
At January 1, 2019	**1,826**	**26,025**	**2,577**	**1,972**	**32,400**
Additions	**-**	**-**	**66**	**-**	**66**
Effect of movement in exchange rate	**-**	**(149)**	**-**	**(7)**	**(156)**
At December 31, 2019	**1,826**	**25,876**	**2,643**	**1,965**	**32,310**
Accumulated Amortization					
At January 1, 2019	**1,826**	**6,182**	**859**	**1,231**	**10,098**
Amortization	**-**	**1,737**	**868**	**721**	**3,326**
Effect of movement in exchange rate	**-**	**(16)**	**-**	**-**	**(16)**
At December 31, 2019	**1,826**	**7,903**	**1,727**	**1,952**	**13,408**
Carrying amount at December 31, 2019	**-**	**17,973**	**916**	**13**	**18,902**

(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	(1,421)	(3,077)	-	-	(4,498)
Effect of movement in exchange rate	-	78	-	12	90
At December 31, 2018	1,826	26,025	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	-	19,843	1,718	741	22,302

During the year ended December 31, 2019, the Corporation acquired intangible assets with a total cost of $0.1 million (2018 - $3.1 million).

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. The carrying amount of $4.5 million relating to licenses was derecognized in the year-ended December 31, 2018.

9. Loans and Borrowings

(Stated in thousands of dollars)

	Currency	Amount of Facility	Date of Maturity	**Currency**	**Carrying Amount at December 31, 2019**	Currency	Carrying Amount at December 31, 2018
Operating Facility	CAD	15,000	Due on demand	CAD	**11,396**	CAD	13,349
Syndicated Facility	CAD	50,000	December 11, 2022	CAD	**10,000**	CAD	5,000
US Operating Facility	USD	15,000	December 11, 2022	USD	**3,000**	USD	5,000

Under the syndicated loan agreement, the Corporation is required to maintain certain financial covenants. As at December 31, 2019 the Corporation was in compliance with all its financial covenants as follows:

Ratio	Covenant	**As at December 31, 2019**
Debt to covenant EBITDA	<3.0x	**0.57**
Interest coverage ratio	>3.0x	**31.29**

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.

On July 29, 2019, the Corporation extended the maturity date of the syndicated loan agreement to December 11, 2022. The Corporation also increased the borrowing amounts in the syndicated facility from CAD $48 million to CAD $50 million and in the US operating facility from USD $5 million to USD $15 million.

The Corporation has approximately CAD $43.6 million and USD $12 million available to be drawn from its credit facilities as at December 31, 2019.

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 $4 million (2018 - $3.6 million) in relation to $16.7 million (2018 - $15.1 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 2020. There are no other deductible temporary differences that have not been recognized at the reporting date.

As at December 31, 2019, the Corporation has unrecognized deferred tax assets of $19.4 million 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. Total unrecognized deductible temporary differences in Canada were $65.7 million (2018 - $59.4), of which $36.9 million (2018 - $45.6 million) pertains to federal non-capital losses that expire between 2029 and 2039 and $28.8 million (2018 - $13.8 million) pertains to other deductible temporary differences that do not expire. The benefit associated with $4.8 million (2018 – $3.1 million) of unused investment tax credits and foreign tax credits are also not being recognized and expire between 2023 and 2037.

b) Recognized Deferred Tax Assets and Liabilities

Deferred tax assets and liabilities are attributable to the following:

Years ended December 31,		**2019**		2018
Deferred income tax assets:				
Non-capital income tax losses (Note 4)	**$**	**3,982,983**	$	4,708,534
Lease liability		**3,425,481**		-
Other (including foreign and other tax credits)		**1,087,240**		609,646
	$	**8,495,704**	$	5,318,180
Deferred income tax liabilities:				
Drilling and other equipment	**$**	**(10,606,838)**	$	(8,250,905)
Right-of-use asset		**(2,699,135)**		-
Other		**(8,903)**		(33,625)
		(13,314,876)		(8,284,530)
Net deferred income tax liability	**$**	**(4,819,172)**	$	(2,966,350)

