PHX
ENERGY SERVICES CORP.

2018 THIRD QUARTER REPORT

PHX Energy Services Corp.

Third Quarter Report for the Three and Nine-Month Periods Ended September 30, 2018 and 2017

Financial Results

For the three-month period ended September 30, 2018, the Corporation generated its highest quarterly earnings per share and net earnings since the third quarter of 2014. The Corporation recognized earnings per share of $0.06 and net earnings of $3.7 million in the 2018-quarter compared to a $0.01 loss per share and a net loss of $0.8 million in the third quarter of 2017. In the three-month period ended September 30, 2018, the Corporation generated consolidated revenue of $85.0 million, a 30 percent increase relative to $65.4 million generated in the 2017-quarter. Adjusted EBITDA was $13.9 million in the 2018-quarter, which is the highest level since the fourth quarter of 2014. Improved profitability was primarily a result of increased activity in the US. The Corporation achieved this level of adjusted EBITDA despite higher cash-settled share-based payments that amounted to $2.9 million in the 2018-quarter as compared to $0.8 million in the 2017-quarter. Cash-settled share-based payments rose primarily due to increases in the Corporation's share price. As a result of cost control measures implemented over the past few years, PHX Energy is capable of generating higher adjusted EBITDA margins as a percent of revenue with substantially less revenue. In the third quarter of 2018, the adjusted EBITDA margin was 20 percent, excluding cash-settled share-based payments, which is higher than in the fourth quarter of 2014 when the adjusted EBITDA margin, excluding cash-settled share-based payments, was 18 percent and revenue was $152.9 million.

The Corporation's consolidated activity levels for the three-month period ended September 30, 2018, increased by 11 percent to 7,008 days from 6,323 days in the 2017-quarter and average consolidated day rates, excluding the motor rental division in the US and the Stream division, rose by 17 percent to $11,803 from $10,127 in the 2017-quarter.

The Corporation's US segment represented 64 percent of its third quarter consolidated revenue as activity levels in the US industry remained robust as a result of the improved global commodity prices. The Corporation's US revenue increased 38 percent quarter-over-quarter, with the US division generating $54.1 million in the 2018-quarter as compared to $39.3 million in the 2017-quarter. In comparison, the overall rig count in the US industry during the third quarter of 2018 increased by 11 percent to 1,051 average rigs running per day as compared to the 946 rigs per day in the third quarter of 2017. However, the average rig count in the Permian basin increased 27 percent quarter-over-quarter, which is where PHX Energy's US operations are primarily focused (Source: Baker Hughes). During the third quarter, approximately 60 percent of PHX Energy's US activity was in the Permian basin.

In contrast, the Canadian industry and PHX Energy's activity levels were relatively flat in the third quarter of 2018, only improving marginally over the third quarter of 2017. Poor weather conditions negatively impacted activity in the latter half of the 2018-quarter and industry horizontal and directional drilling days only increase by 3 percent to 18,439 days (2017 – 17,983 days) (Source: Daily Oil Bulletin). The Canadian segment generated $25.6 million in the 2018-quarter relative to $21.7 million in the 2017-quarter.

During the third quarter, the Corporation continued to reduce the level of its borrowings. As at September 30, 2018 the Corporation had loans and borrowings of $5.0 million and operating facility borrowings of $4.7 million, less its cash and cash equivalents of $5.7 million, PHX Energy's net balance is $4.0 million. As at the end of the third quarter working capital was $55.1 million.

Capital Spending

During the third quarter of 2018, the Corporation further expanded its fleet of Atlas High Performance motors and Velocity Real-Time systems ("Velocity") and incurred $8.1 million in capital expenditures (2017 - $8.9 million).

As at September 30, 2018, the Corporation had $13.4 million of outstanding capital commitments to purchase drilling and other equipment. These commitments include $11.3 million for motors primarily relating to Atlas High Performance motors, $1.4 million for Velocity systems, and $0.7 million primarily relating to machinery and equipment. The Corporation expects this equipment to be delivered by the end of the first quarter of 2019.

On May 30, 2018 the Corporation announced an increase to its 2018 capital expenditure program from $10.5 million to $18.5 million, and subsequently on July 4, 2018, the Corporation announced a further increase to the 2018 capital expenditure program from $18.5 million to $33.5 million. The increases will primarily be dedicated to further expanding the Corporation's performance drilling motor fleet, mainly Atlas High Performance motors for activity in 2019.

Normal Course Issuer Bid

During the third quarter of 2018, the Toronto Stock Exchange ("TSX") approved the renewal of PHX Energy's Normal Course Issuer Bid ("NCIB") to purchase for cancellation, from time-to-time, up to a maximum of 2,915,311 common shares, representing 5 percent of the outstanding common shares at the time the NCIB was renewed. The NCIB commenced on August 8, 2018 and will terminate on August 7, 2019. Purchases of common shares are to be made on the open market through the facilities of the TSX and through alternative trading systems. The price which PHX Energy is to pay for any common shares purchased is to be at the prevailing market price on the TSX or alternate trading systems at the time of such purchase. Pursuant to the NCIB, 291,800 common shares were purchased by the Corporation in the third quarter and cancelled.

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

Thus far, in the 2018 year, the Corporation has purchased and cancelled 416,800 shares.

(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,		
	2018	2017	% Change	**2018**	2017	% Change
Operating Results	***(unaudited)***	*(unaudited)*		***(unaudited)***	*(unaudited)*	
Revenue	**85,033**	65,396	30	**224,800**	180,340	25
Net earnings (loss)	**3,743**	(846)	n.m.	**(591)**	(18,401)	(97)
Earnings (loss) per share – diluted	**0.06**	(0.01)	n.m.	**(0.01)**	(0.32)	(97)
Adjusted EBITDA [1]	**13,934**	11,690	19	**30,715**	15,419	99
Adjusted EBITDA per share – diluted [1]	**0.24**	0.20	20	**0.52**	0.26	100
Adjusted EBITDA as a percentage of revenue [1]	**16%**	18%		**14%**	9%	
Cash Flow						
Cash flows from operating activities	**6,027**	(13,684)	n.m.	**15,871**	(9,910)	n.m.
Funds from operations [1]	**11,461**	8,436	36	**24,376**	12,533	94
Funds from operations per share – diluted[1]	**0.19**	0.14	36	**0.42**	0.21	100
Capital expenditures	**8,067**	8,900	(9)	**15,831**	17,397	(9)
Financial Position (unaudited)				**Sept 30, '18**	Dec 31, '17	
Working capital				**55,089**	49,787	11
Long-term debt				**5,000**	14,000	(64)
Shareholders' equity				**181,944**	181,538	-
Common shares outstanding				**58,029,420**	58,397,887	(1)

n.m. – not meaningful

[1] Refer to non-GAAP measures section that follows the outlook section.

Non-GAAP Measures

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

Energy's performance. The Corporation's method of calculating these measures may differ from that of other organizations, and accordingly, these may not be comparable. Please refer to the non-GAAP measures section following the Outlook section for applicable definitions and reconciliations.

Management's Discussion and Analysis

The following MD&A of the financial condition, results of operations, and cash flow of PHX Energy Services Corp. ("PHX Energy" or the "Corporation") should be read in conjunction with the Corporation's 2017 annual report, including the MD&A, and audited consolidated financial statements and the accompanying notes contained therein, and the Corporation's 2018 unaudited interim 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 31, 2018.

PHX Energy's Interim Financial Report for the three-month and nine-month periods ended September 30, 2018 and 2017 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 31, 2018.

