



2018 FIRST QUARTER REPORT

# PHX Energy Services Corp.

## First Quarter Report for the three-month periods ended March 31, 2018 and 2017

### Financial Results

For the three-month period ended March 31, 2018, PHX Energy's consolidated operating and financial results continued to strengthen, building upon the 2017-year's positive momentum. The Corporation generated consolidated revenue of \$70.8 million, which is 16 percent greater than the \$61.1 million generated in the first quarter of 2017, 17 percent greater than the \$60.7 million generated in the fourth quarter of 2017, and is the highest level of quarterly revenue achieved since the first quarter of 2015. Profitability also improved and the Corporation realized adjusted EBITDA (see "Non-GAAP Measures") of \$6.8 million and a net loss of \$4.3 million in the 2018-quarter compared to adjusted EBITDA of \$3.7 million and a net loss of \$7.1 million in the comparable 2017-quarter. The strong improvement in profitability is primarily the result of an overall recovery in day rates realized in Canada and the US. Consolidated day rates increased by 15 percent to \$10,182 in the first quarter of 2018 versus \$8,824 in the comparable 2017-quarter.

During the 2018-quarter, PHX Energy continued to focus on the US drilling market, mainly the Permian basin, where the industry outlook is more optimistic and there is greater potential for growth. US industry activity, as measured by the average rigs running per day, increased by 30 percent to 966 in the first quarter of 2018 from 742 in the 2017-quarter (Source: Baker Hughes). The US operating segment generated revenue of \$38.1 million in the 2018-quarter, representing 54 percent of the Corporation's consolidated revenue for the period and an increase of 42 percent compared to the \$26.8 million of revenue generated by the segment in the comparable 2017-quarter. For the three-month period ended March 31, 2018, Phoenix USA achieved 2,713 operating days, an increase of 36 percent from 1,990 days realized in the comparable 2017-quarter.

With the many macro and political challenges faced by the Canadian industry and an early start to the spring break-up period, the market's activity was relatively flat quarter-over-quarter with 22,669 horizontal and directional drilling days in the first quarter of the 2018 (2017 – 22,041 days) (Source: Daily Oil Bulletin). Revenue generated by the Canadian segment decreased to \$28.0 million in the 2018-quarter as activity slowed to 3,382 operating days. The impact of lower activity was partially offset by an increase in day rates to \$7,881.

As at March 31, 2018, PHX Energy had long-term debt of \$12.0 million and working capital of \$54.1 million.

## Capital Spending

The Corporation incurred \$3.1 million in capital expenditures in the first quarter of 2018, an increase compared to \$1.8 million spent in the comparable 2017-quarter. The majority of the current year's capital spending was for Velocity Real-Time Systems ("Velocity") and measurement while drilling ("MWD") spare components.

As at March 31, 2018, the Corporation had commitments to purchase drilling and other equipment for \$4.8 million. These commitments include \$2.6 million for motors primarily relating to the 7.25" Atlas High Performance Drilling Motor ("Atlas"), \$1.9 million for Velocity, and \$0.3 million for MWD spare components, tubulars, and machinery and equipment. These commitments are expected to be delivered by the end of the third quarter of 2018. The Corporation continues to anticipate spending \$10.5 million on capital expenditures in the 2018-year.

## Normal Course Issuer Bid

The TSX approved PHX Energy's Normal Course Issuer Bid ("NCIB") to purchase for cancellation, from time-to-time, up to a maximum of 2,929,494 common shares of the Corporation. Purchases of common shares will be made on the open market through the facilities of the TSX and through alternative trading systems. The price which PHX Energy will pay for any common shares purchased will be at the prevailing market price on the TSX or alternate trading systems at the time of such purchase. The NCIB commenced on June 26, 2017 and will terminate on June 25, 2018 or such earlier time as the NCIB is completed or terminated at the option of the Corporation. Pursuant to the NCIB, 125,000 shares were purchased in the 2018-quarter and cancelled by the Corporation.

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

Three-month periods ended March 31,

	2018	2017	% Change
	(unaudited)	(unaudited)	
<b>Operating Results</b>			
Revenue	70,759	61,122	16
Net loss	(4,251)	(7,143)	(40)
Loss per share – diluted	(0.07)	(0.13)	(46)
Adjusted EBITDA <sup>(1)</sup>	6,768	3,743	81
Adjusted EBITDA per share – diluted <sup>(1)</sup>	0.11	0.07	57
Adjusted EBITDA as a percentage of revenue <sup>(1)</sup>	10%	6%	
<b>Cash Flow</b>			
Cash flows from (used in) operating activities	936	(9,896)	n.m.
Funds from operations <sup>(1)</sup>	5,757	3,983	45
Funds from operations per share – diluted <sup>(1)</sup>	0.10	0.07	43
Capital expenditures	3,067	1,799	70
<b>Financial Position (unaudited)</b>	<b>Mar. 31, '18</b>	<b>Dec 31, '17</b>	
Working capital <sup>(1)</sup>	54,061	49,787	9
Long-term debt	12,000	14,000	(14)
Shareholders' equity	180,156	181,538	(1)
Common shares outstanding	58,272,887	58,397,887	-

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

n.m. – not meaningful

## Non-GAAP Measures

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

## Management's Discussion and Analysis

The following MD&A of the financial condition, results of operations, and cash flow of PHX Energy Services Corp. ("PHX Energy" or the "Corporation") should be read in conjunction with the Corporation's 2017 annual report, including the MD&A, and audited consolidated financial statements and the accompanying notes contained therein, and the Corporation's 2018 unaudited interim first quarter report, including the unaudited condensed consolidated financial statements and the accompanying notes contained therein. Readers can also obtain additional information on the Corporation including its Information Circular and Annual Information Form ("AIF") filed on SEDAR at [www.sedar.com](http://www.sedar.com). This MD&A has been prepared taking into consideration information available up to and including May 3, 2018.

PHX Energy's Interim Financial Report for the three-month periods ended March 31, 2018 and 2017 has been prepared in accordance with International Financial Reporting Standards ("IFRS"). The MD&A and Interim Financial Report was reviewed by PHX Energy's Audit Committee and approved by PHX Energy's Board on May 3, 2018.

## Cautionary Statement Regarding Forward-Looking Information and Statements

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

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

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

- The Corporation continues to anticipate spending \$10.5 million on capital expenditures in the 2018-year.
- The 2018 planned capital expenditures are expected to be financed from a combination of one or more of the following: cash flow from operations, the Corporation's unused credit facilities or equity, if necessary. However, if a sustained period of market uncertainty and financial market volatility persists in 2018, the Corporation's activity levels, cash flows and access to credit may be negatively impacted, and the expenditure level would be reduced accordingly. Conversely, if future growth opportunities present themselves, the Corporation would look at expanding this planned capital expenditure amount.

The above are stated under the headings: "Capital Spending" and "Cash Requirements for Capital Expenditures". In addition, statements regarding the expected impact of adopting Changes in Accounting Policies and all information contained within the Contractual Obligations, Business Risk and Outlook section of this report contains forward-looking statements.