Non-capital income tax losses expire between 2020 and 2035. 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, 2018	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
Common shares repurchased	**(4,762,300)**		**(14,071,163)**
Issued shares pursuant to share option plan	**45,000**		**125,955**
Balance as at December 31, 2019	**53,246,420**	**$**	**251,815,183**

b) Weighted-Average Number of Shares

	2019	2018
Issued common shares at January 1,	**57,963,720**	58,397,887
Effect of shares pursuant to Normal Course Issuer Bid	**(1,769,379)**	(189,089)
Effect of share options exercised	**35,014**	21,475
Weighted-average number of common shares at December 31,	**56,229,355**	58,230,273

c) Basic and Diluted Loss per Share

2019		**Loss (numerator)**	**Shares (denominator)**		**Per Share Amount**
Basic loss per share:	**$**	**(2,213,120)**	**56,229,355**	**$**	**(0.04)**
Diluted loss per share:					
Dilutive effect of share option conversions		-	-		
	$	**(2,213,120)**	**56,229,355**	**$**	**(0.04)**

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)

As at December 31, 2019, 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 4,783,601 (2018 – 5,291,101) of which 2,371,101 options (2018 – 2,478,601) had exercise prices below the Corporation share price as at December 31, 2019.

d) Normal Course Issuer Bid (“NCIB”)

During the third quarter of 2019, 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 3,280,889 common shares, representing 10 percent of the Corporation’s public float of Common Shares as at July 31, 2019. The NCIB commenced on August 9, 2019 and will terminate on August 8, 2020. 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 current NCIB, subsequent to August 9, 2019, 2,524,500 common shares were purchased by the Corporation and cancelled as at December 31, 2019.

The Corporation’s previous NCIB commenced on August 8, 2018 and terminated on August 7, 2019. Pursuant to the previous NCIB, 357,500 common shares were purchased by the Corporation in the second half of 2018 and cancelled, and in 2019, the Corporation purchased and cancelled 2,237,800 common shares. In total, pursuant to the previous NCIB 2,595,300 common shares were purchased and cancelled by the Corporation.

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 2019

Number	Exercise Price	Expiration Date	Fair Value
200,000	$ 2.81	March 8, 2024	$ 1.22
50,000	2.83	March 8, 2024	1.21
250,000			

During the year ended December 31, 2019, a total of 45,000 options (2018 – 48,333 options) were exercised at exercise price of $1.95, a total of 312,500 options were forfeited (2018 – 33,334 options), no options were cancelled (2018 – 8,333), and 400,000 options expired (2018 – 368,367). The 312,500 options forfeited were surrendered to the Corporation and payment was made to the option holders equal to the excess of the five-day weighted average share price at date of surrender less the exercise price of the option. The Corporation paid $0.4 million to the option holders as part of the surrender which was reflected in share capital.

As at December 31, 2019, the Corporation had a total of 4,783,601 (2018 – 5,291,101) 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, 2019 in the amount of $0.4 million 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 2019 these variables include, but are not limited to, the Corporation's expected share price volatility over the term of the options of 56 percent, forfeiture rate of nil, and a risk free interest rate of 1.65 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 2019, the Corporation recognized a total compensation expense of $611,681 (2018 - $1,368,819) for share options granted between 2016 and 2019.

A summary of the status of the plan as at December 31, 2019, is presented below:

	2019		2018	
	Options	**Weighted-Average Exercise Price**	Options	Weighted-Average Exercise Price
Outstanding, beginning of year	**5,291,101**	**$ 3.89**	5,499,468	$ 4.41
Granted	**250,000**	**2.81**	250,000	1.99
Exercised	**(45,000)**	**1.95**	(48,333)	1.59
Forfeited / cancelled	**(312,500)**	**1.55**	(41,667)	3.06
Expired	**(400,000)**	**11.76**	(368,367)	10.78
Outstanding, end of year	**4,783,601**	**$ 3.35**	5,291,101	$ 3.89
Options exercisable, end of year	**4,283,593**	**$ 3.49**	4,042,758	$ 4.20

The range of exercise prices for options outstanding at December 31, 2019 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	**1,005,834**	**1.18 yrs**	**$ 1.55**	**1,005,834**	**$ 1.55**
1.71	**175,000**	**2.63 yrs**	**1.71**	**116,666**	**1.71**
1.79	**575,000**	**2.63 yrs**	**1.79**	**383,331**	**1.79**
1.95	**165,267**	**1.79 yrs**	**1.95**	**148,600**	**1.95**
2.00	**200,000**	**3.19 yrs**	**2.00**	**133,332**	**2.00**
2.81	**200,000**	**4.19 yrs**	**2.81**	**66,664**	**2.81**
2.83	**50,000**	**4.19 yrs**	**2.83**	**16,666**	**2.83**
3.41	**25,000**	**1.89 yrs**	**3.41**	**25,000**	**3.41**
4.06	**1,305,000**	**2.17 yrs**	**4.06**	**1,305,000**	**4.06**
4.15	**415,000**	**2.17 yrs**	**4.15**	**415,000**	**4.15**
6.87 - 15.81	**667,500**	**0.18 yrs**	**6.88**	**667,500**	**6.88**
	4,783,601	**1.89 yrs**	**$ 3.35**	**4,283,593**	**$ 3.49**

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. During the year ended December 31, 2019, 750,000 PAs were granted (2018 – 750,000), 566,668 PAs settled at a weighted-average payout multiplier of 192 percent (2018 – 66,664), no PAs were forfeited (2018 - nil). As at December 31, 2019, 1,316,668 PAs were outstanding (2018 – 883,336).

