PHX
ENERGY SERVICES CORP.

THIRD QUARTER **2019**

PHX Energy Services Corp.

Third Quarter Report for the Three and Nine-Month Periods Ended September 30, 2019 and 2018

Financial Results

For the three-month period ended September 30, 2019, PHX Energy achieved adjusted EBITDA of $15.5 million, which is the highest quarterly result since the third quarter of 2014. Consolidated revenue for the third quarter was $93.1 million and was the highest since the first quarter of 2015. Strong growth continued in the US division and this was the primary driver behind the 11 percent increase to adjusted EBITDA and 9 percent increase in consolidated revenue as compared to the third quarter of 2018. In the 2019-quarter there were more premiums and surcharges generated by PHX Energy's high performance technologies in the US and Canada and this aided the improvement in profitability. Average consolidated revenue per day, excluding the motor rental division in the US and Stream division, for the three-month period ended September 30, 2019 was $13,434, a 14 percent increase as compared to the 2018-quarter's average of $11,803.

The Corporation's US activity improved by 10 percent in the 2019-quarter, growing to 3,850 operating days in comparison to 3,506 days in the 2018-quarter. The US segment's revenue for the 2019-quarter increased 26 percent to $68.3 million from $54.1 million in the 2018-quarter. The higher level of activity and revenue in the US is mainly attributable to the greater 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. In contrast to the US division's results, the US rig count declined 12 percent from 1,051 average rigs running per day in the third quarter of 2018 to 920 rigs in the 2019-quarter (Source: Baker Hughes). Given the weakening industry environment, the Corporation's positive momentum in the US is a testament to its operational performance and the opportunities the US market presents.

The ongoing challenges and uncertainty in the Canadian industry persisted in the third quarter and, as was the case in the first two quarters of 2019, activity levels declined as compared to the prior year. The rig count dropped 37 percent quarter-over-quarter with an average of 130 active rigs operating per day in the third quarter of 2019 (2018 – 207 rigs) (Source: Baker Hughes). Due to lower activity in the Canadian industry, for the three-month period ended September 30, 2019 the Canadian segment's revenue declined by 25 percent to $19.1 million relative to $25.6 million in the same 2018-period.

As at September 30, 2019, the Corporation had loans and borrowings of $15 million as well as operating facility borrowings of $6.6 million. These debt items less cash and cash equivalents of $6.7 million resulted in net debt of $14.9 million (December 31, 2018 - $21.5 million). As at September 30, 2019, the Corporation's working capital was $62.2 million.

Capital Spending

The Corporation spent $28.8 million in capital expenditures in the nine-month period ended September 30, 2019, of which $20.8 million was spent on growing the Corporation's fleet of drilling equipment and the remaining $8 million was spent on maintenance of the current fleet of drilling and other equipment. Capital expenditures in the first nine-months of the 2019-year were mainly directed towards Atlas Motors and Velocity Systems and were 82 percent higher than the $15.8 million spent in the corresponding 2018-period. The Corporation funded its 2019 capital spending through net cash flows from operations and its working capital and debt facilities.

As at September 30, 2019, the Corporation had $14.7 million of outstanding capital commitments, of which $4.2 million is expected to be delivered in 2019 and $10.5 million is expected to be delivered in the first half of 2020. Capital commitments are primarily comprised of $10.3 million for performance drilling motors, $2.9 million for measurement while drilling ("MWD") systems, and $1.5 million for other machinery and equipment.

On April 8, 2019, the Corporation announced an increase to its capital expenditure program from $15 million to $25 million. In the second quarter of 2019, PHX Energy's Board of Directors (the "Board") approved an increase to the 2019 capital expenditure program that resulted in the budget being set at $30 million as compared to the $25 million previously announced. On September 6, 2019, the Corporation announced another increase to its capital expenditure program from $30 million to $35 million.

In the 2019-year, the Corporation expects to spend $24.5 million growing the Corporation's fleet of drilling equipment and $10.5 million maintaining the current fleet of drilling and other equipment. The Corporation anticipates that capital expenditures for the 2019-year will be allocated as follows: $16 million towards performance drilling motors primarily relating to Atlas Motors, $15 million on MWD systems, primarily relating to Velocity, and $4 million relating to RSS, and other machinery and equipment.

PHX Energy announces that its Board has approved a preliminary 2020 capital expenditures program of $20 million (the "2020 Program"). The 2020 Program is anticipated to principally be allocated toward expanding the Corporation's High Performance fleets.

Normal Course Issuer Bid

In the third quarter of 2019, the Toronto Stock Exchange ("TSX") approved the renewal of PHX Energy's normal course issuer bid (the "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, in the 2019-quarter, 801,600 common shares were purchased by the Corporation and cancelled.

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 have been 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 has purchased and cancelled 5 percent of its total shares outstanding as at December 31, 2018.

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

	Three-month periods ended September 30,			Nine-month periods ended September 30,		
	2019	2018	% Change	**2019**	2018	% Change
Operating Results	***(unaudited)***	*(unaudited)*		***(unaudited)***	*(unaudited)*	
Revenue	**93,099**	85,033	9	**268,204**	224,800	19
Net income (loss)	**2,594**	3,743	(31)	**(494)**	(591)	(16)
Earnings (loss) per share – diluted	**0.05**	0.06	(17)	**(0.01)**	(0.01)	-
Adjusted EBITDA [(1)]	**15,536**	13,934	11	**37,961**	30,715	24
Adjusted EBITDA per share – diluted [(1)]	**0.27**	0.24	13	**0.66**	0.52	27
Adjusted EBITDA as a percentage of revenue [(1)]	**17%**	16%		**14%**	14%	
Cash Flow						
Cash flows from operating activities	**9,721**	6,027	63	**40,665**	15,871	157
Funds from operations [(1)]	**14,669**	11,461	28	**34,554**	24,376	42
Funds from operations per share – diluted [(1)]	**0.26**	0.19	37	**0.60**	0.42	43
Capital expenditures	**8,444**	8,067	5	**28,840**	15,831	82
Financial Position (unaudited)				**Sept 30, '19**	Dec 31, '18	
Working capital [(1)]				**62,207**	60,316	3
Net debt [(1)]				**14,900**	21,526	(31)
Shareholders' equity				**149,592**	168,414	(11)
Common shares outstanding				**54,969,320**	57,963,720	(5)

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

Non-GAAP Measures

PHX Energy uses throughout this MD&A certain measures to analyze operational and financial performance that do not have standardized meanings prescribed under Canadian generally accepted accounting principles ("GAAP"). These non-GAAP measures include adjusted EBITDA, adjusted EBITDA per share, debt to covenant EBITDA, funds from operations, funds from operations per share, 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.

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 2018 annual report, including the MD&A, and audited consolidated financial statements and the accompanying notes contained therein, and the Corporation's 2019 unaudited interim third 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. This MD&A has been prepared taking into consideration information available up to and including October 30, 2019.

PHX Energy's Interim Financial Report for the three-month and nine-month periods ended September 30, 2019 and 2018 has been prepared in accordance with International Financial Reporting Standards ("IFRS"). The MD&A and Interim Financial Report were reviewed by PHX Energy's Audit Committee and approved by PHX Energy's Board on October 30, 2019.