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

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

## About PHX Energy Services Corp.

The Corporation, through its directional drilling subsidiary entities, provides horizontal and directional drilling technology and services to oil and natural gas producing companies in Canada, the US, Russia and Albania. PHX Energy also provides 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. In the US, EDR technology and services are marketed under the US entity, Stream EDR Services. EDR technology is marketed worldwide, outside Canada and the US, through Stream’s wholly-owned subsidiary Stream Services International Inc.

# Results of Operations

Three-Month Period Ended March 31, 2018

## Revenue

*(Stated in thousands of dollars)*

	Three-month periods ended March 31,		
	2018	2017	% Change
Revenue	70,759	61,122	16

For the three-month period ended March 31, 2018, consolidated revenue grew by 16 percent to \$70.8 million from \$61.1 million in the comparable 2017-quarter. This is the highest level of quarterly revenue achieved since the first quarter of 2015. The sustained stability in the oil and gas industry resulted in improved day rates relative to the comparable 2017-quarter. Average consolidated day rates for the three-month period ended March 31, 2018, excluding the motor rental division in the US and the Stream division, increased by 15 percent to \$10,182 from \$8,824 in the first quarter of 2017. The recovery in day rates was achieved despite the weakened US dollar relative to the same period in 2017. In the three-month period ended March 31, 2018, the Corporation achieved 6,769 consolidated operating days, flat compared to the 6,684 operating days recorded in the 2017-quarter.

As a percentage of total consolidated revenue, US and international revenues were 54 and 7 percent, respectively, for the 2018-quarter as compared to 44 and 8 percent in 2017-quarter.

Crude oil prices continued to strengthen in the first quarter of 2018, with WTI averaging \$62.90, a level not seen in the last three years; however, the industry in North America is polarized. The US industry showed continued momentum reaching an average of 966 rigs running per day in the first quarter of 2018 compared to 742 rigs per day in the first quarter of 2017, a 30 percent increase. In Canada the benefits of the stronger crude oil prices were offset by the uncertainty surrounding issues such as future pipeline projects and access to market, and as such, the average number of rigs operating per day retracted from 295 rigs in the 2017 first quarter to 269 rigs in 2018, a 9 percent decrease. Throughout North America the vast majority of wells continued to be horizontal and directional representing 97 percent of all wells drilled in Canada and 93 percent of the average number of rigs operating per day in the US (Sources: Daily Oil Bulletin and Baker Hughes).



## Operating Costs and Expenses

(Stated in thousands of dollars except percentages)

	Three-month periods ended March 31,		
	2018	2017	% Change
Direct costs	65,929	60,805	8
Gross profit as a percentage of revenue	7%	1%	
Depreciation & amortization (included in direct costs)	10,306	10,931	(6)
Gross profit as percentage of revenue excluding depreciation & amortization	21%	18%	

Direct costs are comprised of field and shop expenses, and include depreciation and amortization on the Corporation's equipment. In the first quarter of 2018, direct costs increased by 8 percent to \$65.9 million from \$60.8 million in the comparable 2017-quarter. The increased direct costs were mainly due to higher expenses related to field labour and equipment repairs, particularly in the US where activity was growing. The Corporation's gross profit as a percentage of revenue increased to 7 percent in the first quarter of 2018 compared to 1 percent in the 2017-quarter.

The reduction in depreciation and amortization expenses in the three-month period ended March 31, 2018 was mainly the result of PHX Energy's lower levels of capital spending relative to the years before the industry downturn and more assets being fully depreciated. Excluding depreciation and amortization, gross profit as a percentage of revenue increased to 21 percent for the three-month period ended March 31, 2018 from 18 percent in the comparable 2017-period.

The improved profitability achieved in the three-month period ended March 31, 2018 was primarily the result of the Corporation's steady activity at higher day rates and lower depreciation and amortization.

(Stated in thousands of dollars except percentages)

	Three-month periods ended March 31,		
	2018	2017	% Change
Selling, general & administrative ("SG&A") costs	8,771	7,210	22
Equity-settled share-based payments (included in SG&A costs)	460	488	(6)
Cash-settled share-based payments (included in SG&A costs)	46	132	(65)
Onerous contracts lease payment	(128)	(107)	20
SG&A costs excluding equity and cash-settled share-based payments and provision for onerous contracts as a percentage of revenue	12%	11%	

The Corporation incurred \$8.8 million of SG&A costs in the three-month period ended March 31, 2018 as compared to \$7.2 million in the 2017-quarter. Included in SG&A costs for the 2018-quarter were equity-settled and cash-settled share-based payments totaling \$0.5 million (2017 - \$0.6 million). Additionally, for the 2018 three-month period, SG&A costs were reduced by \$0.1 million for actual lease payments made under the Corporation's onerous office lease contracts that were reclassified

to reduce the provision for onerous contracts (2017 – \$0.1 million). Excluding the share-based payment amounts and provision for onerous contracts, SG&A costs as a percentage of consolidated revenue was 12 percent in the 2018-quarter compared to 11 percent in the 2017-quarter.

For the three-month period ended March 31, 2018, SG&A costs were higher than the comparable 2017- period, primarily due to greater personnel related costs associated with increased activity in the US. In addition, included in SG&A costs were severance expenses of approximately \$250,000 due to a restructuring of international operations.

Equity-settled share-based payments relate to the amortization of the fair values of issued options of the Corporation using the Black-Scholes model. In the three-month period ended March 31, 2018, equity-settled share-based payments decreased by 6 percent, as compared to the corresponding 2017-quarter, mainly due to fewer options granted in the 2018-quarter compared to the first three-months of 2017.

Cash-settled share-based retention awards, which are included in SG&A costs, are measured at fair value, and in the 2018-quarter cash-settled share-based payments decreased by 65 percent, as compared to the corresponding 2017-quarter. The lower compensation expense is primarily due to fluctuations in the Corporation's share price.

*(Stated in thousands of dollars)*

	Three-month periods ended March 31,		
	2018	2017	% Change
Research & development expense	870	607	43

Research and development ("R&D") expenditures during the three-month period ended March 31, 2018 and 2017 were \$0.9 million and \$0.6 million, respectively. The increase in R&D expenditures in the 2018-quarter is mainly attributable to increased personnel in the R&D department who continue to focus on new technology development and cost-savings and reliability initiatives that will enhance and expand PHX Energy's services.

*(Stated in thousands of dollars)*

	Three-month periods ended March 31,		
	2018	2017	% Change
Finance expense	340	585	(42)

Finance expenses relate to interest charges on the Corporation's long-term and short-term bank facilities. Finance charges decreased to \$0.3 million in the first quarter of 2018 as compared to \$0.6 million in the 2017-quarter. The lower finance expense is primarily due to the lower principal outstanding and lower borrowing rates in the first quarter of 2018 as compared to the 2017-quarter.