Cautionary Statement Regarding Forward-Looking Information and Statements

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

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

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

- The Corporation expects equipment currently on order to be delivered by the end of the first quarter of 2019.
- The increases to the 2018 capital expenditure program will primarily be dedicated to further expanding the Corporation's performance drilling motor fleet, mainly Atlas High Performance motors for activity in 2019.
- Activity in Albania is expected to increase with the addition of a third rig in November 2018.
- These planned expenditures are expected to be financed from a combination of one or more of the following: cash flow from operations, the Corporation's unused credit facilities or equity, if necessary. However, if a sustained period of market uncertainty and financial market volatility persists in 2018, the Corporation's activity levels, cash flows and access to credit may be negatively impacted, and the expenditure level would be reduced accordingly. Conversely, if future growth opportunities present themselves, the Corporation would look at expanding this planned capital expenditure amount.

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

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

Readers are cautioned that the foregoing lists of factors are not exhaustive. Additional information on these and other factors that could affect the Corporation's operations and financial results are included in reports on file with the Canadian Securities Regulatory Authorities and may be accessed through the SEDAR website (www.sedar.com) 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 provides horizontal and directional drilling technology and services and electronic drilling recorder ("EDR") technology and services to oil and natural gas producing companies in Canada, United States, Russia and Albania.

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'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 Fier Albania; Moscow, Russia; and Nizhnevartovsk, 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"). In the US, EDR technology and services are marketed under the US entity, Stream EDR Services. EDR technology is marketed worldwide, in Albania and Russia, through Stream's wholly-owned subsidiary Stream Services International Inc.

Results of Operations

Three and Nine-month Periods Ended September 30, 2018

Revenue

(Stated in thousands of dollars)

	Three-month periods ended September 30,			Nine-month periods ended September 30,		
	2018	2017	% Change	**2018**	2017	% Change
Revenue	**85,033**	65,396	30	**224,800**	180,340	25

Industry activity in the third quarter of 2018 was stronger relative to the 2017-quarter as commodity prices continued to rise in 2018. For the three-month period ended September 30, 2018, consolidated revenue increased by 30 percent to $85.0 million, from $65.4 million recognized in the 2017-quarter. Consolidated operating days rose to 7,008 days as compared to 6,323 days in the 2017-quarter, an improvement of 11 percent. The average consolidated day rate, excluding the motor rental division in the US and the Stream division, improved by 17 percent to $11,803 in the 2018-quarter, compared to $10,127 realized in the 2017-quarter. The growth in revenue was primarily due to higher levels of drilling activity in the US, as well as, higher average consolidated day rates achieved compared to the 2017-quarter. US and international revenue were 64 and 6 percent, respectively, of total consolidated revenue for the 2018-quarter as compared to 60 and 7 percent, respectively, for the 2017-quarter.

The North American rig count increased by 9 percent quarter-over-quarter, with the US rig count increasing 11 percent while the Canadian rig count was flat. The Permian basin remained the most active basin in North America representing 38 percent of all active rigs in the quarter (2017 – 33 percent). Horizontal wells remained the prominent well type throughout North America representing 93 percent of Canadian industry drilling days (2017 – 92 percent), and 88 percent of the US active rigs running per day (2017 – 84 percent) in the third quarter of 2018 (Sources: Daily Oil Bulletin and Baker Hughes).

For the nine-month period ended September 30, 2018, the Corporation achieved consolidated revenue of $224.8 million an increase of 25 percent from $180.3 million in the comparable 2017-period. Higher revenues for the nine-month period ended September 30, 2018 were a result of improved day rates in the period and growing drilling activity in the US. Consolidated operating days were 19,220, compared to 17,756 days in the 2017-period, an 8 percent improvement. The average consolidated day rate, excluding the motor rental division in the US and the Stream division, in the 2018-period was higher by 16 percent at $11,414 versus the comparable 2017-period of $9,878.

Operating Costs and Expenses

(Stated in thousands of dollars except percentages)

	Three-month periods ended September 30,			Nine-month periods ended September 30,		
	2018	2017	% Change	**2018**	2017	% Change
Direct costs	**69,478**	59,996	16	**197,796**	177,577	11
Gross profit as a percentage of revenue	**18%**	8%		**12%**	2%	
Depreciation & amortization (included in direct costs)	**9,505**	9,988	(5)	**29,613**	31,433	(6)
Gross profit as percentage of revenue excluding depreciation & amortization	**29%**	24%		**25%**	19%	

Direct costs are comprised of field and shop expenses, and include depreciation and amortization of the Corporation's equipment. For the three and nine-month periods ended September 30, 2018, the Corporation's direct costs rose to $69.5 million and $197.8 million, respectively, from $60.0 million and $177.6 million in the comparable 2017-periods. These increases were mainly due to higher levels of activity. For the three and nine-month periods ended September 30, 2018, the Corporation's gross profit as a percentage of revenue improved to 18 percent and 12 percent, respectively, compared to 8 percent and 2 percent in the same 2017-periods. Stronger gross profits can be accredited to improved activity and day rates as well as the continued success of strategic cost reduction initiatives implemented in past quarters.

The reduction to the depreciation and amortization expenses for the three and nine-month periods ended September 30, 2018 was primarily the result of PHX Energy's higher level of capital spending in prior years before the industry downturn and more assets being fully depreciated. For the three and nine-month periods ended September 30, 2018, excluding depreciation and amortization, gross profit as a percent of revenue increased to 29 percent and 25 percent, respectively, from 24 percent and 19 percent in the comparable 2017-periods.

The Corporation continued to improve its profitability in 2018, which was primarily a result of the greater volume of activity, higher day rates, and lower depreciation and amortization.

(Stated in thousands of dollars except percentages)

	Three-month periods ended September 30,			Nine-month periods ended September 30,		
	2018	2017	% Change	**2018**	2017	% Change
Selling, general & administrative ("SG&A") costs	**12,983**	7,759	67	**30,765**	22,744	35
Equity-settled share-based payments (included in SG&A costs)	**342**	701	(51)	**1,201**	2,219	(46)
Cash-settled share-based payments (recoveries) (included in SG&A costs)	**2,925**	802	n.m.	**4,076**	775	n.m.
Onerous contracts lease payment (included in SG&A costs)	**(122)**	(95)	28	**(270)**	(272)	(1)
SG&A costs excluding equity and cash-settled share-based payments and provision for onerous contracts as a percentage of revenue	**12%**	10%		**11%**	11%	

n.m. – not meaningful

For the three and nine-month periods ended September 30, 2018, the Corporation incurred SG&A costs of $13.0 million and $30.8 million, respectively, compared to $7.8 million and $22.7 million in the relative 2017-periods. The rise in SG&A costs was mainly a result of higher personnel-related costs associated with increased activity, as well as, fluctuations to the Corporation's share price in the 2018-periods.

Included in SG&A costs for the three and nine-month periods ended September 30, 2018 are equity-settled and cash-settled share-based payments of $3.3 million and $5.3 million, respectively, compared to $1.5 million and $3.0 million in the equivalent 2017-periods. In addition, SG&A costs were reduced for actual lease payments made under the Corporation's onerous office lease contracts that were reclassified to reduce the related provision. For the three and nine-month periods ended September 30, 2018, excluding equity-settled and cash-settled share-based payments and the provision for onerous contracts, SG&A costs as a percentage of consolidated revenue were 12 percent and 11 percent, respectively, compared to 10 percent and 11 percent in the comparable 2017-periods.

Equity-settled share-based payments relate to the amortization of the fair values of issued options of the Corporation using the Black-Scholes model. For the three and nine-month periods ended September 30, 2018, equity-settled share-based payments decreased to $0.3 million and $1.2 million, respectively, from $0.7 million and $2.2 million in the comparable 2017-periods, primarily due to fewer options granted in the 2018-periods as compared to the 2017-periods.