Cautionary Statement Regarding Forward-Looking Information and Statements

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

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

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

- As at September 30, 2019, the Corporation had $14.7 million of outstanding capital commitments, of which $4.2 million is expected to be delivered in 2019 and $10.5 million is expected to be delivered in the first half of 2020.
- In the 2019-year, the Corporation expects to spend $24.5 million growing the Corporation's fleet of drilling equipment and $10.5 million maintaining the current fleet of drilling and other equipment. The Corporation anticipates that capital expenditures for the 2019-year will be allocated as follows: $16 million towards performance drilling motors primarily relating to Atlas Motors, $15 million on MWD systems, primarily relating to Velocity, and $4 million relating to RSS, and other machinery and equipment.
- 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.
- PHX Energy announces that its Board has approved a preliminary 2020 capital expenditures program of $20 million (the "2020 Program"). The 2020 Program is anticipated to principally be allocated toward expanding the Corporation's High Performance fleets.

The above are stated under the headings: "Capital Spending", and "Cash Requirements for Capital Expenditures". In addition, statements 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) 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.

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

Results of Operations

Three and Nine-Month Periods Ended September 30, 2019

Revenue

(Stated in thousands of dollars)

	Three-month periods ended September 30,			Nine-month periods ended September 30,		
	2019	2018	% Change	**2019**	2018	% Change
Revenue	**93,099**	85,033	9	**268,204**	224,800	19

For the three-month period ended September 30, 2019, PHX Energy recorded the highest level of consolidated quarterly revenue since the first quarter of 2015. The Corporation increased consolidated revenue by 9 percent to $93.1 million in the 2019-quarter compared to $85 million in the 2018-quarter. This was partly driven by improved activity in PHX Energy's US division, despite declining rig counts in the US industry. In addition, higher revenue per day was realized in both the US and Canadian divisions. For the three-month period ended September 30, 2019, the average consolidated revenue per day, excluding the motor rental division in the US and the Stream division, was $13,434 in comparison to $11,803 in the same 2018-quarter, a 14 percent increase. Higher revenue per day was mainly due to the greater capacity of PHX Energy's high performance technologies and the resulting increase to the premiums and surcharges generated in the 2019-quarter. For the three-month period ended September 30, 2019, consolidated operating days decreased by 5 percent to 6,629 days from 7,008 days in the corresponding 2018-quarter. The lower operating days are primarily due to large declines in activity in the Corporation's Canadian segment that were offset by improved activity in the US segment. US and international revenue were 73 percent and 6 percent, respectively, of total consolidated revenue for the 2019-quarter relative to 64 and 6 percent, respectively, for the 2018-quarter.

During the third quarter, the volatility in commodity prices continued and the declines experienced impacted industry activity levels. Western Texas Intermediate ("WTI") spot crude oil price was 19 percent lower than in the 2018-quarter averaging USD $56/bbl (2018-quarter – USD $69/bbl) and the Western Canadian Select ("WCS") oil prices showed a 6 percent decrease averaging USD $44/bbl (2018-quarter – USD $47/bbl). Despite declines in both the Canadian and US rig counts the two industry environments continued to be in stark contrast, with the US operating an average of 920 rigs per day in the third quarter, a 12 percent decline quarter-over-quarter, and Canada operating an average of 130 rigs per day, a 37 percent decline quarter-over-quarter. Throughout North America the vast majority of wells continued to be horizontal and directional in the third quarter, representing 95 percent of all wells drilled in Canada and 94 percent of the average number of rigs operating per day in the US (Sources: Daily Oil Bulletin and Baker Hughes).

For the nine-month period ended September 30, 2019, the Corporation increased consolidated revenue by 19 percent to $268.2 million as compared to the $224.8 million reported in the same 2018-period. Consolidated operating days were flat in the 2019-period at 19,221 days for both 2019 and 2018-periods. The average consolidated revenue per day, excluding the motor rental division in the US and the Stream division, for the 2019 nine-month period was $13,290, an increase of 16 percent compared to the average of $11,414 in the 2018-period. Improvements in revenue for the nine-month period ended September 30, 2019 were primarily attributable to the greater capacity of high performance technologies and higher activity levels in the US division. US and international revenue were 74 percent and 6 percent, respectively, of total consolidated revenue for the 2019 nine-month period relative to 64 and 7 percent, respectively, for the 2018-period.

Operating Costs and Expenses

(Stated in thousands of dollars except percentages)

	Three-month periods ended September 30,			Nine-month periods ended September 30,		
	2019	2018	% Change	**2019**	2018	% Change
Direct costs	**77,090**	69,478	11	**228,141**	197,796	15
Gross profit as a percentage of revenue	**17%**	18%		**15%**	12%	
Depreciation & amortization drilling and other equipment (included in direct costs)	**9,894**	9,505	4	**30,178**	29,613	2
Depreciation & amortization right-of-use asset (included in direct costs)	**896**	-	n.m.	**2,641**	-	n.m.
Gross profit as percentage of revenue excluding depreciation & amortization	**29%**	29%		**27%**	25%	

n.m. – not meaningful

Direct costs are comprised of field and shop expenses, and include depreciation and amortization on 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 and nine-month periods ended September 30, 2019, direct costs rose 11 percent and 15 percent, respectively. In both 2019-periods, primarily due to increased activity levels in the US segment, the Corporation incurred greater overall labour costs, volume of equipment repair expenses, and equipment rentals.

For the three-month period ended September 30, 2019, gross profit as a percent of revenue, excluding depreciation and amortization, was 29 percent, which was the same percentage as in the 2018-quarter. For the nine-month period ended September 30, 2019, gross profit as a percent of revenue, excluding depreciation and amortization, was 27 percent in comparison to 25 percent in the 2018-period. Improved profitability thus far in 2019 is primarily due to increased activity and revenue per day in the US segment.

(Stated in thousands of dollars except percentages)

	Three-month periods ended September 30,			Nine-month periods ended September 30,		
	2019	2018	% Change	**2019**	2018	% Change
Selling, general & administrative ("SG&A") costs	**10,616**	12,983	(18)	**35,212**	30,765	14
Cash-settled share-based payments (included in SG&A costs)	**1,078**	2,925	(63)	**5,108**	4,076	25
Equity-settled share-based payments (included in SG&A costs)	**160**	342	(53)	**559**	1,201	(53)
Onerous contracts lease payment (included in SG&A costs)	**-**	(122)	n.m.	**-**	(270)	n.m.
SG&A costs excluding equity and cash-settled share-based payments and provision for onerous contracts as a percentage of revenue	**10%**	12%		**11%**	11%	

n.m. – not meaningful

For the three-month period ended September 30, 2019, SG&A costs decreased by 18 percent to $10.6 million from $13 million in the 2018-quarter primarily due to lower cash-settled share-based payments in the 2019-quarter. For the nine-month period ended September 30, 2019, SG&A costs increased by 14 percent primarily due to higher cash-settled share-based payments as well as higher personnel costs in the 2019-period as compared to 2018-period.