The Corporation recorded a total of $6.9 million in compensation expense relating to these plans for year ended December 31, 2019 (2018 - $4.1 million). The expense is included in selling, general and administrative expense and has a corresponding liability included in trade and other payables. There were 3,555,634 RAs and PAs outstanding as at December 31, 2019 (2018 – 3,443,456).

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

	2019	2018
RAs and PAs outstanding, beginning of year	**3,443,456**	2,103,040
Granted	**1,645,221**	2,469,292
Settled	**(1,479,039)**	(879,504)
Forfeited / cancelled	**(54,004)**	(249,372)
RAs and PAs outstanding, end of year	**3,555,634**	3,443,456

13. Expenses by Nature

(Stated in thousands of dollars)

Years ended December 31,	2019	2018
Salaries and employee benefits	**140,429**	117,600
Share-based payments	**7,471**	5,489
Personnel expenses	**147,900**	123,089
Equipment expenses	**74,245**	60,570
Depreciation and amortization drilling and other equipment	**39,846**	39,738
Consumed repair parts	**34,492**	33,823
Contract labour	**16,654**	24,015
Field and freight expenses	**13,780**	12,297
Insurance and business and sales taxes	**11,872**	8,893
Facility and office expenses	**6,013**	10,274
Travel and entertainment	**5,044**	4,863
Depreciation and amortization right-of-use asset	**3,539**	-
Other	**2,434**	2,027
Provisions for inventory	**2,086**	543
Legal and audit fees	**1,328**	1,257
Provision for onerous contracts	**-**	(314)
	359,233	321,075

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 loss.

14. Other Income

Years ended December 31,		2019		2018
Net gain on disposition of drilling equipment (Note 6)	**$**	**4,429,047**	$	8,376,711
Foreign exchange loss		**(878,658)**		(198,576)
Provision for bad debts		**(387,728)**		(9,458)
	$	**3,162,661**	$	8,168,677

15. Income Taxes

Years ended December 31,		2019		2018
Current tax expense (recovery):				
Current period	$	**786,498**	$	193,563
Adjustment for prior periods		**(87,312)**		(15,737)
		699,186		177,826
Deferred tax recovery:				
Origination and reversal of temporary differences		**2,836,056**		17,243,611
Adjustment for prior periods		**229,000**		47,840
		3,065,056		17,291,451
Total income tax expense	$	**3,764,242**	$	17,469,277

Reconciliation of effective tax rate

Years ended December 31,		2019			2018	
Net loss	$	**(2,213,120)**		$	(18,946,809)	
Total income tax recovery		**3,764,242**			17,469,277	
Income (loss) before income taxes		**1,551,122**			(1,477,532)	
Income tax using the Corporation's domestic tax rate		**411,047**	**26.5%**		(398,939)	27.0%
Non-taxable portion of gains on disposal of assets		**(246,522)**	**(15.9%)**		(295,825)	20.0%
Change in unrecognized deductible temporary differences		**1,781,736**	**n.m.**		18,076,755	n.m.
Effect of tax rates in foreign jurisdictions		**(1,201,645)**	**(77.5%)**		(812,911)	55.0%
Non-deductible share-based payments and other expenses		**357,660**	**23.1%**		598,126	(40.5%)
Effect of change in Alberta tax rate		**2,452,280**	**158.1%**		-	-
Other		**209,686**	**13.5%**		302,071	(20.4%)
	$	**3,764,242**	**n.m.**	$	17,469,277	n.m.

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,	**2019**	2018	**2019**	2018	**2019**	2018	**2019**	2018
Drilling services revenue	**67,142**	86,698	**270,028**	208,112	**20,106**	18,413	**357,276**	313,223
EDR rental revenue	**4,781**	3,912	**-**	-	**-**	-	**4,781**	3,912
Total revenue	**71,923**	90,610	**270,028**	208,112	**20,106**	18,413	**362,057**	317,135
Reportable segment profit (loss) before income taxes [1]	**(5,917)**	(4,078)	**20,899**	11,382	**(43)**	525	**14,939**	7,829

[1] Includes adjustments to intercompany transactions.