For the three and nine-month periods ended September 30, 2018, cash-settled share-based payments included in SG&A increased to $2.9 million and $4.1 million, respectively, compared to $0.8 million in both of the corresponding 2017-periods. The higher compensation expense for cash-settled share-based payments was primarily due to increases in the Corporation's share price in the third quarter of 2018.

(Stated in thousands of dollars)

	Three-month periods ended September 30,			Nine-month periods ended September 30,		
	2018	2017	% Change	**2018**	2017	% Change
Research & development expense	**837**	287	n.m.	**2,506**	1,658	51

n.m. – not meaningful

Research and development ("R&D") expenditures during the three and nine-month periods ended September 30, 2018 were $0.8 million (2017 - $0.3 million) and $2.5 million (2017 - $1.7 million), respectively. The greater R&D expenses in the 2018-periods are primarily due to increased personnel costs in the R&D department. In the third quarter, PHX Energy continued to focus R&D efforts on developing new technology, improving reliability of equipment and decreasing costs in order to enhance and expand PHX Energy's services.

(Stated in thousands of dollars)

	Three-month periods ended September 30,			Nine-month periods ended September 30,		
	2018	2017	% Change	**2018**	2017	% Change
Finance expense	**264**	482	(45)	**929**	1,495	(38)

Finance expenses relate to interest charges on the Corporation's long-term and short-term bank facilities. For the three and nine-month periods ended September 30, 2018, finance charges declined to $0.3 million (2017 - $0.5 million) and $0.9 million (2017 - $1.5 million), respectively. The reductions in finance charges in both 2018-periods were primarily attributed to lower levels of borrowings and lower borrowing rates compared to the prior year periods.

(Stated in thousands of dollars)

	Three-month periods ended September 30,		Nine-month periods ended September 30,	
	2018	2017	**2018**	2017
Net gain on disposition of drilling equipment	**(2,358)**	(3,548)	**(6,209)**	(3,789)
Foreign exchange losses (gains)	**(86)**	119	**(304)**	374
Provision for (Recovery of) bad debts	**(8)**	123	**(15)**	375
Other expense (income)	**(2,452)**	(3,306)	**(6,528)**	(3,040)

During the three and nine-month periods ended September 30, 2018, other income of $2.5 million and $6.5 million, respectively, was realized compared to $3.3 million and $3.0 million in the equivalent 2017-periods. Other income is mainly comprised of gains on the disposition of drilling equipment that typically result from insurance programs undertaken whereby proceeds for the lost equipment are at current replacement values, which are higher than the respective equipment's book value. The recognized gain is net of losses which typically result from any asset retirements that were made before the end of the equipment's useful life and self-insured downhole equipment losses. In the nine-month period ended September 30, 2018 more downhole equipment losses occurred compared to in the 2017-period; in contrast, fewer downhole equipment losses were noted in the third quarter of 2018 compared to the same quarter of 2017.

(Stated in thousands of dollars, except percentages)

	Three-month periods ended September 30,		Nine-month periods ended September 30,	
	2018	2017	**2018**	2017
Provision for (Recovery of) income taxes	**180**	1,025	**(77)**	(1,691)
Effective tax rates	**5%**	n.m.	**11%**	8%

n.m. – not meaningful

The provision for income taxes for the 2018-quarter was $0.2 million (2017 - $1.0 million), and the recovery of income taxes for the nine-month period ended September 30, 2018 was $0.1 million (2017 - $1.7 million). The expected combined Canadian federal and provincial tax rate for 2018 is 27 percent. The effective tax rate for the three-month period ended September 30, 2018 was lower than the expected rate due to the effect of tax rates in foreign jurisdictions and non-taxable capital gain. The effective tax rate for the nine-month period ended September 30, 2018 was lower than the expected rate mainly as a result of the effect of non-deductible expenses such as equity-settled share-based payments.

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,		
	2018	2017	% Change	**2018**	2017	% Change
Revenue	**25,646**	21,731	18	**66,307**	64,623	3
Reportable segment income (loss) before tax	**1,831**	(1,363)	n.m.	**(1,469)**	(5,842)	n.m.

n.m. – not meaningful

For the three month-period ended September 30, 2018, PHX Energy's Canadian segment's revenue was $25.6 million which was an 18 percent improvement from the $21.7 million in the same 2017-quarter. The Canadian segment benefited from slightly improved volumes in the 2018-quarter, as operating days in the third quarter rose by 5 percent to 2,923 from 2,795 in the 2017-quarter. In addition as a result of the client mix in the quarter, the average day rates rose by 13 percent to $8,408 from $7,424 in the 2017-quarter. Due to improved day rates, PHX Energy's Canadian operations recognized a reportable segment income before tax of $1.8 million compared to a loss of $1.4 million in the same 2017-quarter.

In the Canadian industry weather conditions in the latter half of the quarter hampered activity growth and the industry's horizontal and directional drilling activity as measured by drilling days only grew by 3 percent from 17,983 days in the 2017-quarter to 18,439 days in the 2018-quarter (Source: Daily Oil Bulletin).

During the third quarter of 2018, oil drilling, as measured by drilling days, represented approximately 81 percent of PHX Energy's Canadian activity and the Corporation remained active in the Montney, Bakken, Shaunavon, Duvernay, Cardium, Provost and Viking areas.

For the nine-month period ended September 30, 2018, the Canadian segment's revenue was relatively flat, with a 3 percent increase to $66.3 million compared to $64.6 million in the corresponding 2017-period. In the 2018-period, average day rates in the Canadian segment increased to $8,227 as compared to $7,250 in the same 2017-period, a positive movement of 13 percent (excluding Stream revenue of $3.0 million in both the 2018 and 2017-period). However, higher day rates were partially offset by lower volumes in the 2018-period as operating days were down 9 percent, with 7,694 operating days recorded versus 8,498 days in the 2017-period. The Canadian industry activity was relatively flat in comparison, with 50,174 horizontal and directional drilling days reported in the nine-month period of 2018 as compared to 50,707 horizontal and directional drilling days in 2017 (Sources: Daily Oil Bulletin). For the nine-month period ended September 30, 2018, reportable segment loss before tax was $1.5 million compared to $5.8 million in the 2017-period.

Stream Services

Included in the Canadian segment's revenue for the three and nine-month periods ended September 30, 2018 is $1.1 million (2017- $1.0 million) and $3.0 million (2017 - $3.0 million), respectively, of revenue generated by the Stream division. For the three and nine-month periods ended September 30, 2018, Stream's operating days were 1,613 days and 4,354 days, respectively, as compared to 1,338 days and 3,930 days in the respective 2017-periods. However, the increase in activity was offset by a decrease in the average day rate for the three and nine-month periods ended September 30, 2018 to $662 and $690, respectively, down from $737 and $768 in the same 2017-periods. The decrease in the average day rate period-over-period was due to a higher share of lower rate services being provided in the 2018-periods.

For the three and nine-month periods ended September 30, 2018, the Stream division incurred reportable losses before tax of $1.0 million (2017 - $1.1 million) and $3.2 million (2017 - $2.9 million). Stream's losses for the three and nine-month periods ended September 30, 2018 relate primarily to depreciation expenses of $0.6 million and $1.7 million, respectively.