Cash-settled share-based payments relate to the Corporation's Retention Award Plan and are measured at fair value. For the three-month period ended September 30, 2019, cash-settled share-based payments decreased 63 percent to $1.1 million from $2.9 million in the 2018-quarter. For the nine-month period ended September 30, 2019, cash-settled share-based payments increased 25 percent to $5.1 million from $4.1 million in the same 2018-period. Changes in cash-settled share-based payments in the respective periods can be mainly attributed 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 by the Corporation using the Black-Scholes model. For the three and nine-month periods ended September 30, 2019, equity-settled share-based payments were 53 percent lower in both periods 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 contracts lease payments are no longer recorded.

(Stated in thousands of dollars)

	Three-month periods ended September 30,			Nine-month periods ended September 30,		
	2019	2018	% Change	**2019**	2018	% Change
Research & development expense	**1,193**	837	43	**2,973**	2,506	19

Research and development ("R&D") expenditures for the three and nine-month periods ended September 30, 2019 were $1.2 million and $3 million, respectively, as compared to $0.8 million and $2.5 million in the same 2018-periods. PHX Energy continues to focus on R&D efforts aimed at developing new technologies, improving reliability of equipment, and decreasing costs to operations. In both 2019-periods, the increase in R&D expenditures mainly related to prototype expenses to further enhance Velocity's operational performance.

(Stated in thousands of dollars)

	Three-month periods ended September 30,			Nine-month periods ended September 30,		
	2019	2018	% Change	**2019**	2018	% Change
Finance expense	**306**	264	16	**1,090**	929	17
Finance expense lease liability	**622**	-	n.m.	**1,897**	-	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 three and nine-month periods ending September 30, 2019 the Corporation's finance expense grew to $0.3 million and $1.1 million, respectively, an increase of 16 percent and 17 percent, respectively. Higher finance expenses are primarily due to higher average long-term borrowings as a result of increased capital expenditures in the respective 2019-periods compared 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 September 30,		Nine-month periods ended September 30,	
	2019	2018	**2019**	2018
Net gain on disposition of drilling equipment	**(514)**	(2,358)	**(3,390)**	(6,209)
Foreign exchange losses (gains)	**44**	(86)	**557**	(304)
Provision for (Recovery of) bad debts	**62**	(8)	**388**	(15)
Other income	**(408)**	(2,452)	**(2,445)**	(6,528)

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. For the three and nine-month periods ended September 30, 2019, the

Corporation realized a $0.5 million and $3.4 million gain on dispositions, respectively, compared to $2.4 million and $6.2 million gain on dispositions in the corresponding 2018-periods. For both 2019-periods, there were fewer instances of high value downhole equipment losses and more occurrences of asset retirements relative to the 2018-periods.

Foreign exchange losses (gains) relate to unrealized and realized exchange losses in the period. For the three and nine-month periods ended September 30, 2019, the Corporation recognized $44 thousand and $0.6 million in losses, respectively, relative to $0.1 million and $0.3 million gains in the corresponding 2018-periods. Losses in the 2019-periods were mainly due to settlement of US-denominated intercompany payables in the International segment.

Provision for bad debts for the three and nine-month periods ended September 30, 2019 primarily relate to bad debt provisions for a few customers in the US division.

(Stated in thousands of dollars, except percentages)

	Three-month periods ended September 30,		Nine-month periods ended September 30,	
	2019	2018	**2019**	2018
Provision for (Recovery of) income taxes	**1,086**	180	**1,830**	(77)
Effective tax rates	**30%**	5%	**n.m.**	11%

n.m. – not meaningful

Provision for income taxes for the three and nine-month periods ended September 30, 2019, were $1.1 million and $1.8 million, respectively, as compared to $0.2 million and a recovery of income taxes of $0.1 million in the respective 2018-periods. Deferred taxes in the 2019-periods was impacted by unrecognized deferred tax assets with respect to deductible temporary differences in the Canadian jurisdictions, which were recognized in the corresponding 2018-periods.

Segmented Information

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

Canada

(Stated in thousands of dollars)

	Three-month periods ended September 30,			Nine-month periods ended September 30,		
	2019	2018	% Change	**2019**	2018	% Change
Revenue	**19,123**	25,646	(25)	**54,651**	66,307	(18)
Reportable segment profit (loss) before tax	**1,571**	1,831	(14)	**616**	(1,469)	n.m.

n.m. – not meaningful

The Canadian industry continued to experience challenges in 2019, despite these obstacles PHX Energy remained focused on maintaining market share, controlling costs and improving profitability. For the three and nine-month periods ended September 30, 2019, PHX Energy's Canadian revenue was $19.1 million and $54.7 million, respectively, in comparison to revenue of $25.6 million and $66.3 million in the corresponding 2018-periods, a decrease of 25 percent and 18 percent, respectively. Lower revenue in PHX Energy's Canada segment was due to declining drilling activity, however, this was partially offset by slightly higher revenue per day. For the three and nine-month periods ended September 30, 2019, average revenue per day was $8,648 and $8,644, respectively, compared to $8,408 and $8,227 in the corresponding 2018-quarter.

For the three-month period ended September 30, 2019, the Corporation's Canadian operating days declined 30 percent to 2,056 days, compared to 2,923 days in the relative 2018-quarter. The decline in the Canadian segment's activity was slightly less than the decline in industry activity. The industry's horizontal and directional drilling activity contracted 34 percent as measured by drilling days shrinking from 18,462 days in the 2018-quarter to 12,201 days in the 2019-quarter (Source: Daily Oil Bulletin).

During the third quarter of 2019, oil drilling, as measured by drilling days, represented approximately 49 percent of PHX Energy's Canadian activity and the Corporation remained active in the Montney, Wilrich, Charlie Lake, Duvernay, Cardium, and Notekiwin areas.

For the nine-month period ended September 30, 2019, operating days declined 23 percent to 5,890 days, compared to 7,694 days in the same 2018-period. The Canadian industry activity declined 32 percent to 33,973 horizontal and directional drilling days reported in the nine-month period of 2019 as compared to 50,145 horizontal and directional drilling days in 2018 (Sources: Daily Oil Bulletin).

Despite the lower revenue and activity levels that have resulted from the challenges faced in the Canadian industry, the Corporation's Canadian segment generated reportable segment profit before tax of $1.6 million and $0.6 million for the three and nine-month periods ended September 30, 2019, respectively. The Canadian operations were able to maintain profitability as a result of generating higher average revenue per day and lower overall costs in the 2019-periods relative to the same 2018-periods.

Stream Services

Included in the Canadian segment's revenue is the Stream division, which generated $1.3 million and $3.7 million of revenue in the three and nine-month periods ending September 30, 2019, respectively, as compared to $1.1 million and $3 million of revenue in the corresponding 2018-periods. Stream continued to increase activity in 2019, resulting in higher operating days for both 2019-periods. For the three and nine-month periods ended September 30, 2019, Stream's operating days increased to 2,043 days and 6,612 days, respectively, from 1,613 days and 4,354 in the comparable 2018-periods. The increase in operating days in the 2019-periods is slightly offset by lower average revenue per day as compared to the 2018-periods as Stream provided a higher share of lower rate services in 2019 in alternative markets. In the third quarter of 2019 the average revenue per day was $658 as compared to $662 in the 2018-quarter and in the 2019 nine-month period average revenue per day was $566 as compared to $690 in the same 2018-period.