*(Stated in thousands of dollars)*

	Three-month periods ended March 31,	
	2018	2017
Net gain on disposition of drilling equipment	(779)	(147)
Foreign exchange (gains) losses	(128)	172
Provision (Recovery of) for bad debts	(8)	228
Other expense (income)	(915)	253

For the three-month period ended March 31, 2018, other income was comprised of a net gain on disposition of drilling equipment of \$0.8 million (2017 - \$0.1 million), foreign exchange gains of \$0.1 million (2017 - \$0.2 million loss), and insignificant recovery of bad debts (2017 – provision of \$0.2 million). During the period ended March 31, 2018, the Corporation recognized a gain on disposition of drilling equipment primarily due to 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. In the 2018-quarter, the increase to the gain on disposition of drilling equipment resulted mainly from a greater number of insured downhole equipment losses.

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

	Three-month periods ended March 31,	
	2018	2017
Provision for (Recovery of) income taxes	14	(1,195)
Effective tax rates	-	14%

The provision of income taxes for the three-month period ended March 31, 2018 was \$14,000 as compared to a \$1.2 million recovery in the 2017-quarter. The expected combined Canadian federal and provincial tax rate for 2018 is 27 percent (2017 – 27 percent). The effective tax rate in the 2018-period was lower primarily due to increased profitability in the US offset by tax recoveries internationally.

## Segmented Information

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

### Canada

*(Stated in thousands of dollars)*

	Three-month periods ended March 31,		
	2018	2017	% Change
Revenue	27,975	29,442	(5)
Reportable segment profit before tax	1,511	768	97

PHX Energy's Canadian revenue for the three-month period ended March 31, 2018 decreased by 5 percent to \$28.0 million from \$29.4 million in the corresponding 2017-period. Lower revenues were primarily the result of lower activity during the 2018-quarter versus the comparable 2017-quarter partially due to an early onset of the spring break-up period in 2018. The Canadian segment reported 3,382 operating days in the first quarter of 2018, a decrease from the 4,004 days in the 2017-quarter. In comparison, total industry horizontal and directional drilling activity, as measured by drilling days, was relatively flat in the 2018-quarter with 22,669 days recorded versus 22,041 days in the 2017-quarter (Source: Daily Oil Bulletin). Positively offsetting volume changes, PHX Energy's average day rates increased by 12 percent to \$7,881 in the 2018-quarter from \$7,009 in the comparable 2017-period (excluding Stream revenue of \$1.3 million and \$1.4 million, respectively). As oil prices have stabilized, the pricing environment improved and PHX Energy made strong efforts to negotiate better day rates with its clients. The Corporation improved its discipline in job selection which assisted in achieving higher day rates in the quarter, however this approach also contributed to the lower volume of activity as low margin jobs were reduced to strengthen profitability.

During the 2018-quarter, 69 percent of the Canadian division's activity was oil well drilling and PHX Energy was active in the Montney, Wilrich, Bakken, Shaunavon, Duvernay, Cardium and Viking areas. The Corporation's Canadian operations maintained a healthy market share and diversified client base, and this combined with its solid reputation in the Canadian market has aided the improvement in profitability.

The Canadian operations' reportable segment profit before tax for the first quarter of 2018 was \$1.5 million as compared to \$0.8 million profit in the 2017-quarter. The improved profitability of the Canadian segment in the 2018-quarter was primarily the result of higher day rates achieved and disciplined job selection.

## Stream Services

Included in the Canadian segment's revenue for the first quarter of 2018 is \$1.3 million of revenue generated by the Stream division (2017 - \$1.4 million). During the three-month period ended March 31, 2018, Stream achieved 1,919 operating days in the 2018-quarter compared to 1,739 days in the 2017-quarter. The positive impact of increased activity was however offset by a 13 percent decrease in average day rates to \$689 in the first quarter of 2018 from \$794 in the 2017-quarter. The decrease in day rates was mainly due to a greater proportion of low-rate services provided to other sectors of the market in the 2018-quarter.

For the three-month period ended March 31, 2018, the Stream division incurred reportable losses before tax of \$1.1 million (2017 - \$0.5 million). The Stream division's losses in the 2018-period pertain mostly to the depreciation expenses of \$0.6 million.

## United States

*(Stated in thousands of dollars)*

	Three-month periods ended March 31,		
	2018	2017	% Change
Revenue	38,067	26,815	42
Reportable segment loss before tax	(4,168)	(6,170)	(32)

In the first quarter of 2018, PHX Energy's US operations generated revenue of \$38.1 million, an increase of 42 percent from \$26.8 million in the 2017-quarter. This level of first quarter revenue was the highest achieved by the US segment since 2015. The increase in revenue resulted mainly from Phoenix USA growing its client base and volume of activity, and as a result, operating days increased by 36 percent to 2,713 days in the 2018-quarter from 1,990 days in the 2017-quarter. PHX Energy's rate of activity growth was in line with the gains made to the US industry's rig count. In the first quarter of 2018, the number of horizontal and directional rigs running per day rose by 34 percent from an average of 674 horizontal and directional rigs running per day during the 2017-quarter to 903 in the 2018-quarter (Source: Baker Hughes). Average day rates, excluding the motor rental division in Midland, Texas and the Rocky Mountain region, slightly increased from \$13,094 in the 2017-quarter to \$13,846 in the 2018-period. The improvement in day rates was offset by a 4 percent weakening in the average US dollar foreign exchange rate quarter-over-quarter.

Horizontal and directional drilling represented 93 percent of the industry's average number of rigs running on a daily basis during the first quarter of 2018, which was slightly higher than the percentage in the 2017-quarter. For the three-month period ended March 31, 2018, 95 percent of the US operating division's activity was oil well drilling, as measured by wells drilled and excluding the motor rental and gyro surveying divisions. The Permian basin represents 45 percent of all active rigs operating in the US today and during the first quarter of 2018 approximately 70 percent of Phoenix USA's activity was

focused in this area. In addition the Corporation was active in the Eagle Ford, Bakken, Mississippian/Woodford, Marcellus, Niobrara and Utica basins (Source: Baker Hughes).

Reportable segment loss before tax for the three-month period ended March 31, 2018 was \$4.2 million compared to losses of \$6.2 million in the 2017-quarter. The reduction to the segment losses in 2018 was largely the result of improved activity levels and average day rates.

## International

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

	Three-month periods ended March 31,		
	2018	2017	% Change
Revenue	4,717	4,865	(3)
Reportable segment loss before tax	(360)	(605)	(40)

For the three-month period ended March 31, 2018, the Corporation's international revenue decreased slightly by 3 percent to \$4.7 million from the \$4.9 million generated in the 2017-quarter. PHX Energy generated 7 percent of its consolidated revenue from its international operations in the first quarter of 2018 (2017 - 8 percent). International operating days, excluding the MWD rental activity in Russia, decreased by 2 percent to 675 days in the 2018-quarter from 691 days in the 2017-quarter. The decrease in international operating days was primarily due to lower activity levels in Albania.