United States

(Stated in thousands of dollars)

	Three-month periods ended September 30,			Nine-month periods ended September 30,		
	2018	2017	% Change	**2018**	2017	% Change
Revenue	**54,129**	39,339	38	**143,842**	101,360	42
Reportable segment income (loss) before tax	**3,219**	712	n.m.	**2,937**	(9,469)	n.m

n.m. – not meaningful

The US segment continued its strong performance for the 2018-year and achieved the second highest third quarter and nine-month to date revenue in the Corporation's history, with the first highest being achieved in the relative periods ended September 30, 2014. For the three-month period ended September 30, 2018 revenue grew to $54.1 million as compared to $39.3 million in the same respective 2017-quarter. Revenue gains in the quarter are mainly attributed to increased activity and day rates. PHX Energy's US segment operating days rose to 3,506 days, an increase of 18 percent as compared to 2,969 days in the corresponding 2017-quarter and the average day rate, excluding the Corporation's US motor rental division, increased by 15 percent to $15,083 in the 2018-quarter (2017 - $13,123). In comparison, the average number of horizontal and directional rigs running per day in the US increased by 13 percent quarter-over-quarter, growing from an average of 876 active rigs per day in 2017 to an average of 988 active rigs per day (Source: Baker Hughes). The average day rate, excluding the Corporation's US motor rental division, increased by 4 percent as a result of the US dollar strengthening in the 2018-quarter over the 2017-quarter. The US denominated average day rate increased by 10 percent quarter-over-quarter.

Horizontal and directional rigs represented 94 percent of the average number of US rigs running per day (2017 – 93 percent) and the Permian basin continued to dominate the US industry, representing 46 percent of the average operating rigs per day in the 2018-quarter (Source: Baker Hughes). During the three-month period ended September 30, 2018, PHX Energy was focused on the Permian basin, which represented approximately 60 percent of the wells drilled by the Corporation. As a result of the strengthening oil prices and this focus on the Permian basin, oil well drilling represented 98 percent of PHX Energy's US activity. In addition to the Permian basin, Phoenix USA continued to be active in the Eagle Ford, Granite Wash, SCOOP/STACK, Marcellus, Bakken and Niobrara basins.

For the nine-month period ended September 30, 2018, US revenue grew to $143.8 million from $101.4 million in the comparable 2017-period, an increase of 42 percent. During the 2018 nine-month period, the US segment saw continued improvements in drilling activity, in addition, PHX Energy's day rates also improved relative to the same period in 2017. Operating days rose by 32 percent to 9,741 days from 7,362 days in the same 2017-period. In comparison, US industry activity, as measured by the average number of horizontal and directional rigs running on a daily basis, rose by 21 percent period-over-period averaging 958 rigs in the 2018 nine-month period as compared to an average of 789 rigs in the comparable 2017-period. The average day rate, excluding the Corporation's US motor rental division, improved to $14,520 in the 2018-period from $13,504 in the same 2017-period, an increase of 8 percent.

For the three and nine-month periods ended September 30, 2018, the reportable segment income before tax was $3.2 million and $2.9 million, respectively, compared to $0.7 million and a reportable segment loss of $9.5 million in the equivalent 2017-periods. The improved margins in both 2018-periods are mainly attributable to the rise in activity levels and day rates.

International

(Stated in thousands of dollars)

	Three-month periods ended September 30,			Nine-month periods ended September 30,		
	2018	2017	% Change	**2018**	2017	% Change
Revenue	**5,258**	4,326	22	**14,651**	14,357	2
Reportable segment income (loss) before tax	**1,221**	(69)	n.m.	**831**	(784)	n.m.

n.m. – not meaningful

For the three-month period ended September 30, 2018, PHX Energy's international segment revenue increased by 22 percent to $5.3 million compared to $4.3 million in the 2017-quarter. Higher international revenue was primarily driven by increased volumes in Albania and more measurement while drilling ("MWD") rental revenue in Russia. In the 2018-quarter international operating days were 579 days, 3 percent higher than the 560 days in the 2017-quarter. Revenue for the nine-month period ended September 30, 2018 was flat, although full service revenue in Russia declined, this was offset by increases in Albanian activity and higher MWD rental revenue in Russia. For the nine-month period ended September 30, 2018, operating days declined by 6 percent to 1,785 operating days, in comparison to 1,897 days in the corresponding 2017-period. For the three and nine-month periods ended September 30, 2018, the international segment's revenue was 6 percent and 7 percent, respectively, of total consolidated revenue.

In in the 2018 quarter PHX Energy's Russian operating days were 406 days, a decrease of 24 percent from 534 days in the 2017-quarter . Key operators in the region experienced lower activity, but this was partially offset by increases to higher margin MWD rental services, which the division continues to grow.

PHX Energy's Albanian drilling activity significantly increased in the 2018-quarter and 173 operating days were generated as compared to 26 operating days in the 2017-quarter. In 2017, one rig was active throughout the first half of 2017, however operations were suspended in the third quarter of 2017 and remained idle exiting 2017. In 2018, Albania operations were re-commenced in the latter half of the first quarter with one rig, and a second rig was added to the operation in the latter half of the second quarter. Activity in Albania is expected to increase with the addition of a third rig in November 2018.

The international segment achieved reportable segment income for the three and nine-month periods ended September 30, 2018 of $1.2 million and $0.8 million, respectively, compared to reportable segment losses of $0.1 million and $0.8 million in the same 2017-periods. The improved margins in both 2018-periods were mainly due to increased drilling activity in Albania and greater MWD rental services in PHX Energy's Russian operations, which generates higher margins over the full service business.

Summary of Quarterly Results

(Stated in thousands of dollars except per share amounts)

	Sept-18	Jun-18	Mar-18	Dec-17	Sept-17	Jun-17	Mar-17	Dec-16
Revenue	**85,033**	**69,009**	70,759	60,660	65,396	53,822	61,122	46,629
Net earnings (loss)	**3,743**	**(84)**	(4,251)	(5,126)	(846)	(10,412)	(7,143)	(15,074)
Earnings (Loss) per share – basic	**0.06**	**-**	(0.07)	(0.09)	(0.01)	(0.18)	(0.13)	(0.30)
Earnings (Loss) per share – diluted	**0.06**	**-**	(0.07)	(0.09)	(0.01)	(0.18)	(0.13)	(0.30)
Adjusted EBITDA	**13,934**	**10,013**	6,768	4,684	11,689	(13)	3,743	(3,299)
Funds from operations	**11,461**	**7,158**	5,757	2,490	8,436	113	3,983	2,060

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

Liquidity

(Stated in thousands of dollars)

	Three-month periods ended September 30,		Nine-month periods ended September 30,	
	2018	2017	**2018**	2017
Funds from operations	**11,461**	8,436	**24,376**	12,533

	Sept. 30, '18	Dec. 31, '17
Working capital	**55,089**	49,787

For the three and nine-month periods ended September 30, 2018, the Corporation generated funds from operations of $11.5 million (2017 - $8.4 million) and $24.4 million (2017 - $12.5 million), respectively. The increase in funds from operations in both 2018-periods primarily resulted from higher activity levels and improved profitability in 2018 over the comparable 2017-periods.

As at September 30, 2018, the Corporation had working capital of $55.1 million, which is $5.3 million higher than the $49.8 million reported at December 31, 2017. The change is primarily due to the increase in trade and other receivables as a result of revenue growth in the 2018-period.

Investing Activities

For the three-month period ended September 30, 2018, PHX Energy used $2.4 million of net cash in investing activities as compared to $3.8 million in 2017-quarter. During the 2018-quarter, PHX Energy received proceeds of $3.2 million (2017 - $4.9 million) related primarily to the involuntary disposal of drilling equipment in well bores.