As a result of higher operating days and disciplined cost management, reportable segment losses before tax decreased to $0.3 million and $1 million for the three and nine-month periods ended September 30, 2019, respectively, as compared to $1 million and $3.2 million in the 2018-periods, respectively.

United States

(Stated in thousands of dollars)

	Three-month periods ended September 30,			Nine-month periods ended September 30,		
	2019	2018	% Change	**2019**	2018	% Change
Revenue	**68,265**	54,129	26	**198,399**	143,842	38
Reportable segment income before tax	**4,975**	3,219	55	**10,802**	2,937	268

Thus far in 2019, the Corporation's US operations have experienced a rising demand for its high performance technologies, which have increased in capacity during the year. This combined with targeted marketing efforts and the superior operational performance of personnel and equipment has led PHX Energy's US division to once again outperform the industry.

For the three-month period ended September 30, 2019, US revenue was $68.3 million, a 26 percent increase compared to the $54.1 million in the corresponding 2018-quarter. The 2019 third quarter revenue was the highest quarterly revenue since the fourth quarter of 2014. Average revenue per day, excluding the Corporation's motor rental division, increased by 13 percent in the 2019-quarter to CAD $17,032 as compared to CAD $15,083 in the 2018-quarter. The higher average revenue per day relates to premiums and surcharges for the Corporation's high performance technologies, particularly those resulting from increased RSS activity. The US segment's operating days increased by 10 percent in the 2019-quarter to 3,850 days as compared to 3,506 days in the 2018-quarter. Reportable segment income was $5 million in the 2019-quarter, up 55 percent when compared to the $3.2 million in the 2018-quarter.

In contrast to the Corporation's US segments results, the US industry rig count decreased by 12 percent quarter-over-quarter. There were an average of 868 active horizontal and directional rigs per day in the third quarter of 2019 compared to an average of 988 active horizontal and directional rigs per day in the 2018-quarter (Source: Baker Hughes). Horizontal and directional rigs represented 94 percent of the average number of US rigs running per day (2018 – 94 percent). The Permian basin continued to be the dominate play in the US industry, representing 47 percent of the average operating rigs per day in the 2019-quarter (2018 quarter – 46 percent); although, the Permian did see a 10 percent decline in activity that was in line with the overall rate of decline in the US rig count. (Source: Baker Hughes). During the three-month period ended September 30, 2019, the Permian basin represented approximately 78 percent of the wells drilled by the Corporation and nearly all of PHX Energy's US activity was oil well drilling. In addition to the Permian basin, Phoenix USA continued to be active in the Eagle Ford, Granite Wash, SCOOP/STACK, Marcellus, Bakken Utica and Niobrara basins.

For the nine-month period ended September 30, 2019, US revenue rose to $198.4 million, a 38 percent increase, compared to $143.8 million recognized in the 2018-period. Operating days for the nine-month period ended September 30, 2019, increased 18 percent to 11,502 days as compared to 9,741 days in the same 2018-period. PHX Energy's activity again outpaced the industry's horizontal and directional rig count, which showed a slight decline, 3 percent. In the nine-month period there were an average of 930 horizontal and directional rigs running on a daily basis as compared to 958 rigs in the comparable 2018-period (Source: Baker Hughes). Permian basin activity represented 78 percent of Phoenix USA's activity in the first nine months of 2019.

For the nine-month period ended September 30, 2019, revenue per day, excluding the Corporation's motor rental division, increased 13 percent to CAD $16,465, relative to CAD $14,520 in the corresponding 2018-period. For the nine-month period ended September 30, 2019, a reportable segment income of $10.8 million was realized as compared to $2.9 million in the same 2018-period. Higher profitability in the period is mainly attributable to higher revenue per day and operating days in the period.

International

(Stated in thousands of dollars)

	Three-month periods ended September 30,			Nine-month periods ended September 30,		
	2019	2018	% Change	**2019**	2018	% Change
Revenue	**5,711**	5,258	9	**15,154**	14,651	3
Reportable segment income before tax	**304**	1,221	(75)	**369**	831	(56)

For the three and nine-month periods ended September 30, 2019, the international segment's revenue was $5.7 million and $15.2 million, respectively, as compared to $5.3 million and $14.7 million in the corresponding 2018-period. The improvement in revenue in both periods was primarily due to higher operating days in Albania.

For the three-month period ended September 30, 2019, PHX Energy's Russia division's revenue was $3.5 million, 7 percent lower compared to the $3.7 million in the 2018-quarter. PHX Energy's Russia division realized higher operating days in 2019-quarter, generating 455 days compared to 406 days in the 2018-quarter. However, this increased activity was offset by a higher share of lower priced services and a general decline in market day rates.

For the three-month period ended September 30, 2019, PHX Energy's Albania division recognized revenue of $2.3 million as compared to $1.5 million in the same 2018-quarter. The Albania division operated on three rigs in the third quarter of 2019 compared to two rigs in the 2018-quarter. Operating days increased 55 percent to 269 days in the 2019-quarter relative to 173 days in the corresponding 2018-quarter.

The international segment recognized reportable segment income for the three and nine-month periods ended September 30, 2019 of $0.3 million (2018 - $1.2 million) and $0.4 million (2018 - $0.8 million), respectively. The lower margins were primarily due to lower activity in Russia for some key clients and the general decline in market day rates.

Summary of Quarterly Results

(Stated in thousands of dollars except per share amounts)

	Sept-19	Jun-19	Mar-19	Dec-18	Sept-18	Jun-18	Mar-18	Dec-17
Revenue	**93,099**	82,984	92,121	92,335	85,033	69,009	70,759	60,660
Net income (loss)	**2,594**	(2,020)	(1,067)	(18,355)	3,743	(84)	(4,251)	(5,126)
Earnings (loss) per share – basic	**0.05**	(0.04)	(0.02)	(0.32)	0.06	-	(0.07)	(0.09)
Earnings (loss) per share – diluted	**0.05**	(0.04)	(0.02)	(0.32)	0.06	-	(0.07)	(0.09)
Adjusted EBITDA [(1)]	**15,536**	10,995	11,431	14,736	13,934	10,013	6,768	4,684
Funds from operations [(1)]	**14,669**	9,785	10,100	12,803	11,461	7,158	5,757	2,490

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

Liquidity

(Stated in thousands of dollars)

	Three-month periods ended September 30,		Nine-month periods ended September 30,	
	2019	2018	**2019**	2018
Funds from operations[(1)]	**14,669**	11,461	**34,554**	24,376

[(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.

	September 30, '19	Dec. 31, '18
Working capital[(1)]	**62,207**	60,316

[(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 and nine-month periods ended September 30, 2019, mainly due to greater activity in the US segment and increased overall profitability, the Corporation generated higher funds from operations of $14.7 million (2018 - $11.5 million) and $34.6 million (2018 - $24.4 million), respectively.