The first quarter is typically a slower period for the Russian drilling industry due to the extremely cold weather, despite this Phoenix Russia was more active in the three-month period ended March 31, 2018 as compared to the same period in 2017. In the first quarter of 2018, the Russian division achieved operating days of 634 as compared to the 546 days recorded in the 2017-quarter. Phoenix Russia continues to offer full service directional services as well as MWD rentals to this market and has continued to secure work with select Operators in the region.

For the three-month period ended March 31, 2018, the Albanian division generated 41 operating days, a decrease compared to the 145 days recorded in the 2017-quarter. Operations in Albania were idle exiting 2017 and were re-commenced in the latter half of the 2018-quarter where as in 2017 operations were active throughout the first quarter.

Reportable segment loss from international operations for the three-month period March 31, 2018 was \$0.4 million, which is \$0.2 million less than the loss of \$0.6 million reported in the comparable 2017-quarter. The improvement in the international operations' profitability in the 2018-quarter was mainly due to increased drilling activity and expanded MWD rental activity in Russia.

## Summary of Quarterly Results

(Stated in thousands of dollars except per share amounts)

	Mar-18	Dec-17	Sept-17	Jun-17	Mar-17	Dec-16	Sept-16	Jun-16
Revenue	<b>70,759</b>	60,660	65,396	53,822	61,122	46,629	34,964	26,359
Net earnings (loss)	<b>(4,251)</b>	(5,126)	(846)	(10,412)	(7,143)	(15,074)	(10,679)	(13,360)
Earnings (Loss) per share – basic	<b>(0.07)</b>	(0.09)	(0.01)	(0.18)	(0.13)	(0.30)	(0.21)	(0.32)
Earnings (Loss) per share – diluted	<b>(0.07)</b>	(0.09)	(0.01)	(0.18)	(0.13)	(0.30)	(0.21)	(0.32)
Adjusted EBITDA	<b>6,768</b>	4,684	11,689	(13)	3,743	(3,299)	(2,485)	(3,788)
Funds from (used in) operations	<b>5,757</b>	2,490	8,436	113	3,983	2,060	(1,894)	(3,192)

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

## Liquidity

(Stated in thousands of dollars)

	Three-month periods ended March 31,	
	2018	2017
Funds from operations <sup>(1)</sup>	<b>5,757</b>	3,983

  

	Mar. 31, '18	Dec. 31, '17
Working capital <sup>(1)</sup>	<b>54,061</b>	49,787

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

With the overall improved profitability achieved by the Corporation in the first quarter 2018, funds from operations increased to \$5.8 million in the three-month period ended March 31, 2018 as compared to \$4.0 million in 2017-quarter.

As at March 31, 2018, the Corporation had working capital of \$54.1 million, which is \$4.3 million higher than the \$49.8 million reported at December 31, 2017. The increased working capital at March 31, 2018 was primarily due to higher trade and other receivables which resulted from increased revenues in the first quarter of 2018 compared to revenues generated in the final quarter of 2017.

## Investing Activities

PHX Energy used net cash in investing activities of \$2.4 million in both the first quarter of 2018 and 2017. In the first quarter of 2018, the Corporation received proceeds of \$2.7 million (2017 - \$1.4 million) from the disposition of drilling equipment, primarily related to the involuntary disposal of drilling equipment in well bores. Additionally, the Corporation spent \$3.1 million on capital expenditures in the first quarter of 2018 (2017 - \$1.8 million). These expenditures included:

- \$2.3 million in MWD systems and spare components,
- \$0.7 million in downhole performance drilling motors, machinery and equipment and vehicles; and
- \$0.1 million in furniture and fixtures, computer hardware and EDR systems and spare components.

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

During the three-month period ended March 31, 2018, the Corporation acquired \$3,696 in intangible assets (2017 - \$0.5 million).

The change in non-cash working capital balances of \$2.0 million (use of cash) for the three-month period ended March 31, 2018, relates to the net change in the Corporation's trade payables that are associated with the acquisition of capital assets. This compares to a \$1.5 million (use of cash) for the three-month period ended March 31, 2017.

## Financing Activities

The Corporation reported cash flows generated from financing activities of \$1.8 million in the three-month period ended March 31, 2018 as compared to \$8.1 million in the comparable 2017-quarter. In the 2018-quarter:

- the Corporation repurchased 125,000 shares through the NCIB totaling \$0.2 million; and
- the Corporation drew net proceeds of \$2.1 million from its operating and syndicated facilities.



## Capital Resources

As of March 31, 2018, the Corporation had \$12.0 million drawn on its syndicated facility, and \$9.7 million drawn on its operating facility. As at March 31, 2018, the Corporation had approximately CAD \$41.3 million and USD \$5.0 million available to be drawn from its credit facilities. The credit facilities are secured by substantially all of the Corporation's assets.

As at March 31, 2018, the Corporation was in compliance with all its financial covenants.

## Cash Requirements for Capital Expenditures

Historically, the Corporation has financed its capital expenditures and acquisitions through cash flows from operating activities, debt and equity. The 2018 capital budget remains at \$10.5 million. These planned expenditures are expected to be financed from a combination of one or more of the following: cash flow from operations, the Corporation's unused credit facilities or equity, if necessary. However, if a sustained period of market uncertainty and financial market volatility persists in 2018, the Corporation's activity levels, cash flows and access to credit may be negatively impacted, and the expenditure level would be reduced accordingly. Conversely, if future growth opportunities present themselves, the Corporation would look at expanding this planned capital expenditure amount.

## Contractual Obligations

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

*(Stated in thousands of dollars)*

	2018	2019	2020	2021	2022
Trade and other payables	42,514	-	-	-	-
Operating leases	7,176	6,600	6,226	5,995	4,951
Drilling and other equipment	4,817	-	-	-	-
Loans and borrowings	9,702	-	12,000	-	-
Total	64,209	6,600	18,226	5,995	4,951

## Off-Balance Sheet Arrangements

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

## Proposed Transactions

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

## Critical Accounting Estimates

The consolidated interim financial statements have been prepared in accordance with IAS 34 Interim Financial Reporting. The Corporation's significant accounting policies are described in its annual audited consolidated financial statements for the year ended December 31, 2017. Management, in preparing these financial statements, is required to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses. These estimates and judgments are based upon assumptions that are considered reasonable under the circumstances. Actual results could differ from such estimates and judgments by a material amount. The significant judgments made by Management in applying the Corporation's accounting policies and the key sources of estimation uncertainty have not changed significantly since December 31, 2017.

## Changes in Accounting Policies

These condensed consolidated interim financial statements have been prepared utilizing the same accounting policies and methods as the consolidated financial statements of the Corporation for the year ended December 31, 2017, unless specified.

### a) New Standards

#### i. IFRS 9 Financial Instruments

IFRS 9 replaces the existing guidance in IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 largely retains the existing requirements in IAS 39 for the classification and measurement of financial liabilities. However, it eliminates the previous IAS 39 categories for financial assets of held to maturity, loans and receivables and available for sale.