In the third quarter of 2018, the Corporation spent $8.1 million on capital expenditures (2017 - $8.9 million), comprised of:

- $4.5 million in downhole performance drilling motors,
- $3.2 million in MWD systems and spare components, and
- $0.4 million in machining and equipment, and other assets.

The capital expenditure program undertaken in the period was financed generally from cash flow from operating activities.

The change in non-cash working capital balance of $2.5 million (source of cash) for the three-month period ended September 30, 2018, relates to the net change in the Corporation's trade payables that are associated with the acquisition of capital assets. This compares to a $1.0 million source of cash for the three-month period ended September 30, 2017.

Financing Activities

The Corporation reported cash flows used in financing activities of $6.2 million in the three-month period ended September 30, 2018 as compared to $14.8 million (source of cash) in the 2017-quarter. The Corporation made aggregate net repayments of $5.5 million on its operating and syndicated facilities during the third quarter of 2018.

Capital Resources

As of September 30, 2018, the Corporation had $5.0 million drawn on its syndicated facility, $4.7 million drawn on its operating facility, nil drawn on its US operating facility, and cash and cash equivalents of $5.7 million. As at September 30, 2018, the Corporation had approximately CAD $53.3 million and USD $5.0 million available to be drawn from its credit facilities. The credit facilities are secured by substantially all of the Corporation's assets.

As at September 30, 2018, the Corporation was in compliance with all its financial covenants.

Cash Requirements for Capital Expenditures

Historically, the Corporation has financed its capital expenditures and acquisitions through cash flows from operating activities, debt and equity. On May 30, 2018, the Corporation announced an increase to its 2018 capital expenditure program from $10.5 million to $18.5 million. Subsequently on July 4, 2018, the Corporation announced an additional increase to the 2018 capital expenditure program from $18.5 million to $33.5 million. The increase to the 2018 program is expected to be principally directed to the expansion of Atlas High Performance motors for 2019 activity. These planned expenditures are expected to be financed from a combination of one or more of the following: cash flow from operations, the Corporation's unused credit facilities or equity, if necessary. However, if a sustained period of market uncertainty and financial market volatility persists in 2018, the Corporation's activity levels, cash flows and access to credit may be negatively impacted, and the expenditure level would be reduced accordingly. Conversely, if future growth opportunities present themselves, the Corporation would look at expanding this planned capital expenditure amount.

Contractual Obligations

The following table reflects the Corporation's anticipated payment of contractual obligations related to continuing operations as at September 30, 2018.

(Stated in thousands of dollars)

	2018	2019	2020	2021	2022
Trade and other payables	56,373	-	-	-	-
Operating leases	7,020	6,529	6,092	5,678	4,285
Drilling and other equipment	7,211	6,171	-	-	-
Loans and borrowings	-	-	5,000	-	-
Total	70,604	12,700	11,092	5,678	4,285

Off-Balance Sheet Arrangements

The Corporation had no off-balance sheet arrangements as at September 30, 2018 and 2017, other than operating leases.

Proposed Transactions

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

Critical Accounting Estimates

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

Changes in Accounting Policies

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

a) New Standards

i. IFRS 9 Financial Instruments

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

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

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

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

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

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

When determining whether the credit risk of a financial asset has increased significantly since initial recognition and when estimating ECLs, the Corporation considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes both quantitative and qualitative information and analysis based on the Corporation's historical experience, informed credit assessment, and forward-looking information.

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

ii. IFRS 15 Revenue from Contracts with Clients

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

Under IFRS 15, revenue is recognized when a client obtains control of the goods or services. Determining the timing of the transfer of control – at a point in time or over time – requires judgement. Revenue is measured based on the consideration specified in the contract with a client and excludes amounts collected on behalf of third parties. The Corporation recognizes revenue when it transfers control over a product or service to a client. The Corporation's services are sold based upon bid acceptance or contracts with clients that includes fixed or determinable prices based upon daily, hourly, or job rates.

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

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

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

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

b) Interpretations Not Yet Adopted

i. IFRS 16 Leases

In January 2016, the International Accounting Standards Board issued the final version of IFRS 16, Leases. IFRS 16 will replace the existing leases Standard, IAS 17 Leases, and related Interpretations. The Standard sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract (i.e., the lessee and the lessor). IFRS 16 introduces a single lessee accounting model and requires a lessee to recognize

assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. Currently, operating lease expenses are charged to the statement of comprehensive income. The Standard also contains enhanced disclosure requirements for lessees. IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17.

The effective date for adoption of IFRS 16 is annual periods beginning on or after January 1, 2019, though early adoption is permitted for companies applying IFRS 15 Revenue from Contracts with Clients. The Corporation intends to adopt IFRS 16 for the annual period beginning on January 1, 2019. The transition to IFRS 16 consists of three key phases: scoping all identified leases, analyzing impact of transition, and implementing changes to policies and internal controls. In addition, the impact of IFRS 16 relating to key performance measures, debt covenants, and budget process is being further investigated. As at September 30, 2018, the Corporation has completed its scoping exercise and will continue to assess the impact of the transition and implementation of the policy changes relating to IFRS 16 throughout the remainder of 2018.

Business Risk Factors

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

Corporate Governance

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

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, 2018 and ending on September 30, 2018 that has materially affected, or is reasonably likely to materially affect, the Corporation's internal controls over financial reporting. No material changes in the Corporation's internal controls over financial reporting were identified during such period that has materially affected, or are reasonably likely to materially affect, the Corporation's internal controls over financial reporting.

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

Outstanding Corporation Share Data

(In thousands of shares)	**As at October 31, 2018**
Common shares outstanding	58,029,420
Dilutive securities:	
Options	5,291,101
Corporation shares – diluted	63,320,521

Outlook

In the third quarter, PHX Energy continued the positive momentum from the prior two quarters by generating strong operating results. The Corporation achieved the highest quarterly adjusted EBITDA since the fourth quarter of 2014 and the highest net earnings since the third quarter of 2014. Revenue and activity growth was led by the US operations and all operating regions saw increased operating margins.

As anticipated, in the third quarter the US division maintained the robust levels of activity and revenue that were achieved in the second quarter of the year as a result of the strong rig counts and the growing reputation of Phoenix USA. The US drilling market remains the largest area of activity in PHX Energy's operating regions, and over the past few years PHX Energy has built upon its established operations and marketing expertise in this region with the addition of various high performance technologies that offer competitive advantages that operators are actively seeking. Both the Velocity Real-Time System and the Atlas High Performance motors are recognized throughout the market as industry leading technologies. However, as in the prior quarter, PHX Energy continues to work through the constraints impacting the Corporation's fleet of equipment, inventory of repair components and manufacturing of new equipment. These constraints are tempering the rate at which Phoenix USA is expanding its market share and PHX Energy has worked diligently to alleviate these restraints both through its 2018 capital expenditure program and by working with suppliers to accelerate delivery of components. The Corporation anticipates these efforts will begin to have an impact in the first quarter of 2019, and as a result PHX Energy will see further gains in its US activity levels in the new year. The Permian basin continues to dominate the US industry's activity, despite the anticipation that the rig count gains may slow due to commodity take away concerns in the area. PHX Energy remains focused on this region and has a well-established infrastructure to support further growth in the Permian basin.

In Canada, both the industry and PHX Energy's activity levels remained relatively flat as compared to the third quarter of 2017, due to the political constraints and uncertainty around the energy sector in the country as well as unfavorable weather conditions. Amidst the industry challenges, PHX Energy has remained focused on its strengths in this market and still holds a prominent place, being one of the most active directional providers in the industry. The Corporation's high performance technologies also provide advantages to Canadian drilling applications and a proportional percentage of the Velocity Real-Time System and Atlas High Performance motor fleets are deployed in Canada. Looking to the fourth quarter of the year, PHX Energy believes activity levels and day rates will remain consistent with those achieved in the third quarter, and anticipates an uptick in activity in the 2019 winter drilling season which is typically more active for the Canadian industry.