As at September 30, 2019, the Corporation had working capital of $62.2 million, which is $1.9 million higher than the $60.3 million reported at December 31, 2018, mainly due to lower trade and other payables and operating facility balance in the third quarter of 2019.

Investing Activities

For the three-month period ended September 30, 2019, PHX Energy used $4.5 million of net cash in investing activities as compared to $2.4 million of net cash from investing activities in the 2018-quarter. During the 2019-quarter, the Corporation received proceeds of $5.8 million primarily from the involuntary disposal of drilling equipment in well bores, relative to $3.2 million received in 2018. PHX Energy spent $8.4 million on capital expenditures of drilling and other equipment in the 2019-quarter compared to $8.1 million in the 2018-quarter. 2019-quarter expenditures were comprised of:

- $4.9 million in MWD systems and spare components;
- $2.4 million in downhole performance drilling motors, and
- $1.1 million in RSS, machinery and equipment and other assets.

The capital expenditure program undertaken in the period was financed generally from cash flow from operating activities. Of the total capital expenditures in the 2019-quarter $6.8 million was used to grow the Corporation's fleet of drilling equipment and the remaining $1.6 million was used to maintain the current fleet of drilling and other equipment.

The change in non-cash working capital balance of $1.6 million (use of cash) for the three-month period ended September 30, 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 $2.5 million (source of cash) for the three-month period ended September 30, 2018.

Financing Activities

The Corporation reported cash flows used in financing activities of $6.1 million in the three-month period ended September 30, 2019 as compared to $6.2 million in the 2018-quarter. In the 2019-quarter, the Corporation:

- repurchased 1,414,400 shares for $4 million under the NCIB,
- made net repayments of $1.3 million to its syndicated facilities; and
- made payment of $0.8 million towards it lease liability in line with the newly adopted IFRS 16 Leases standard.

Capital Resources

As of September 30, 2019, the Corporation had $15 million drawn on its syndicated facility, $6.6 million drawn on its operating facility, and a cash balance of $6.7 million. As at September 30, 2019, the Corporation had approximately CAD $43.4 million and USD $15 million available to be drawn from its credit facilities. The credit facilities are secured by substantially all of the Corporation's assets.

As at September 30, 2019, the Corporation was in compliance with all its financial covenants. 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.

Cash Requirements for Capital Expenditures

Historically, the Corporation has financed its capital expenditures and acquisitions through cash flows from operating activities, debt and equity. In the third quarter of 2019, the Board approved an increase to PHX Energy's 2019 capital expenditure program from $30 million to $35 million. The increase to the capital expenditure program was primarily dedicated to purchasing long lead items required to further expand the Atlas Motor and Velocity fleets for activity in 2020.

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 2019, 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.

Off-Balance Sheet Arrangements

The Corporation had no off-balance sheet arrangements as at September 30, 2019 and 2018.

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, 2018. 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, 2018.

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, 2018, unless specified.

a) New Standard – IFRS 16 Leases

In January 2016, the International Accounting Standards Board issued the final version of IFRS 16, Leases. IFRS 16 replaced 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 introduced 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. Historically, operating lease expenses were 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. Other areas of the lease accounting model have been impacted, including the definition of a lease. 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. The details of the changes in accounting policies are disclosed below.

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 Condensed 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 12 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 Condensed Consolidated Statements 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 12 months or less will be excluded from the IFRS 16 lessee model and will be recognized directly in the statements of comprehensive income (loss) in line with historical treatment.
- Leases for which the lease term ends within 12 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 $33.9 million and lease liabilities of $45.7 million. The impact of the transition on the Condensed Consolidated Statements of Financial Position is summarized below:

	January 1, 2019
Right-of-use assets (1)	33,882
Deferred tax assets	700
Lease liabilities (2)	45,705
Deferred income	(1,300)
Provision for onerous contracts	(1,832)
Retained earnings	(7,991)

(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.

Impacts for the period

As a result of applying IFRS 16, the Corporation recognized right-of-use assets in the amount of $31.6 million and lease liabilities of $43.7 million as at September 30, 2019. Due to the addition of right-of-use asset and lease liabilities in 2019, the Corporation recognized depreciation expense and finance expense lease liability of $2.6 million and $1.9 million, respectively, for the nine-month period ended September 30, 2019.

Business Risk Factors

The business risk factors applicable to the Corporation have not materially changed since December 31, 2018. Refer to the "Business Risk Factors" section of the MD&A in the PHX Energy's 2018 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.

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 July 1, 2019 and ending on September 30, 2019 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

(In thousands of shares)	**As at October 30, 2019**
Common shares outstanding	54,969,320
Dilutive securities:	
Options	5,296,101
Corporation shares – diluted	60,265,421

Outlook

Profitability continued to strengthen in the third quarter, building upon the improvements that began earlier in 2018. In the quarter, the Corporation achieved the highest quarterly adjusted EBIDTA since the third quarter of 2014 and the highest consolidated quarterly revenue since the first quarter of 2015. These ongoing achievements were made despite Canadian and US industry activity declining and are a result of the Corporation's strategic focus on the US market and the initiative to build a fleet of differentiating high performance technologies that deliver higher margins.

The Corporation's US segment continues to be the engine driving the improved financial performance, despite a weakening in the industry. In the third quarter, revenue achieved in the US was the highest quarterly revenue since the fourth quarter 2014. Despite the lower rig counts, the US remains the most significant area of growth for the Corporation. Even with the gains achieved over the past year there is still potential for PHX Energy to capture more market share. Operators in this market are strongly focused on drilling performance and are insisting on specific high performance technologies as they continue to push for faster and more efficient drilling. This trend of high grading drilling technologies is strengthening and PHX Energy is well positioned to capitalize on this demand. PHX Energy will continue to expand its Velocity, Atlas Motor and PowerDrive Orbit RSS fleets, increasing capacity to fuel further growth. As PHX Energy continues to execute on its US growth and technology development strategies, the Corporation is optimistic that US operations will continue to outpace the US industry.

The third quarter in Canada was consistent with the first half of the year, with declining rig counts persisting. The issues related to market access, public perception of the energy sector and political agendas are haunting the energy sector and it appears there will be no change to this environment in the near term. Despite these challenging times, the Corporation is focused on maintaining a viable business in Canada and has adapted its operations to this new norm. As in the US market, the Canadian segment is utilizing the performance and financial advantages created by its fleet of high performance technologies. Additionally the Corporation is leveraging its infrastructure and expertise in Canada to support the growth in the US. Although PHX Energy does not anticipate an uptick in activity which typically comes with the winter drilling season in the fourth and first quarters, it believes that it can maintain the level of performance achieved in the third quarter with its strong marketing relationships, industry leading operations, premium technologies, and strategies to support its continued growth in the US.

In the third quarter, PHX Energy's international operations increased activity quarter-over-quarter and Albanian operations generated increased revenue as it remained active on three rigs in the country. In Russia however, revenue slightly declined as a result of a larger portion of lower priced services being provided and overall pricing pressure in the industry. PHX Energy believes that there are opportunities for growth in Russia and is implementing operational and marketing strategies to capitalize on these in future quarters.