(Stated in thousands of dollars)

	Canada		United States		International		Total	
As at December 31,	**2019**	2018	**2019**	2018	**2019**	2018	**2019**	2018
Drilling and other equipment	**19,814**	27,863	**53,713**	59,996	**4,889**	6,306	**78,416**	94,165
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,	**2019**	2018
Reportable segment income before income taxes	**$ 14,939**	$ **7,829**
Corporate:		
Selling, general and administrative expenses	**8,247**	**8,416**
Research and development expenses	**3,869**	**3,354**
Finance expense	**1,426**	**1,208**
Finance expense lease liability	**2,509**	**-**
Impairment loss	**500**	**4,498**
Other income	**(3,163)**	**(8,169)**
Earnings (loss) before income taxes	**$ 1,551**	$ **(1,478)**

17. Changes in Non-Cash Working Capital

(Stated in thousands of dollars)

Years ended December 31,		2019		2018
Trade and other receivables	**$**	**10,346**	$	(37,352)
Inventories		**(3,269)**		(5,549)
Prepaid expenses		**(141)**		488
Investment and foreign tax credits		**356**		4,557
Trade and other payables		**(3,135)**		22,949
Impact of foreign exchange rate changes in working capital		**(5,488)**		(3,214)
	$	**(1,331)**	$	(18,121)

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, 2019, one customer comprised 7 percent of the total revenue (2018 - 6 percent of revenue). The customer's revenue is reported within the US operating segment.

As at December 31, 2019, the ageing of trade and other receivables that were not impaired was as follows:

(Stated in thousands of dollars)		2019
Neither past due nor impaired	**$**	**50,299**
Past due 1-30 days		**28,315**
Past due 31-60 days		**7,129**
Past due 61-90 days		**3,181**
Past due over 90 days		**4,718**
	$	**93,642**

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 represented 5 percent or approximately $4.7 million of total receivables on the statement of financial position at December 31, 2019. 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 $0.8 million for all amounts it considers uncollectable at December 31, 2019 (2018 - $0.5 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, 2019:

(Stated in thousands of dollars)

	2020	2021	2022	2023	2024
Loans and borrowings	11,396	-	13,896	-	-
Drilling and other equipment purchase commitments	19,531	-	-	-	-
Trade and other payables	54,892	-	-	-	-
	85,819	-	13,896	-	-

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 $152,070 for the year ended December 31, 2019.

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, 2019, foreign exchange losses of $0.9 million (2018 – $0.2 million) resulted mainly from fluctuations in the CAD-RUB 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, 2019	**CAD**	**USD**	**RUB**
Cash and cash equivalents	**-**	**331,511**	**66,997,623**
Trade and other receivables	**-**	**3,900**	**178,608,038**
Trade and other payables	**-**	**(4,551,623)**	**(29,865,292)**
Intercompany receivables	**700,392**	**-**	**-**
Intercompany payables	**(13,207,293)**	**-**	**-**
Statement of financial position exposure	**(12,506,901)**	**(4,216,212)**	**215,740,369**

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

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

	Average Rate		December 31, Close Rate	
	2019	2018	**2019**	2018
USD	**1.3268**	1.2961	**1.2988**	1.3642
RUB	**48.7454**	48.4518	**47.3611**	50.9614

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)	**2019**	2018
CAD (10% strengthening)	**$ (962,958)**	$ (237,063)
USD (10% strengthening)	**(547,602)**	(275,116)
RUB (10% strengthening)	**414,111**	620,914

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, 2019, the Corporation had $25.3 million (2018 – $25.2 million) in loans and borrowings and $148.9 million (2018 – $173.7 million) in shareholders' equity. The Corporation's resulting long-term debt to equity ratio was 0.17 as at December 31, 2019 (2018 – 0.15).

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, 2019, 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, 2019.

20. Leases

a) Leases as lessee (IFRS 16)

The Corporation leases shop facilities, offices, and vehicles. The shop and office leases typically run for a period between 5 to 15 years, with an option to renew the lease after that date. Vehicle leases typically run for a period between 3 to 6 years with an option to purchase the vehicle.

The shop and office leases were entered into many years ago as combined leases of lands and buildings. Previously these leases were classified as operating leases under IAS 17. Prior to 2019, office leases were sub-leased by the Corporation and applied against the right-of-use asset. The office lease and sublease expires in the year 2023.