PHX Energy's international operations saw an increase in revenue in the third quarter of 2018 over the comparable 2017-quarter. In Russia, the Corporation continued to focus on the MWD rental business and in Albania the Corporation was active on two rigs in the quarter. In upcoming quarters, the Corporation anticipates a slight decline in Russia's full service activity

levels as it continues to place emphasis on the higher margin MWD rental market. In Albania, PHX Energy expects activity to increase to three rigs in the fourth quarter.

Technology Update

In the third quarter, the Corporation continued its efforts to increase the capacity of its high performance drilling technology fleets, mainly Velocity Real-Time Systems and Atlas High Performance motors, and PHX Energy remains optimistic about the opportunities that will materialize in the first half of 2019 when new capacity is deployed. The Corporation's efforts to expand its services to offer market access to Atlas High Performance motors beyond its full service operations has started to contribute to the profitability and this new division will be an area of focus in the future. Additionally, PHX Energy is focused on expanding its fleet of disruptive technologies and is developing and acquiring new high margin products.

As part of PHX Energy's strategic objective to be a provider of disruptive technologies, the Corporation has become vertically integrated in its technology development and manufacturing process. PHX Energy controls all aspects of the product life cycle including engineering, procurement, manufacturing, operations, quality control and continuous improvement. This has allowed PHX Energy to commercialize and deploy these technologies with lower costs, greater reliability and a quicker path to market.

The Corporation remains focused on its strategic objectives that have generated the improved profitability in 2018 and strengthened its financial position, including relatively low long-term debt levels. Looking forward to 2019, PHX Energy anticipates this positive momentum will continue. PHX Energy foresees the improvement to profitability will be maintained as a result of its diligent focus on internal efficiencies and the higher margins generated by its growing high performance fleet of technologies.

Michael Buker
President
October 31, 2018

Non-GAAP Measures

1) Adjusted EBITDA

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

The following is a reconciliation of net earnings to adjusted EBITDA:

(Stated in thousands of dollars)

	Three-month periods ended September 30,		Nine-month periods ended September 30,	
	2018	2017	**2018**	2017
Net income (loss)	**4,464**	(846)	**130**	(18,401)
Add (deduct):				
Depreciation and amortization	**9,505**	9,988	**29,613**	31,433
Provision for (Recovery of) income taxes	**(541)**	1,025	**(798)**	(1,691)
Finance expense	**264**	482	**929**	1,495
Equity-settled share-based payments	**342**	701	**1,201**	2,219
Unrealized foreign exchange (gain) loss	**(100)**	340	**(360)**	364
Adjusted EBITDA as reported	**13,934**	11,690	**30,715**	15,419

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

2) Funds from Operations

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

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

(Stated in thousands of dollars)

	Three-month periods ended September 30,		Nine-month periods ended September 30,	
	2018	2017	**2018**	2017
Cash flows from operating activities	**6,027**	(13,684)	**15,871**	(9,910)
Add (deduct):				
Changes in non-cash working capital	**4,808**	25,968	**7,935**	25,466
Interest paid	**94**	244	**442**	740
Income taxes paid (received)	**532**	(4,092)	**128**	(3,763)
Funds from operations	**11,461**	8,436	**24,376**	12,533

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

3) Debt to Covenant EBITDA Ratio

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

4) Working Capital

Working capital is defined as the Corporation's current assets less its current liabilities and is used to assess the Corporation's short-term liquidity.

Definitions

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

Condensed Consolidated Statements of Financial Position

(unaudited)

	September 30, 2018	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	**$ 5,724,935**	$ 4,122,539
Trade and other receivables	**84,345,541**	66,635,311
Inventories	**25,926,296**	22,009,483
Prepaid expenses	**2,510,805**	2,915,878
Current tax assets	**-**	1,353,622
Total current assets	**118,507,577**	97,036,833
Non-current assets:		
Drilling and other equipment (Note 6)	**83,194,619**	98,569,594
Goodwill	**8,876,351**	8,876,351
Intangible assets (Note 7)	**24,543,713**	26,925,046
Deferred tax assets	**18,418,152**	14,828,714
Total non-current assets	**135,032,835**	149,199,705
Total assets	**$ 253,540,412**	$ 246,236,538
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Operating facility (Note 8)	**$ 4,747,954**	$ 5,620,464
Trade and other payables	**56,372,968**	41,629,783
Current tax liabilities	**2,297,611**	-
Total current liabilities	**63,418,533**	47,250,247
Non-current liabilities:		
Loans and borrowings (Note 8)	**5,000,000**	14,000,000
Provision for onerous contracts	**1,845,000**	2,015,000
Deferred income	**1,333,340**	1,433,339
Total non-current liabilities	**8,178,340**	17,448,339
Equity:		
Share capital (Note 9a)	**265,932,957**	266,838,036
Contributed surplus	**10,463,819**	9,315,926
Retained earnings	**(107,029,570)**	(106,438,399)
Accumulated other comprehensive income	**12,576,333**	11,822,389
Total equity	**181,943,539**	181,537,952
Total liabilities and equity	**$ 253,540,412**	$ 246,236,538

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,	
	2018	2017	**2018**	2017
Revenue	**$ 85,032,830**	$ 65,396,316	**$ 224,800,407**	$ 180,340,476
Direct costs	**69,477,782**	59,995,834	**197,795,786**	177,576,571
Gross profit	**15,555,048**	5,400,482	**27,004,621**	2,763,905
Expenses:				
Selling, general and administrative expenses	**12,983,042**	7,758,571	**30,765,451**	22,743,776
Research and development expenses	**836,752**	286,809	**2,506,363**	1,657,872
Finance expense	**264,046**	482,056	**929,017**	1,494,825
Other income (Note 10)	**(2,452,247)**	(3,305,599)	**(6,528,264)**	(3,040,009)
	11,631,593	5,221,837	**27,672,567**	22,856,464
Earnings (loss) before income taxes	**3,923,455**	178,645	**(667,946)**	(20,092,559)
Provision for (Recovery of) income taxes				
Current	**1,388,630**	(67,491)	**3,315,087**	230,911
Deferred	**(1,208,674)**	1,092,217	**(3,391,862)**	(1,921,982)
	179,956	1,024,726	**(76,775)**	(1,691,071)
Net income (loss)	**3,743,499**	(846,081)	**(591,171)**	(18,401,488)
Other comprehensive income (loss)				
Foreign currency translation	**(2,541,426)**	(3,340,547)	**753,944**	(5,672,877)
Total comprehensive income (loss) for the period	**$ 1,202,073**	$ (4,186,628)	**$ 162,773**	$ (24,074,365)
Earnings (Loss) per share – basic	**$ 0.06**	$ (0.01)	**$ (0.01)**	$ (0.32)
Earnings (Loss) per share – diluted	**$ 0.06**	$ (0.01)	**$ (0.01)**	$ (0.32)

See accompanying notes to unaudited condensed consolidated interim financial statements.