Technology Update

High performance technologies have proven the significant positive impact they can have on Operator's drilling operations and this has led Operator's to become more specific and targeted with their requirements. With the lower rig counts competition has intensified, and Operators can demand a directional provider deploy specific technologies in order to be awarded the work. This boasts well for PHX Energy and its high performance fleet, and the Corporation must remain at the forefront of technology development.

The impact the current high performance technologies have made on profitability, market share and performance is one of the most significant in the Corporation's history. This is the result of an unwavering commitment over the past number of years to differentiate PHX Energy as a leading provider of downhole technologies. Today, the Corporation is laser focused on this objective, allocating its capital expenditure program to increase its capacity while continuing its engineering and development efforts towards improved technologies. PHX Energy is steadfast on protecting its position in the market as a top tier technology leader.

The Corporation has built its financial position to be one of the more favorable in the sector, with a strong balance sheet and relatively low debt levels. PHX Energy is committed to a conservative approach to its financial management and further strengthening this position. In an environment where it is increasingly difficult to reward shareholders through valuations, PHX Energy is in a unique position to utilize strategies, such as the NCIB, to help create shareholder value.

Michael Buker, President
October 30, 2019

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 September 30,		Nine-month periods ended September 30,	
	2019	2018	**2019**	2018
Net income (loss)	**2,594**	3,743	**(494)**	(591)
Add (deduct):				
Depreciation and amortization drilling and other equipment	**9,894**	9,505	**30,178**	29,613
Depreciation and amortization right-of-use asset[1]	**896**	-	**2,642**	-
Provision for (Recovery of) income taxes	**1,086**	180	**1,830**	(77)
Finance expense	**306**	264	**1,090**	929
Finance expense lease liability[1]	**622**	-	**1,897**	-
Equity-settled share-based payments	**160**	342	**559**	1,201
Unrealized foreign exchange (gain) loss	**(22)**	(100)	**259**	(360)
Adjusted EBITDA as reported	**15,536**	13,934	**37,961**	30,715

[1] Cash payment on leases included in IFRS 16 for the three and nine-month periods ended September 30, 2019 was $1.4 million and $4.3 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 September 30,		Nine-month periods ended September 30,	
	2019	2018	**2019**	2018
Cash flows from operating activities	**9,721**	6,027	**40,665**	15,871
Add (deduct):				
Changes in non-cash working capital	**4,699**	4,808	**(6,756)**	7,935
Interest paid	**172**	94	**668**	442
Income taxes paid (received)	**77**	532	**(23)**	128
Funds from (used in) operations	**14,669**	11,461	**34,554**	24,376

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 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.

Condensed Consolidated Statements of Financial Position

(unaudited)

	September 30, 2019	December 31, 2018
ASSETS		
Current assets:		
Cash and cash equivalents	$ **6,667,910**	$ 3,643,418
Trade and other receivables	**90,827,920**	103,987,716
Inventories	**30,529,040**	27,558,003
Prepaid expenses	**3,294,154**	2,428,221
Current tax assets	**55,941**	625,964
Total current assets	**131,374,965**	138,243,322
Non-current assets:		
Drilling and other equipment (Note 6)	**85,031,445**	94,164,880
Right-of-use asset (Note 3)	**31,602,910**	-
Intangible assets	**20,138,047**	22,301,680
Goodwill	**8,876,351**	8,876,351
Deferred tax assets	**568,299**	594,049
Total non-current assets	**146,217,052**	125,936,960
Total assets	$ **277,592,017**	$ 264,180,282
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Lease liability (Note 3)	$ **2,823,969**	$ -
Operating facility (Note 7)	**6,568,072**	13,348,562
Trade and other payables	**59,775,517**	64,578,428
Total current liabilities	**69,167,558**	77,926,990
Non-current liabilities:		
Lease liability (Note 3)	**40,839,263**	-
Loans and borrowings (Note 7)	**15,000,000**	11,821,000
Deferred tax liability	**2,993,562**	2,886,606
Provision for onerous contracts (Note 3)	**-**	1,832,000
Deferred income (Note 3)	**-**	1,300,007
Total non-current liabilities	**58,832,825**	17,839,613
Equity:		
Share capital (Note 8a)	**256,566,776**	265,760,391
Contributed surplus	**11,148,473**	10,631,982
Retained earnings	**(133,869,411)**	(125,385,208)
Accumulated other comprehensive income	**15,745,796**	17,406,514
Total equity	**149,591,634**	168,413,679
Total liabilities and equity	$ **277,592,017**	$ 264,180,282

See accompanying notes to unaudited condensed consolidated interim financial statements.

Condensed Consolidated Statements of Comprehensive Income / Loss

(unaudited)

	Three-month periods ended September 30,		Nine-month periods ended September 30,	
	2019	2018	**2019**	2018
Revenue	**$ 93,099,227**	$ 85,032,830	**$ 268,203,575**	$ 224,800,407
Direct costs	**77,089,805**	69,477,782	**228,140,741**	197,795,786
Gross profit	**16,009,422**	15,555,048	**40,062,834**	27,004,621
Expenses:				
Selling, general and administrative expenses	**10,615,982**	12,983,042	**35,212,139**	30,765,451
Research and development expenses	**1,193,183**	836,752	**2,972,786**	2,506,363
Finance expense	**306,097**	264,046	**1,089,722**	929,017
Finance expense lease liability (Note 3)	**622,196**	-	**1,896,879**	-
Other income (Note 9)	**(407,597)**	(2,452,247)	**(2,445,385)**	(6,528,264)
	12,329,861	11,631,593	**38,726,141**	27,672,567
Earnings (loss) before income taxes	**3,679,561**	3,923,455	**1,336,693**	(667,946)
Provision for (Recovery of) income taxes				
Current	**121,492**	1,388,630	**590,276**	3,315,087
Deferred	**964,563**	(1,208,674)	**1,239,976**	(3,391,862)
	1,086,055	179,956	**1,830,252**	(76,775)
Net earnings (loss)	**2,593,506**	3,743,499	**(493,559)**	(591,171)
Other comprehensive income (loss)				
Foreign currency translation	**1,001,351**	(2,541,426)	**(1,660,718)**	753,944
Total comprehensive income (loss) for the period	**$ 3,594,857**	$ 1,202,073	**$ (2,154,277)**	$ 162,773
Earnings (loss) per share – basic	**$ 0.05**	$ 0.06	**$ (0.01)**	$ (0.01)
Earnings (loss) per share – diluted	**$ 0.05**	$ 0.06	**$ (0.01)**	$ (0.01)

See accompanying notes to unaudited condensed consolidated interim financial statements.