The Corporation elected not to recognize right-of-use assets and lease liabilities for leases that were short-term, expired in 2019, or were low-value items like office equipment. Information about leases for which the Corporation is the lessee is presented below.

i. Right-of-Use Assets

Right-of-use assets relate to leased properties that do not meet the definition of investment property.

(Stated in thousands of dollars)

	Shop and Office Buildings	Vehicles	Total
2019			
Balance at January 1	$ **35,150**	$ **1,094**	$ **36,244**
Depreciation charge for the year	**(3,126)**	**(413)**	**(3,539)**
Additions to right-of-use assets	**200**	**365**	**565**
Derecognition of right-of-use assets [(1)]	**(90)**	**(16)**	**(106)**
Effect of movement in exchange rate	**(295)**	**(43)**	**(338)**
Balance at December 31	**31,839**	**987**	**32,826**

(1) Derecognition of right-of-use assets during 2019 is as a result of entering in to finance sub-leases of offices, and early termination of a vehicle lease.

ii. Amounts Recognized in Consolidated Statements of Comprehensive Loss

(Stated in thousands of dollars)

Years ended December 31,	**2019**
2019 – Leases under IFRS 16	
Interest on lease liabilities	**2,526**
Income from sub-leasing right-of-use assets presented in “finance expense lease liability”	**(17)**
Expenses relating to short-term leases	**931**
Expenses relating to leases of low-value assets, excluding short-term leases of low value	**136**

(Stated in thousands of dollars)

Years ended December 31,	2018
2018 – Operating leases under IAS 17	
Lease expense	6,825
Income from sub-leasing	(185)

iii. Amounts Recognized in Consolidated Statements of Cash Flows

(Stated in thousands of dollars)

Years ended December 31,	**2019**
Total cash outflow for IFRS 16 leases	**(5,729)**

iv. Extension Options

Shop and office leases contain extension options exercisable by the Corporation during the term of the lease. Where practicable, the Corporation seeks to include extension options in new leases to provide operational flexibility. The extension options held are exercisable only by the Corporation and not by the lessors. The Corporation assesses at lease commencement date whether it is reasonable certain to exercise the options if there is a significant event or significant changes in the circumstances within it control.

The Corporation has estimated that the potential future lease payments, should it elect to exercise the extension option would result in an increase in lease liability of $0.1 million.

v. Maturity Analysis

The following table sets out a maturity analysis of lease payments, showing the undiscounted lease payments to be paid after the reporting date.

		2019
2019 – Leases under IFRS 16		
2020	**$**	**6,015**
2021		**6,086**
2022		**5,633**
2023		**4,634**
2024 and after		**4,993**

(1) Includes a shop lease to commence in 2020 with yearly payments of $0.6 million over term of 10 years with a 5 year renewal option.

		2018
2018 – Leases under IAS 17		
2019	$	8,343
2020		7,518
2021		7,085
2022		6,373
2023 and after		4,698

(1) Includes base rent and operating rental costs for office leases. IFRS 16 only includes base rent.

b) Leases as Lessor

During 2019, the Corporation has sub-leased offices that are presented as part of a right-of-use asset. During the 2019 year the Corporation recognized interest income on lease receivables of $17 thousand (2018 – nil).

The following table sets out a maturity analysis of lease payments, showing the undiscounted lease payments to be received after the reporting date.

		2019
2019 – Leases under IFRS 16		
2020	**$**	**120**
2021		**127**
2022		**134**
2023		**11**
2024 and after		**-**

		2018
2018 – Leases under IAS 17		
2019	$	441
2020		441
2021		441
2022		441
2023 and after		37

[(1)] Includes base rent and operating rental costs for office leases. IFRS 16 only includes base rent.

21. Related Parties

a) 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,	2019	2018
Base salaries, benefits, and directors' remuneration	**$ 2,340,480**	$ 2,344,262
Short-term bonuses and commissions	**4,635,797**	3,680,737
Share-based compensation	**3,229,164**	2,655,734
	$ 10,205,441	$ 8,680,733

Key management personnel and director transactions

Directors of the Corporation control 17 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 13) and can elect to receive certain percentages of these fees as RAs under the retention award plan. As at December 31, 2019, the directors have 784,888 of RAs outstanding (2018 – 742,283).

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, 2019, an officer purchased $24 thousand of equipment from the Corporation (2018 – nil). There were no other purchases of goods or services from or to a related party in 2019 (2018-nil).

22. Significant Subsidiaries

		Ownership Interest	
	Country of Incorporation	2019	2018
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.

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 Engineering 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