Condensed Consolidated Statements of Changes in Equity

(unaudited)

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 Income	**-**	**-**	**-**	**-**	**(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**

Nine-month period ended September 30, 2017	Share Capital Number	Share Capital Amount ($)	Contributed Surplus	Accumulated Other Comprehensive Income	Retained Earnings	Total Equity
Balance, December 31, 2016	50,810,721	$ 237,539,242	$ 6,817,458	$ 16,941,171	$ (82,910,425)	$ 178,387,446
Net issuance of share capital	7,763,566	29,590,358	-	-	-	29,590,358
Share-based payments	-	-	2,218,672	-	-	2,218,672
Fair value of options exercised	-	101,547	(101,547)	-	-	-
Net loss	-	-	-	-	(18,401,488)	(18,401,488)
Foreign currency translation	-	-	-	(5,672,877)	-	(5,672,877)
Balance, September 30, 2017	58,574,287	$ 267,231,147	8,934,583	11,268,294	(101,311,913)	186,122,111

See accompanying notes to unaudited condensed consolidated interim financial statements.

Condensed Consolidated Statements of Cash Flows

(unaudited)

	Three-month periods ended September 30,		Nine-month periods ended September 30,	
	2018	2017	**2018**	2017
Cash flows from operating activities:				
Net income (loss)	**$ 3,743,499**	$ (846,081)	**$ (591,171)**	$ (18,401,488)
Adjustments for:				
Depreciation and amortization	**9,505,407**	9,988,025	**29,612,677**	31,433,424
Provision for (Recovery of) income taxes	**179,956**	1,024,726	**(76,775)**	(1,691,071)
Unrealized foreign exchange loss (gain)	**(101,286)**	339,407	**(359,717)**	363,840
Gain on disposition of drilling equipment	**(2,358,209)**	(3,547,501)	**(6,209,463)**	(3,788,667)
Equity-settled share-based payments	**341,860**	700,803	**1,200,656**	2,218,672
Finance expense	**264,046**	482,056	**929,017**	1,494,825
Provision for (Recovery of) bad debts	**(7,553)**	123,360	**(15,441)**	375,260
Provision for inventory obsolescence	**49,049**	300,000	**256,157**	900,000
Provision for onerous contracts	**(122,000)**	(95,000)	**(270,000)**	(272,000)
Amortization of deferred income	**(33,333)**	(33,333)	**(99,999)**	(99,999)
Interest paid	**(93,951)**	(244,272)	**(441,842)**	(739,588)
Income taxes received (paid)	**(532,119)**	4,092,277	**(127,996)**	3,763,191
Change in non-cash working capital	**(4,808,355)**	(25,968,400)	**(7,934,636)**	(25,466,029)
Net cash from (used in) operating activities	**6,027,011**	(13,683,933)	**15,871,467**	(9,909,630)
Cash flows from investing activities:				
Proceeds on disposition of drilling equipment	**3,197,615**	4,929,341	**11,165,720**	7,960,388
Acquisition of drilling and other equipment	**(8,066,652)**	(8,900,250)	**(15,831,277)**	(17,396,837)
Acquisition of intangible assets	**(26,135)**	(861,306)	**(32,733)**	(1,492,583)
Change in non-cash working capital	**2,459,181**	1,036,639	**1,259,571**	363,187
Net cash used in investing activities	**(2,435,991)**	(3,795,576)	**(3,438,719)**	(10,565,845)
Cash flows from financing activities:				
Proceeds from (Repayment of) loans and borrowings	**(4,000,000)**	10,872,000	**(9,000,000)**	(13,142,050)
Proceeds from (Repayment of) operating facility	**(1,500,675)**	3,988,889	**(872,510)**	(884,757)
Repurchase of shares under the NCIB	**(797,258)**	(33,350)	**(1,034,758)**	(33,350)
Proceeds from issuance of share capital	**76,916**	-	**76,916**	29,154,582
Net cash from (used in) financing activities	**(6,221,017)**	14,827,539	**(10,830,352)**	15,094,425
Net increase (decrease) in cash and cash equivalents	**(2,629,997)**	(2,651,970)	**1,602,396**	(5,381,050)
Cash and cash equivalents, beginning of period	**8,354,932**	4,278,213	**4,122,539**	7,007,293
Cash and cash equivalents, end of period	**$ 5,724,935**	$ 1,626,243	**$ 5,724,935**	$ 1,626,243

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, 2018 and 2017

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, 2017.

These condensed consolidated interim financial statements were authorized by the Board of Directors on October 31, 2018.

b) Basis of Measurement

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

c) Functional and Presentation Currency

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

d) Use of Estimates and Judgments

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

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

3. Significant Accounting Policies

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

a) New Standards

i. IFRS 9 Financial Instruments

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

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

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

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

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

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

When determining whether the credit risk of a financial asset has increased significantly since initial recognition and when estimating ECLs, the Corporation considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes both quantitative and qualitative information and analysis based on the Corporation's historical experience, informed credit assessment, and forward-looking information.

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

ii. IFRS 15 Revenue from Contracts with Clients

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

Under IFRS 15, revenue is recognized when a client obtains control of the goods or services. Determining the timing of the transfer of control – at a point in time or over time – requires judgement. Revenue is measured based on the

consideration specified in the contract with a client and excludes amounts collected on behalf of third parties. The Corporation recognizes revenue when it transfers control over a product or service to a client. The Corporation's services are sold based upon bid acceptance or contracts with clients that includes fixed or determinable prices based upon daily, hourly, or job rates.

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

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

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

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

b) Interpretations Not Yet Adopted

i. IFRS 16 Leases

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

The effective date for adoption of IFRS 16 is annual periods beginning on or after January 1, 2019, though early adoption is permitted for companies applying IFRS 15 Revenue from Contracts with Clients. The Corporation intends to adopt IFRS 16 for the annual period beginning on January 1, 2019. The transition to IFRS 16 consists of three key phases: scoping all identified leases, analyzing impact of transition, and implementing changes to policies and internal controls. In addition, the impact of IFRS 16 relating to key performance measures, debt covenants, and budget process is being further investigated. As at September 30, 2018, the Corporation has completed its scoping exercise and will continue to assess the impact of the transition and implementation of the policy changes relating to IFRS 16 throughout the remainder of 2018.

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,	**2018**	2017	**2018**	2017	**2018**	2017	**2018**	2017
Drilling services revenue	**24,578**	20,745	**54,129**	39,339	**5,258**	4,326	**83,965**	64,410
EDR rental revenue	**1,068**	986	**-**	-	**-**	-	**1,068**	986
Total revenue	**25,646**	21,731	**54,129**	39,339	**5,258**	4,326	**85,033**	65,396
Reportable segment profit (loss) before income taxes	**1,831**	(1,363)	**3,219**	712	**1,221**	(69)	**6,271**	(720)

(Stated in thousands of dollars)

	Canada		United States		International		Total	
Nine-month periods ended September 30,	**2018**	2017	**2018**	2017	**2018**	2017	**2018**	2017
Drilling services revenue	**63,301**	61,606	**143,842**	101,360	**14,651**	14,357	**221,794**	177,323
EDR rental revenue	**3,006**	3,017	**-**	-	**-**	-	**3,006**	3,017
Total revenue	**66,307**	64,623	**143,842**	101,360	**14,651**	14,357	**224,800**	180,340
Reportable segment profit (loss) before income taxes	**(1,469)**	(5,842)	**2,937**	(9,469)	**831**	(784)	**2,299**	(16,095)

(Stated in thousands of dollars)

	Canada		United States		International		Total	
As at September 30,	**2018**	2017	**2018**	2017	**2018**	2017	**2018**	2017
Drilling and other equipment	**31,231**	45,908	**44,827**	44,560	**7,137**	10,408	**83,195**	100,876
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,	
	2018	2017	**2018**	2017
Reportable segment loss before income taxes	**6,271**	(720)	**2,299**	(16,095)
Corporate:				
Selling, general and administrative expenses	**3,699**	1,638	**6,060**	3,885
Research and development expenses	**837**	287	**2,506**	1,658
Finance expense	**264**	482	**929**	1,495
Other income	**(2,452)**	(3,306)	**(6,528)**	(3,040)
Income (Loss) before income taxes	**3,923**	179	**(668)**	(20,093)

5. Seasonality of Operations

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

6. Drilling and Other Equipment

a) Acquisitions and Disposals

During the nine-month period ended September 30, 2018, the Corporation acquired assets with a cost of $15.8 million (2017 - $17.4 million).