Condensed Consolidated Statements of Changes in Equity

(unaudited)

Nine-month period ended September 30, 2019	**Share Capital Number**	**Share Capital Amount ($)**	**Contributed Surplus**	**Accumulated Other Comprehensive Income**	**Retained Earnings**	**Total Equity**
Balance, December 31, 2018	**57,963,720**	**$ 265,760,391**	**$ 10,631,982**	**$ 17,406,514**	**$ (125,385,208)**	**$ 168,413,679**
Adjustment Initial application of IFRS 16	**-**	**-**	**-**	**-**	**(7,990,644)**	**(7,990,644)**
Net issuance of share capital	**45,000**	**87,750**	**-**	**-**	**-**	**87,750**
Common Shares repurchased	**(3,039,400)**	**(9,324,191)**	**-**	**-**	**-**	**(9,324,191)**
Share-based payments	**-**	**-**	**559,317**	**-**	**-**	**559,317**
Fair value of options exercised	**-**	**42,826**	**(42,826)**	**-**	**-**	**-**
Net loss	**-**	**-**	**-**	**-**	**(493,559)**	**(493,559)**
Foreign currency translation	**-**	**-**	**-**	**(1,660,718)**	**-**	**(1,660,718)**
Balance, September 30, 2019	**54,969,320**	**$ 256,566,776**	**11,148,473**	**15,745,796**	**(133,869,411)**	**149,591,634**

Nine-month period ended September 30, 2018	Share Capital Number	Share Capital Amount ($)	Contributed Surplus	Accumulated Other Comprehensive Income	Retained Earnings	Total Equity
Balance, December 31, 2017	58,397,887	$ 266,838,036	$ 9,315,926	$ 11,822,389	$ (106,438,399)	$ 181,537,952
Net issuance of share capital	48,333	76,916	-	-	-	76,916
Common Shares repurchased	(416,800)	(1,034,758)	-	-	-	(1,034,758)
Share-based payments	-	-	1,200,656	-	-	1,200,656
Fair value of options exercised		52,763	(52,763)	-	-	-
Net loss	-	-	-	-	(591,171)	(591,171)
Foreign currency translation	-	-	-	753,944	-	753,944
Balance, September 30, 2018	58,029,420	$ 265,932,957	10,463,819	12,576,333	(107,029,570)	181,943,539

See accompanying notes to unaudited condensed consolidated interim financial statements.

Condensed Consolidated Statements of Cash Flows

(unaudited)

	Three-month periods ended September 30, 2019	Three-month periods ended September 30, 2018	Nine-month periods ended September 30, 2019	Nine-month periods ended September 30, 2018
Cash flows from operating activities:				
Net income (loss)	**$ 2,593,506**	$ 3,743,499	**$ (493,559)**	$ (591,171)
Adjustments for:				
Depreciation and amortization	**9,893,523**	9,505,407	**30,178,287**	29,612,677
Depreciation and amortization right-of-use asset	**895,878**	-	**2,641,400**	-
Provision for (Recovery of) income taxes	**1,086,055**	179,956	**1,830,252**	(76,775)
Unrealized foreign exchange loss (gain)	**(21,904)**	(101,286)	**259,105**	(359,717)
Gain on disposition of drilling equipment	**(513,628)**	(2,358,209)	**(3,390,124)**	(6,209,463)
Equity-settled share-based payments	**160,260**	341,860	**559,317**	1,200,656
Finance expense	**306,097**	264,046	**1,089,722**	929,017
Provision for (Recovery of) bad debts	**61,590**	(7,553)	**387,728**	(15,441)
Provision for inventory obsolescence	**207,958**	49,049	**1,491,260**	256,157
Provision for onerous contracts	**-**	(122,000)	**-**	(270,000)
Amortization of deferred income	**-**	(33,333)	**-**	(99,999)
Interest paid	**(172,424)**	(93,951)	**(667,712)**	(441,842)
Income taxes received (paid)	**(77,482)**	(532,119)	**23,389**	(127,996)
Change in non-cash working capital	**(4,698,171)**	(4,808,355)	**6,755,880**	(7,934,636)
Net cash from operating activities	**9,721,258**	6,027,011	**40,664,945**	15,871,467
Cash flows from investing activities:				
Proceeds on disposition of drilling equipment	**5,779,886**	3,197,615	**11,823,951**	11,165,720
Acquisition of drilling and other equipment	**(8,443,739)**	(8,066,652)	**(28,840,422)**	(15,831,277)
Acquisition of intangible assets	**(66,180)**	(26,135)	**(66,180)**	(32,733)
Change in non-cash working capital	**(1,631,833)**	2,459,181	**(5,345,034)**	1,259,571
Net cash used in investing activities	**(4,361,866)**	(2,435,991)	**(22,427,685)**	(3,438,719)
Cash flows from financing activities:				
Repurchase of shares under the NCIB	**(3,978,754)**	(797,258)	**(9,324,191)**	(1,034,758)
Proceeds from (Repayment of) operating facility	**9,827**	(1,500,675)	**(6,780,490)**	(872,510)
Payments of Lease Liability	**(819,493)**	-	**(2,374,837)**	-
Proceeds from (Repayment of) loans and borrowings	**(1,308,700)**	(4,000,000)	**3,179,000**	(9,000,000)
Proceeds from issuance of share capital	**-**	76,916	**87,750**	76,916
Net cash used in financing activities	**(6,097,120)**	(6,221,017)	**(15,212,768)**	(10,830,352)
Net increase (decrease) in cash and cash equivalents	**(737,728)**	(2,629,997)	**3,024,492**	1,602,396
Cash and cash equivalents, beginning of period	**7,405,638**	8,354,932	**3,643,418**	4,122,539
Cash and cash equivalents, end of period	**$ 6,667,910**	$ 5,724,935	**$ 6,667,910**	$ 5,724,935

See accompanying notes to unaudited condensed consolidated interim financial statements.

Notes to the Condensed Consolidated Financial Statements

For the three and nine-month periods ended September 30, 2019 and 2018

In Canadian dollars (unaudited)

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, 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, 2018.

These condensed consolidated interim financial statements were authorized by the Board of Directors on October 30, 2019.

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 ("CAD"), 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, 2018.

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, 2018, unless specified.

a) New Standard – IFRS 16 Leases

In January 2016, the International Accounting Standards Board issued the final version of IFRS 16, Leases. IFRS 16 replaced 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 introduced 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. Historically, operating lease expenses were 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. Other areas of the lease accounting model have been impacted, including the definition of a lease. 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. The details of the changes in accounting policies are disclosed below.

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 Condensed 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 12 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 Condensed Consolidated Statements 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 12 months or less will be excluded from the IFRS 16 lessee model and will be recognized directly in the statements of comprehensive income (loss) in line with historical treatment.
- Leases for which the lease term ends within 12 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 $33.9 million and lease liabilities of $45.7 million. The impact of the transition on the Condensed Consolidated Statements of Financial Position is summarized below:

	January 1, 2019
Right-of-use assets (1)	33,882
Deferred tax assets	700
Lease liabilities (2)	45,705
Deferred income	(1,300)
Provision for onerous contracts	(1,832)
Retained earnings	(7,991)

(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.

Impacts for the period

As a result of applying IFRS 16, the Corporation recognized right-of-use assets in the amount of $31.6 million and lease liabilities of $43.7 million as at September 30, 2019. Due to the addition of right-of-use asset and lease liabilities in 2019, the Corporation recognized depreciation expense and finance expense lease liability of $2.6 million and $1.9 million, respectively, for the nine-month period ended September 30, 2019.