Under IFRS 9, on initial recognition, a financial asset is classified as measured at: amortized cost; Fair Value through Other Comprehensive Income ("FVOCI") – debt investment; FVOCI – equity investment; or Fair Value through Profit Loss ("FVTPL"). The classification of financial assets under IFRS 9 is generally based on the business model in which a financial asset is managed and its contractual cash flow characteristics. The effect of adopting IFRS 9 on the carrying amounts of financial assets at January 1, 2018 relates solely to the new impairment requirements, as described further below.

IFRS 9 replaces the 'incurred loss' model in IAS 39 with an 'expected credit loss' ("ECL") model. The new impairment model applies to financial assets measured at amortized cost, contract assets and debt investments at FVOCI, but not to investments in equity instruments.

The financial assets at amortized cost consist of trade receivables and cash and cash equivalents. Under IFRS 9, loss allowances are measured on either of the following bases:

- 12-month ECLs: these are ECLs that result from possible default events within the 12 months after the reporting date; and
- lifetime ECLs: these are ECLs that result from all possible default events over the expected life of a financial instrument.

The Corporation has elected to measure loss allowances for trade and other receivables at an amount equal to lifetime ECLs. Loss allowances for financial assets measured at amortized cost are deducted from the gross carrying amount of the assets.

When determining whether the credit risk of a financial asset has increased significantly since initial recognition and when estimating ECLs, 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.

IFRS 9 is effective for annual reporting periods beginning on or after January 1, 2018, with early adoption permitted. The Corporation has adopted IFRS 9 for the annual period beginning on January 1, 2018. The Corporation has finalized its review of financial assets and liabilities in the reporting period and noted no material impact on the consolidated financial statements.

## **ii. IFRS 15 Revenue from Contracts with Clients**

IFRS 15 establishes a comprehensive framework for determining whether, how much, and when revenue is recognized. It replaces existing revenue recognition guidance, including IAS 18 Revenue. IFRS 15 is effective for annual reporting periods beginning on or after January 1, 2018, with early adoption permitted. The Corporation has adopted IFRS 15 using the cumulative effect method for the annual period beginning on January 1, 2018, as a result the Corporation has changed its accounting policy for revenue recognition as detailed below.

Under IFRS 15, 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.

The Corporation has finalized its review of sales contracts with clients in the reporting period and noted no material impact on the consolidated financial statements.

## **b) Interpretations Not Yet Adopted**

### **i. IFRS 16 Leases**

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

The effective date for adoption of IFRS 16 is annual periods beginning on or after January 1, 2019, though early adoption is permitted for companies applying IFRS 15 Revenue from Contracts with Clients. The Corporation intends to adopt IFRS 16 for the annual period beginning on January 1, 2019. The Corporation has commenced reviewing its various lease and service contracts to determine the impact that the adoption of the standard will have on its financial statements.

## **Business Risk Factors**

The business risk factors applicable to the Corporation have not materially changed since December 31, 2017. Refer to the "Business Risk Factors" section of the MD&A in the PHX Energy's 2017 annual report.

## **Corporate Governance**

This MD&A has been prepared by the Management of PHX Energy and it has been reviewed and approved by the Audit Committee and the Board of Directors of the Corporation. Additional information relating to the Corporation's Corporate Governance can be found in the Corporation's Annual Information Form and Information Circular in respect of its annual meeting of shareholders, each of which are annually filed on SEDAR at [www.sedar.com](http://www.sedar.com).

## Disclosure Controls and Procedures

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

## Internal Controls Over Financial Reporting

The Corporation's Chief Executive Officer and Chief Financial Officer have designed, or caused to be designed under their supervision, internal controls over financial reporting related to the Corporation, including its consolidated subsidiaries to provide reasonable assurance regarding the reliability of the Corporation's financial reporting and preparation of financial statements together with other financial information for external purposes in accordance with IFRS.

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

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

## Outstanding Corporation Share Data

<i>(In thousands of shares)</i>	
	<b>As at May 3, 2018</b>
Common shares outstanding	58,272,887
Dilutive securities:	
Options	5,747,801
Corporation shares – diluted	64,020,688

## Outlook

PHX Energy is pleased to report its first quarter results. Consolidated revenue, activity, and adjusted EBITDA increased over the prior year's quarter and adjusted EBITDA results exceed the Corporation's internal forecast for the quarter. The improvement in profitability outpaced the revenue gains as a result of PHX Energy's continued discipline towards its cost structure.

Despite lower activity levels, the Corporation's Canadian operations' profitability improved in the first quarter of the year. As is typical, near the end of quarter volumes began to decline with the seasonal spring break-up period and the slowdown will continue through the second quarter. Unfortunately, the Canadian market is faced with many challenges beyond the Corporation's control and the large obstacles that are present in the political and macro-environment are limiting the industry's potential despite the improved commodity prices. Canadian Operators constrained by these obstacles are not fully benefiting from the upside.

In contrast, the outlook for the US market is optimistic and the industry is continuing to rebound with the number of active rigs climbing. The Permian basin is the focal point of this positive momentum with 45 percent of the industry's activity. PHX Energy is entrenched in this market and remains focused on gaining greater activity. Despite a slower start to the year, PHX Energy's US operations saw substantial growth in operating days and revenue. Additionally, the US division expanded its client base in the quarter, which will help propel further growth in future quarters. PHX Energy's fleet of high performance technology is assisting in the Corporation's ability to attract additional work, and PHX Energy plans to continue to deploy new capacity to this market as it comes on line. Phoenix USA is well positioned to further increase its volume of activity and a large focus in the upcoming quarters will be placed on executing upon this objective.

PHX Energy's international operations remain focused in Russia, and despite the first quarter being the traditionally slower period due to colder temperatures, PHX Energy, through both its full service and MWD rental business, increased revenue over the 2017 first quarter. After an idle period in the past few quarters, Phoenix Albania resumed operations in mid-February and the Corporation is currently operating on one rig.

The Corporation remains focused on having a competitive EDR product in the market place. In 2017, Stream launched the DataStream product line, and the division continues to work on advancing and marketing this technology. Operations in Canada and the US are ongoing, and PHX Energy remains focused on initiatives that will position Stream in a profitable position.



## Technology Update

PHX Energy remains diligently focused on its strategy to develop and deploy new generation technology that offers a competitive advantage to its clients. As a result of our past product development and engineering initiatives, the Corporation now has a line of high performance technologies, namely Velocity and the 7.25" Atlas High Performance Drilling Motor, that supplement its leading-edge fleet of conventional systems. Over the past 3 years, nearly all capital expenditures have been dedicated to building the high performance fleets. Currently, PHX Energy is receiving additional capacity that was ordered in late 2017 and early 2018, and there are further orders to be received in the third quarter of the year.

As 2018 progresses, PHX Energy will continue to leverage its diversified operations, focusing on executing growth strategies in all operating regions.