Assets with a carrying amount of $5.0 million (2017 - $4.2 million) were disposed of as a result of tools lost down hole and scrapped assets, resulting in a net gain on disposition of $6.2 million (2017 - $3.8 million), which is included in other income in the condensed consolidated statement of comprehensive income.

b) Capital Commitments

As at September 30, 2018, the Corporation has commitments to purchase drilling and other equipment for $13.4 million; to be delivered by the end of the first quarter in 2019. On May 30, 2018 the Corporation announced an increase to the Corporation's 2018 capital expenditure program from $10.5 million to $18.5 million. On July 4, 2018 the Corporation announced an increase to the Corporation's 2018 capital expenditure program from $18.5 million to $33.5 million. The increases will primarily be dedicated to further expanding the Corporation's performance drilling motor fleet, mainly Atlas High Performance motors for activity in 2019.

7. Intangible Assets

During the nine-month period ended September 30, 2018, the Corporation acquired intangible assets with a total cost of $32,733 (2017 - $1.5 million).

As at September 30, 2018, the Corporation has contingent liabilities arising from existing license and development agreements and are expected to be paid as follows:

(Stated in thousands of dollars)

	2018	2019
Development costs	-	434
Total	-	434

8. Loans and Borrowings

(Stated in thousands of dollars)

	Currency	Amount of Facility	Date of Maturity	**Currency**	**Carrying Amount at September 30, 2018**	Currency	Carrying Amount at December 31, 2017
Operating Facility	CAD	15,000	Due on demand	CAD	**4,748**	CAD	5,620
Syndicated Facility	CAD	48,000	December 11, 2020	CAD	**5,000**	CAD	14,000
US Operating Facility	USD	5,000	December 11, 2020	USD	**-**	USD	-

Under the syndicated loan agreement, the Corporation is required to maintain certain financial covenants. As at September 30, 2018 the Corporation was in compliance with all its financial covenants as follows:

Ratio	Covenant	**September 30, 2018**
Debt to covenant EBITDA	< 3.0x	**0.28**
Interest coverage ratio	> 3.0x	**24.50**
Net capital expenditures and intangible asset acquisitions, net of proceeds from asset dispositions	< $30.0 million	**$4.7 million**

9. Share Capital

a) Authorized and Issued Shares

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

	Number		Amount
Balance as at January 1, 2017	50,810,721	$	237,539,242
Issued shares pursuant to equity financing and private placement	7,687,500		30,750,000
Transaction costs	-		(1,737,500)
Tax effect of transaction costs	-		469,125
Issued shares pursuant to share option plan	91,666		243,630
Common Shares repurchased	(192,000)		(426,461)
Balance as at December 31, 2017	58,397,887	$	266,838,036
Common Shares repurchased	**(416,800)**		**(1,034,758)**
Issued shares pursuant to share option plan	**48,333**		**129,679**
Balance as at September 30, 2018	**58,029,420**	**$**	**265,932,957**

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

b) Share Option Program (Equity-Settled)

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

Summary of option grants in 2018

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

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

During the three and nine-month periods ended September 30, 2018, the Corporation recognized total compensation expense of $0.3 million and $1.2 million, respectively (2017 - $0.7 million and $2.2 million) for share options granted between 2016 and 2018.

A summary of the status of the plan as at September 30, 2018, is presented below:

	2018		2017	
	Options	**Weighted-Average Exercise Price**	Options	Weighted-Average Exercise Price
Outstanding, beginning of period	**5,499,468**	**$ 4.41**	3,462,803	$ 5.27
Granted	**250,000**	**1.99**	2,590,000	3.41
Exercised	**(48,333)**	**1.59**	(91,666)	1.55
Forfeited / cancelled	**(41,667)**	**3.06**	(273,334)	3.87
Expired	**(368,367)**	**10.78**	(85,001)	9.14
Outstanding, end of period	**5,291,101**	**3.89**	5,602,802	4.48
Options exercisable, end of period	**4,042,758**	**4.20**	3,096,123	5.82

The range of exercise prices for options outstanding at September 30, 2018 are as follows:

Options Outstanding				Options Exercisable	
Original Exercise Price	Number	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number	Weighted-Average Exercise Price
$ 1.55	1,318,334	2.43 yrs	$ 1.55	1,318,334	$ 1.55
1.71	175,000	3.88 yrs	1.71	58,333	1.71
1.79	575,000	3.88 yrs	1.79	191,665	1.79
1.95	210,267	2.91 yrs	1.95	176,933	1.95
2.00	200,000	4.44 yrs	2.00	66,664	2.00
3.41	25,000	3.15 yrs	3.41	16,666	3.41
4.06	1,305,000	3.43 yrs	4.06	869,997	4.06
4.15	415,000	3.43 yrs	4.15	276,666	4.15
6.87 - 15.81	1,067,500	1.24 yrs	8.71	1,067,500	8.71
	5,291,101	2.82 yrs	$ 3.89	4,042,758	$ 4.20

c) Normal Course Issuer Bid

During the third quarter of 2018, the Toronto Stock Exchange ("TSX") approved the renewal of PHX Energy's Normal Course Issuer Bid ("NCIB") to purchase for cancellation, from time-to-time, up to a maximum of 2,915,311 common shares, representing 5 percent of the outstanding common shares at the time the NCIB was renewed. The NCIB commenced on August 8, 2018 and will terminate on August 7, 2019. Purchases of common shares are to be made on the open market through the facilities of the TSX and through alternative trading systems. The price which PHX Energy is to pay for any common shares purchased is to be at the prevailing market price on the TSX or alternate trading systems at the time of such purchase. Pursuant to the NCIB, 291,800 common shares were purchased by the Corporation in the third quarter and cancelled.

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

Thus far in the 2018 year, the Corporation has purchased and cancelled 416,800 shares.

10. Other Income

(Stated in thousands of dollars)

	Three-month periods ended September 30,		Nine-month periods ended September 30,	
	2018	2017	**2018**	2017
Net gain on disposition of drilling equipment	**(2,358)**	(3,548)	**(6,209)**	(3,789)
Foreign exchange losses (gains)	**(86)**	119	**(304)**	374
Provision for (Recovery of) bad debts	**(8)**	123	**(15)**	375
Other expenses (income)	**(2,452)**	(3,306)	**(6,528)**	(3,040)

11. Fair Values of Financial Instruments

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

Corporate Information

Board of Directors

John Hooks

Randolph ("Randy") M. Charron

Myron Tétreault

Judith Athaide

Lawrence Hibbard

Roger Thomas

Terry Freeman

Officers

John Hooks
CEO

Michael Buker
President

Cameron Ritchie
Sr. Vice President Finance and CFO
Corporate Secretary

Craig Brown
Sr. Vice President International Operations and Technology

Daniel Blanchard
Vice President Executive Sales

Jeffery Shafer
Vice President Sales and Marketing

Legal Counsel

Burnet, Duckworth & Palmer LLP
Calgary, Alberta

Auditors

KPMG LLP
Calgary, Alberta

Bankers

HSBC Bank Canada
Calgary, Alberta

Transfer Agent

Computershare Trust Company of Canada
Calgary, Alberta