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 September 30,	**2019**	2018	**2019**	2018	**2019**	2018	**2019**	2018
Drilling services revenue	**17,779**	24,578	**68,265**	54,129	**5,711**	5,258	**91,755**	83,965
EDR rental revenue	**1,344**	1,068	**-**	-	**-**	-	**1,344**	1,068
Total revenue	**19,123**	25,646	**68,265**	54,129	**5,711**	5,258	**93,099**	85,033
Reportable segment profit before income taxes	**1,571**	1,831	**4,975**	3,219	**304**	1,221	**6,850**	6,271

(Stated in thousands of dollars)

	Canada		United States		International		Total	
Nine-month periods ended September 30,	**2019**	2018	**2019**	2018	**2019**	2018	**2019**	2018
Drilling services revenue	**50,909**	63,301	**198,399**	143,842	**15,154**	14,651	**264,462**	221,794
EDR rental revenue	**3,742**	3,006	**-**	-	**-**	-	**3,742**	3,006
Total revenue	**54,651**	66,307	**198,399**	143,842	**15,154**	14,651	**268,204**	224,800
Reportable segment profit (loss) before income taxes	**616**	(1,469)	**10,802**	2,937	**369**	831	**11,787**	2,299

(Stated in thousands of dollars)

	Canada		**United States**		**International**		**Total**	
As at September 30,	**2019**	2018	**2019**	2018	**2019**	2018	**2019**	2018
Drilling and other equipment	**23,537**	31,231	**56,547**	44,827	**4,947**	7,137	**85,031**	83,195
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 September 30,		Nine-month periods ended September 30,	
	2019	2018	**2019**	2018
Reportable segment profit before income taxes	**6,850**	6,271	**11,787**	2,299
Corporate:				
Selling, general and administrative expenses	**1,457**	3,699	**6,935**	6,060
Research and development expenses	**1,193**	837	**2,973**	2,506
Finance expense	**306**	264	**1,090**	929
Finance expense lease liability	**622**	-	**1,897**	-
Other income	**(408)**	(2,452)	**(2,445)**	(6,528)
Earnings (loss) before income taxes	**3,680**	3,923	**1,337**	(668)

5. Seasonality of Operations

A 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 nine-month period ended September 30, 2019, the Corporation acquired assets with a cost of $28.8 million (2018 - $15.8 million).

Assets with a carrying amount of $8.4 million (2018 - $5.0 million) were disposed of as a result of tools lost down hole and scrapped assets, resulting in a net gain on disposition of $3.4 million (2018 - $6.2 million), which is included in other income in the condensed consolidated statement of comprehensive income.

b) Capital Commitments

As at September 30, 2019, the Corporation has commitments to purchase drilling and other equipment for $14.7 million; delivery is expected to occur before the first half of 2020.

7. Loans and Borrowings

(Stated in thousands of dollars)

	Currency	Amount of Facility	Date of Maturity	**Currency**	**Carrying Amount at September 30, 2019**	Currency	Carrying Amount at December 31, 2018
Operating Facility	CAD	15,000	Due on demand	CAD	**6,568**	CAD	13,349
Syndicated Facility	CAD	50,000	December 11, 2022	CAD	**15,000**	CAD	5,000
US Operating Facility	USD	15,000	December 11, 2022	USD	**-**	USD	5,000

Under the syndicated loan agreement, the Corporation is required to maintain certain financial covenants. As at September 30, 2019 the Corporation was in compliance with all its financial covenants as follows:

Ratio	Covenant	**September 30, 2019**
Debt to covenant EBITDA	< 3.0x	**0.45**
Interest coverage ratio	> 3.0x	**35.34**

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 $48.0 million to CAD $50.0 million and in the US operating facility from USD $5.0 million to USD $15.0 million.

8. 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, 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	**(3,039,400)**		**(9,324,191)**
Issued shares pursuant to share option plan	**45,000**		**130,576**
Balance as at September 30, 2019	**54,969,320**	**$**	**256,566,776**

b) 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			

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 the three and nine-month periods ended September 30, 2019, the Corporation recognized total compensation expense of $0.2 million and $0.6 million, respectively (2018 - $0.3 million and $1.2 million) for share options granted between 2016 and 2019.

A summary of the status of the plan as at September 30, is presented below:

	2019		2018	
	Options	**Weighted-Average Exercise Price**	Options	Weighted-Average Exercise Price
Outstanding, beginning of period	**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	**-**	**-**	(41,667)	3.06
Expired	**(200,000)**	**15.81**	(368,367)	10.78
Outstanding, end of period	**5,296,101**	**3.41**	5,291,101	3.89
Options exercisable, end of period	**4,796,093**	**3.54**	4,042,758	4.20

The range of exercise prices for options outstanding at September 30, are as follows:

Options Outstanding				Options Exercisable	
Original Exercise Price	Number	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number	Weighted-Average Exercise Price
$ 1.55	1,318,334	1.43 yrs	$ 1.55	1,318,334	$ 1.55
1.71	175,000	2.88 yrs	1.71	116,666	1.71
1.79	575,000	2.88 yrs	1.79	383,331	1.79
1.95	165,267	2.04 yrs	1.95	148,600	1.95
2.00	200,000	3.44 yrs	2.00	133,332	2.00
2.81	200,000	4.44 yrs	2.81	66,664	2.81
2.83	50,000	4.44 yrs	2.83	16,666	2.83
3.41	25,000	2.15 yrs	3.41	25,000	3.41
4.06	1,305,000	2.43 yrs	4.06	1,305,000	4.06
4.15	415,000	2.43 yrs	4.15	415,000	4.15
6.87 - 15.81	867,500	0.39 yrs	7.07	867,500	7.07
	5,296,101	2.03 yrs	$ 3.41	4,796,093	$ 3.54

c) 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. For the nine-month period ended September 30, 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), and, as at September 30, 2019, 1,316,668 PAs were outstanding (2018 – 883,336).

The Corporation recorded a total of $5.1 million compensation expense relating to these plans for the nine-month period ended September 30, 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 3,636,199 RAs and PAs outstanding as at September 30, 2019 (2018 – 3,636,328).

A summary of the status of the plan as at September 30, is presented below:

	2019	2018
RAs and PAs outstanding, beginning of year	**3,443,456**	2,103,040
Granted	**1,622,897**	2,467,589
Settled	**(1,399,485)**	(765,759)
Forfeited / cancelled	**(30,669)**	(168,542)
RAs and PAs outstanding, end of year	**3,636,199**	3,636,328

d) 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, in the third quarter of 2019 801,600 common shares were purchased by the Corporation and cancelled.

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 have been purchased and cancelled by the Corporation.

9. Other Income

(Stated in thousands of dollars)

	Three-month periods ended September 30,		Nine-month periods ended September 30,	
	2019	2018	**2019**	2018
Net gain on disposition of drilling equipment	**(514)**	(2,358)	**(3,390)**	(6,209)
Foreign exchange losses (gains)	**44**	(86)	**557**	(304)
Provision for (Recovery of) bad debts	**62**	(8)	**388**	(15)
Other expenses (income)	**(408)**	(2,452)	**(2,445)**	(6,528)

10. 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

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