Michael Buker  
President  
May 3, 2018

## Non-GAAP Measures

### 1) Adjusted EBITDA

Adjusted EBITDA, defined as earnings before finance expense, income taxes, depreciation and amortization, impairment losses on goodwill and intangible assets, equity share-based payments, and unrealized foreign exchange gains or losses, 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 March 31,	
	2018	2017
Net Loss	(4,251)	(7,143)
Add:		
Depreciation and amortization	10,306	10,931
Provision for (Recovery of) income taxes	14	(1,195)
Finance expense	340	585
Equity-settled share-based payments	460	488
Unrealized foreign exchange (gain) loss	(101)	77
Adjusted EBITDA as reported	6,768	3,743

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

## 2) Funds from Operations

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

The following is a reconciliation of cash flows from operating activities to funds from operations:

*(Stated in thousands of dollars)*

	Three-month periods ended March 31,	
	2018	2017
Net cash flows from operating activities	936	(9,896)
Add (deduct):		
Changes in non-cash working capital	5,088	13,466
Interest paid	228	303
Income taxes (received) paid	(495)	110
Funds from operations	5,757	3,983

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

### 3) Debt to covenant EBITDA Ratio

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

### 4) 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.

## Definitions

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

## Condensed Consolidated Statements of Financial Position

(unaudited)

	March 31, 2018	December 31, 2017
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 4,531,173	\$ 4,122,539
Trade and other receivables	75,006,391	66,635,311
Inventories	22,501,647	22,009,483
Prepaid expenses	3,228,635	2,915,878
Current tax assets	1,009,005	1,353,622
Total current assets	106,276,851	97,036,833
Non-current assets:		
Drilling and other equipment (Note 6)	91,726,486	98,569,594
Goodwill	8,876,351	8,876,351
Intangible assets (Note 7)	26,114,342	26,925,046
Deferred tax assets	14,698,334	14,828,714
Total non-current assets	141,415,513	149,199,705
Total assets	\$ 247,692,364	\$ 246,236,538
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Operating facility (Note 8)	\$ 9,701,943	\$ 5,620,464
Trade and other payables	42,513,794	41,629,783
Total current liabilities	52,215,737	47,250,247
Non-current liabilities:		
Loans and borrowings (Note 8)	12,000,000	14,000,000
Provision for onerous contracts	1,921,000	2,015,000
Deferred income	1,400,006	1,433,339
Total non-current liabilities	15,321,006	17,448,339
Equity:		
Share capital (Note 9a)	266,600,536	266,838,036
Contributed surplus	9,776,128	9,315,926
Retained earnings	(110,689,399)	(106,438,399)
Accumulated other comprehensive income	14,468,356	11,822,389
Total equity	180,155,621	181,537,952
Total liabilities and equity	\$ 247,692,364	\$ 246,236,538

See accompanying notes to unaudited condensed consolidated interim financial statements.

## Condensed Consolidated Statements of Comprehensive Loss

(unaudited)

	Three-month periods ended March 31,	
	2018	2017
Revenue	\$ 70,758,554	\$ 61,122,415
Direct costs	65,929,457	60,805,182
Gross profit	4,829,097	317,233
Expenses:		
Selling, general and administrative expenses	8,770,725	7,209,659
Research and development expenses	870,330	607,459
Finance expense	339,727	585,164
Other expenses (income) (Note 10)	(914,619)	253,198
	9,066,163	8,655,480
Loss before income taxes	(4,237,066)	(8,338,247)
Provision for (Recovery of) income taxes		
Current	(144,833)	51,000
Deferred	158,767	(1,246,087)
	13,934	(1,195,087)
Net loss	(4,251,000)	(7,143,160)
Other comprehensive income (loss)		
Foreign currency translation	2,645,967	611,203
Total comprehensive loss for the period	\$ (1,605,033)	\$ (6,531,957)
Loss per share – basic	\$ (0.07)	\$ (0.13)
Loss per share – diluted	\$ (0.07)	\$ (0.13)

See accompanying notes to unaudited condensed consolidated interim financial statements.

## Condensed Consolidated Statements of Changes in Equity

(unaudited)

Three-month period ended	Share Capital		Contributed Surplus	Accumulated Other Comprehensive Income	Retained Earnings	Total Equity
March 31, 2018	Number	Amount (\$)				
Balance, December 31, 2017	58,397,887	\$ 266,838,036	\$ 9,315,926	\$ 11,822,389	\$ (106,438,399)	\$ 181,537,952
Net issuance of share capital	-	-	-	-	-	-
Common Shares repurchased	(125,000)	(237,500)	-	-	-	(237,500)
Share-based payments	-	-	460,202	-	-	460,202
Fair value of options exercised	-	-	-	-	-	-
Net loss	-	-	-	-	(4,251,000)	(4,251,000)
Foreign currency translation	-	-	-	2,645,967	-	2,645,967
Balance, March 31, 2018	58,272,887	\$ 266,600,536	\$ 9,776,128	\$ 14,468,356	\$ (110,689,399)	\$ 180,155,621

Three-month period ended	Share Capital		Contributed Surplus	Accumulated Other Comprehensive Income	Retained Earnings	Total Equity
March 31, 2017	Number	Amount (\$)				
Balance, December 31, 2016	50,810,721	\$ 237,539,242	\$ 6,817,458	\$ 16,941,171	\$ (82,910,425)	\$ 178,387,446
Net issuance of share capital	7,779,166	29,623,708	-	-	-	29,623,708
Common Shares repurchased	-	-	-	-	-	-
Share-based payments	-	-	488,136	-	-	488,136
Fair value of options exercised	-	101,547	(101,547)	-	-	-
Net loss	-	-	-	-	(7,143,160)	(7,143,160)
Foreign currency translation	-	-	-	611,203	-	611,203
Balance, March 31, 2017	58,589,887	\$ 267,264,497	\$ 7,204,047	\$ 17,552,374	\$ (90,053,585)	\$ 201,967,333

See accompanying notes to unaudited condensed consolidated interim financial statements.

## Condensed Consolidated Statements of Cash Flows

(unaudited)

	Three-month periods ended March 31,	
	2018	2017
Cash flows from operating activities:		
Net loss	\$ (4,251,000)	\$ (7,143,160)
Adjustments for:		
Depreciation and amortization	10,306,246	10,931,018
Provision for (Recovery of) income taxes	13,934	(1,195,087)
Unrealized foreign exchange loss (gain)	(101,069)	76,820
Gain on disposition of drilling equipment	(778,659)	(147,262)
Equity-settled share-based payments	460,202	488,136
Finance expense	339,727	585,164
Provision for (Recovery of) bad debts	(7,888)	227,783
Provision for (Recovery of) inventory obsolescence	(64,738)	300,000
Provision for onerous contracts	(128,000)	(107,000)
Amortization of deferred income	(33,333)	(33,333)
Interest paid	(227,543)	(303,478)
Income taxes received (paid)	495,491	(109,735)
Change in non-cash working capital	(5,087,843)	(13,466,159)
Net cash from (used in) operating activities	935,527	(9,896,293)
Cash flows from investing activities:		
Proceeds on disposition of drilling equipment	2,706,864	1,402,862
Acquisition of drilling and other equipment	(3,066,570)	(1,798,618)
Acquisition of intangible assets	(3,696)	(523,258)
Change in non-cash working capital	(2,007,470)	(1,499,302)
Net cash used in investing activities	(2,370,872)	(2,418,316)
Cash flows from financing activities:		
Repayment of loans and borrowings	(2,000,000)	(17,019,200)
Proceeds from (Repayment of) operating facility	4,081,479	(4,024,226)
Repurchase of shares under the NCIB	(237,500)	-
Proceeds from issuance of share capital	-	29,154,582
Net cash from financing activities	1,843,979	8,111,156
Net increase (decrease) in cash and cash equivalents	408,634	(4,203,453)
Cash and cash equivalents, beginning of period	4,122,539	7,007,293
Cash and cash equivalents, end of period	\$ 4,531,173	\$ 2,803,840

See accompanying notes to unaudited condensed consolidated interim financial statements.



# Notes to the Condensed Consolidated Financial Statements

For the three-month periods ended March 31, 2018 and 2017

*In Canadian dollars (unaudited)*

## 1. Reporting Entity

PHX Energy is a publicly-traded Corporation listed on the Toronto Stock Exchange under the symbol "PHX". The Corporation's registered office is at Suite 1400, 250 - 2<sup>nd</sup> 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, Albania, and Russia. The Corporation also develops and manufactures technologies that are made available for internal operational use.

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

## 2. Basis of Preparation

### a) Statement of Compliance

These condensed consolidated interim financial statements have been prepared in accordance with IAS 34 Interim Financial Reporting. The condensed consolidated interim financial statements do not include all of the information required for full annual financial statements and should be read in conjunction with the consolidated financial statements of the Corporation as at and for the year ended December 31, 2017.

These condensed consolidated interim financial statements were authorized by the Board of Directors on May 3, 2018.

### b) Basis of Measurement

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

### **c) Functional and Presentation Currency**

These condensed consolidated interim financial statements are presented in Canadian dollars, which is the Corporation's functional currency.

### **d) Use of Estimates and Judgments**

The preparation of the condensed consolidated interim financial statements in conformity with International Financial Reporting Standards ("IFRS") requires Management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

In preparing these condensed consolidated interim financial statements, the significant judgments made by Management in applying the Corporation's accounting policies and the key sources of estimation uncertainty have not changed significantly since December 31, 2017.

## **3. Significant Accounting Policies**

These condensed consolidated interim financial statements have been prepared utilizing the same accounting policies and methods as the consolidated financial statements of the Corporation for the year ended December 31, 2017, unless specified.

### **a) New Standards**

#### **i. IFRS 9 Financial Instruments**

IFRS 9 replaces the existing guidance in IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 largely retains the existing requirements in IAS 39 for the classification and measurement of financial liabilities. However, it eliminates the previous IAS 39 categories for financial assets of held to maturity, loans and receivables and available for sale.

Under IFRS 9, on initial recognition, a financial asset is classified as measured at: amortized cost; Fair Value through Other Comprehensive Income ("FVOCI") – debt investment; FVOCI – equity investment; or Fair Value through Profit Loss ("FVTPL"). The classification of financial assets under IFRS 9 is generally based on the business model in which a financial asset is managed and its contractual cash flow characteristics. The effect of adopting IFRS 9 on the carrying amounts of financial assets at January 1, 2018 relates solely to the new impairment requirements, as described further below.

IFRS 9 replaces the 'incurred loss' model in IAS 39 with an 'expected credit loss' ("ECL") model. The new impairment model applies to financial assets measured at amortized cost, contract assets and debt investments at FVOCI, but not to investments in equity instruments.

The financial assets at amortized cost consist of trade receivables and cash and cash equivalents. Under IFRS 9, loss allowances are measured on either of the following bases:

- 12-month ECLs: these are ECLs that result from possible default events within the 12 months after the reporting date; and
- lifetime ECLs: these are ECLs that result from all possible default events over the expected life of a financial instrument.

The Corporation has elected to measure loss allowances for trade and other receivables at an amount equal to lifetime ECLs. Loss allowances for financial assets measured at amortized cost are deducted from the gross carrying amount of the assets.

When determining whether the credit risk of a financial asset has increased significantly since initial recognition and when estimating ECLs, 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.

IFRS 9 is effective for annual reporting periods beginning on or after January 1, 2018, with early adoption permitted. The Corporation has adopted IFRS 9 for the annual period beginning on January 1, 2018. The Corporation has finalized its review of financial assets and liabilities in the reporting period and noted no material impact on the consolidated financial statements.

## **ii. IFRS 15 Revenue from Contracts with Clients**

IFRS 15 establishes a comprehensive framework for determining whether, how much, and when revenue is recognized. It replaces existing revenue recognition guidance, including IAS 18 Revenue. IFRS 15 is effective for annual reporting periods beginning on or after January 1, 2018, with early adoption permitted. The Corporation has adopted IFRS 15 using the cumulative effect method for the annual period beginning on January 1, 2018, as a result the Corporation has changed its accounting policy for revenue recognition as detailed below.

Under IFRS 15, 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.

The Corporation has finalized its review of sales contracts with clients in the reporting period and noted no material impact on the consolidated financial statements.

## b) Interpretations Not Yet Adopted

### i. IFRS 16 Leases

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

The effective date for adoption of IFRS 16 is annual periods beginning on or after January 1, 2019, though early adoption is permitted for companies applying IFRS 15 Revenue from Contracts with Clients. The Corporation intends to adopt IFRS 16 for the annual period beginning on January 1, 2019. The Corporation has commenced reviewing its various lease and service contracts to determine the impact that the adoption of the standard will have on its financial statements.

## 4. Operating Segments

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

### Information about reportable segments

*(Stated in thousands of dollars)*

	Canada		United States		International		Total	
Three-month periods ended March 31,	2018	2017	2018	2017	2018	2017	2018	2017
Drilling services revenue	26,653	28,061	38,067	26,815	4,717	4,865	69,437	59,741
EDR rental revenue	1,322	1,381	-	-	-	-	1,322	1,381
Total Revenue	27,975	29,442	38,067	26,815	4,717	4,865	70,759	61,122
Reportable segment profit (loss) before income taxes	1,511	768	(4,168)	(6,170)	(360)	(605)	(3,017)	(6,007)

*(Stated in thousands of dollars)*

	Canada		United States		International		Total	
As at March 31,	2018	2017	2018	2017	2018	2017	2018	2017
Drilling and other equipment	38,767	45,628	43,692	53,574	9,267	12,129	91,726	111,331
Goodwill	8,876	8,876	-	-	-	-	8,876	8,876

Reconciliation of reportable segment profit and other material items*(Stated in thousands of dollars)*

	Three-month periods ended March 31,	
	2018	2017
Reportable segment loss before income taxes	(3,017)	(6,007)
Corporate:		
Selling, general and administrative expenses	925	886
Research and development expenses	870	607
Finance expense	340	585
Other income	(915)	253
Income (Loss) before income taxes	(4,237)	(8,338)

## 5. Seasonality of Operations

A significant portion of the Corporation's operations are carried out in Western Canada. The ability to move heavy equipment in the Canadian oil and natural gas fields is dependent on weather conditions. As warm weather returns in the spring, the winter's frost comes out of the ground rendering many secondary roads incapable of supporting the weight of heavy equipment until they have thoroughly dried out. The duration of this "spring break-up" has a direct impact on the Corporation's activity levels. In addition, many exploration and production areas in northern Canada are accessible only in winter months when the ground is frozen enough to support equipment. The timing of freeze-up and spring break-up affects the ability to move equipment in and out of these areas. As a result, late March through May is traditionally the Corporation's least active time, and as such the operating results of the Corporation will vary on a quarterly basis.

## 6. Drilling and Other Equipment

### a) Acquisitions and Disposals

During the three-month period ended March 31, 2018, the Corporation acquired assets with a cost of \$3.1 million (2017 - \$1.8 million).

Assets with a carrying amount of \$1.9 million (2017 - \$1.3 million) were disposed of as a result of tools lost down hole and scrapped assets, resulting in a net gain on disposition of \$0.8 million (2017 - \$0.1 million), which is included in other income in the condensed consolidated statement of comprehensive income.

### b) Capital Commitments

As at March 31, 2018, the Corporation has commitments to purchase drilling and other equipment for \$4.8 million; delivery is expected to occur before August 31, 2018.

## 7. Intangible Assets

During the three-month period ended March 31, 2018, the Corporation acquired intangible assets with a total cost of \$3,696 (2017 - \$0.5 million).

As at March 31, 2018, the Corporation has contingent liabilities arising from existing license and development agreements and are expected to be paid as follows:

*(Stated in thousands of dollars)*

	2018	2019	Total
Development Costs	740	-	740
Total	740	-	740

## 8. Loans and Borrowings

(Stated in thousands of dollars)

	Currency	Amount of Facility	Date of Maturity	Currency	Carrying Amount at March 31, 2018	Currency	Carrying Amount at December 31, 2017
Operating Facility	CAD	15,000	Due on demand	CAD	9,702	CAD	5,620
Syndicated Facility	CAD	48,000	December 11, 2020	CAD	12,000	CAD	14,000
US Operating Facility	USD	5,000	December 11, 2020	USD	-	USD	-

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

Ratio	Covenant	March 31, 2018
Debt to covenant EBITDA	< 3.5x	0.95
Interest coverage ratio	> 3.0x	12.91
Net capital expenditures and intangible asset acquisitions	< \$30.0 million	\$0.4 million

## 9. Share Capital

### a) Authorized and Issued Shares

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

	Number	Amount
Balance as at January 1, 2017	50,810,721	\$ 237,539,242
Issued shares pursuant to equity financing and private placement	7,687,500	30,750,000
Transaction costs	-	(1,737,500)
Tax effect of transaction costs	-	469,125
Issued shares pursuant to share option plan	91,666	243,630
Common Shares repurchased	(192,000)	(426,461)
Balance as at December 31, 2017	58,397,887	\$ 266,838,036
Repurchased through normal course issuer bid	(125,000)	(237,500)
Balance as at March 31, 2018	58,272,887	\$ 266,600,536

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



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

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

### Summary of option grants in 2018

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

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

During the three-month period ended March 31, 2018, the Corporation recognized total compensation expense of \$0.5 million (2017 - \$0.5 million) for share options granted between 2016 and 2018.

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

	2018		2017	
	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price
Outstanding, beginning of period	5,499,468	\$ 4.41	3,462,803	\$ 5.27
Granted	250,000	1.99	1,840,000	4.08
Exercised	-	-	(91,666)	1.55
Forfeited / cancelled	-	-	(77,500)	4.12
Expired	(1,667)	9.14	-	-
Outstanding, end of period	5,747,801	4.31	5,133,637	4.93
Options exercisable, end of period	3,254,454	5.43	1,756,962	7.74

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

Options Outstanding					Options Exercisable	
Original Exercise Price	Number	Weighted-Average Remaining Contractual Life	Weighted- Average Exercise Price		Number	Weighted-Average Exercise Price
\$ 1.55	1,378,334	2.93 yrs	\$ 1.55		886,663	\$ 1.55
1.71	175,000	4.38 yrs	1.71		58,333	1.71
1.79	575,000	4.38 yrs	1.79		191,665	1.79
1.95	215,267	3.40 yrs	1.95		93,599	1.95
2.00	200,000	4.94 yrs	2.00		-	-
3.41	25,000	3.65 yrs	3.41		8,333	3.41
4.06	1,330,000	3.93 yrs	4.06		443,329	4.06
4.15	415,000	3.93 yrs	4.15		138,332	4.15
6.87 - 15.81	1,434,200	1.39 yrs	9.24		1,434,200	9.24
	5,747,801	3.13 yrs	\$ 4.31		3,254,454	\$ 5.43

### c) Normal Course Issuer Bid

The TSX approved PHX Energy's Normal Course Issuer Bid ("NCIB") to purchase for cancellation, from time-to-time, up to a maximum of 2,929,494 common shares of the Corporation. Purchases of common shares will be made on the open market through the facilities of the TSX and through alternative trading systems. The price which PHX Energy will pay for any common shares purchased will be at the prevailing market price on the TSX or alternate trading systems at the time of such purchase. The NCIB commenced on June 26, 2017 and will terminate on June 25, 2018 or such earlier time as the NCIB is completed or terminated at the option of the Corporation. Pursuant to the NCIB, 125,000 shares were purchased in the 2018-quarter and cancelled by the Corporation.

## 10. Other Income

(Stated in thousands of dollars)

	Three-month periods ended March 31,	
	2018	2017
Gain on disposition of drilling equipment	(779)	(147)
Foreign exchange losses (gains)	(128)	172
Provision for (Recovery of) bad debts	(8)	228
Other Expenses (Income)	(915)	253

## 11. Fair Values of Financial Instruments

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

# Corporate Information

## Board of Directors

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

## Officers

John Hooks  
CEO  
  
Michael Buker  
President  
  
Cameron Ritchie  
Sr. Vice President Finance and CFO  
Corporate Secretary  
  
Craig Brown  
Sr. Vice President International Operations  
and Technology  
  
Daniel Blanchard  
Vice President Executive Sales  
  
Jeffery Shafer  
Vice President Sales and Marketing

## Legal Counsel

Burnet, Duckworth & Palmer LLP  
Calgary, Alberta

## Auditors

KPMG LLP  
Calgary, Alberta

## Bankers

HSBC Bank Canada  
Calgary, Alberta

## Transfer Agent

Computershare Trust Company of Canada  
Calgary, Alberta