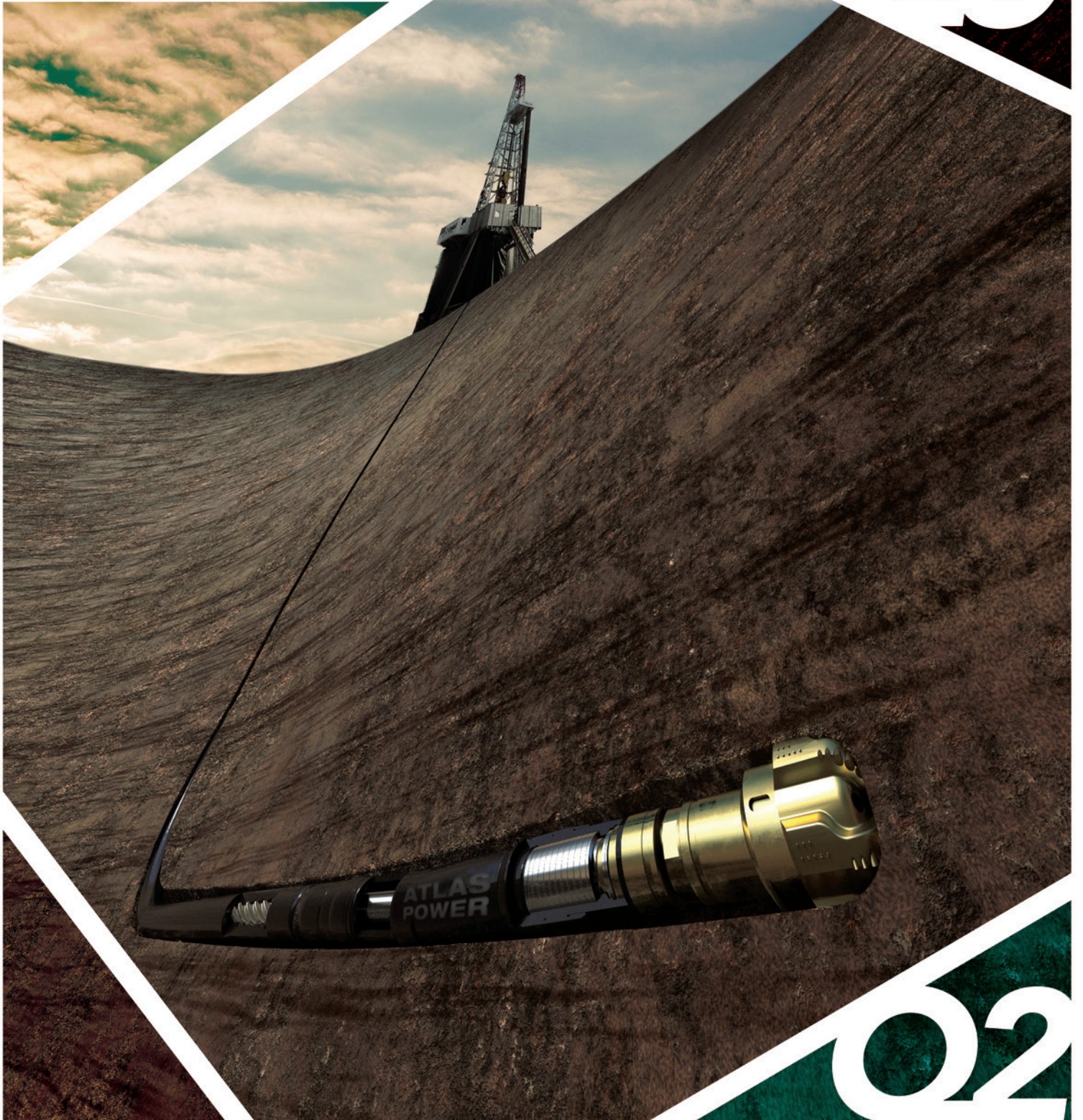




PHX

ENERGY SERVICES CORP.

2020



PHX Energy Services Corp.

Second Quarter Report for the three and six-month periods ended June 30, 2020 and 2019

Financial Results

For the three-month period ended June 30, 2020, PHX Energy realized adjusted EBITDA of \$5.3 million (11 percent of revenue) as compared to \$11 million (13 percent of revenue) in the corresponding 2019-quarter. Adjusted EBITDA in the 2020-quarter includes \$1.1 million in government grants earned as part of the Canada Emergency Wage Subsidy ("CEWS") program. Positive adjusted EBITDA was achieved despite the negative impact of COVID-19 on consolidated revenue and operating activity in all regions. For the three-month period ended June 30, 2020, the Corporation generated consolidated revenue of \$46.8 million, a decline of 44 percent relative to the \$83 million recognized in the second quarter of 2019. There were 2,990 consolidated operating days recorded in the 2020-quarter, which is 46 percent lower than the 5,567 days in the 2019-quarter. In contrast, consolidated revenue per day, excluding the motor rental division in the US, increased by 5 percent to \$14,932, compared to revenue per day of \$14,181 in the 2019-quarter.

For the three-month period ended June 30, 2020, the US division's revenue, which represented 82 percent of consolidated revenue, fell to the lowest quarterly revenue since the fourth quarter of 2018. US revenue in the 2020-quarter was \$38.4 million compared to \$67.1 million in the corresponding 2019-quarter, a decrease of 43 percent. The lower revenue in the quarter was mainly due to the declining rig count in the US. The Corporation's US operating days in the 2020-quarter decreased by 44 percent to 2,172 days as compared to 3,903 days in the same 2019-quarter. The decrease in the Corporation's drilling activity was not as steep as what was experienced in the US industry which declined by 60 percent from 939 average rigs running per day in the second quarter of 2019 to 378 rigs in the 2020-quarter (Source: Baker Hughes). US revenue per day rose slightly by 2 percent to \$16,774 from revenue per day of \$16,409 in the corresponding 2019-quarter.

For the three-month period ended June 30, 2020, the Canadian segment's revenue decreased to \$4.6 million from \$10.7 million in the 2019-quarter. The Corporation's Canadian operating days in the 2020-quarter were 63 percent lower than in the 2019-quarter, whereas the industry experienced a 74 percent decrease in horizontal and directional drilling days. The negative impact of this decline in activity to revenue was partially offset by an increase in revenue per day, which rose by 23 percent to \$10,873 in the second quarter of 2020 compared to \$8,860 in the 2019-quarter.

Throughout the first half of 2020, the Corporation maintained a strong balance sheet position and as at June 30, 2020 had a cash balance of \$14.6 million with no bank loans and borrowings outstanding. As a result of lower earnings, for the three-

month period ended June 30, 2020, the Corporation's free cash flow decreased to \$0.6 million as compared to \$4.8 million realized in the corresponding 2019-quarter (see "Non-GAAP Measures").

Responding to COVID-19

On March 11, 2020, the World Health Organization declared the novel coronavirus or COVID-19 a global pandemic and the Corporation adopted heightened safety protocols as a result of COVID-19. At present, the Corporation's business is considered essential in Canada and the US given the important role that PHX Energy's activities play in delivering oil and natural gas to North American markets. The Corporation anticipates that changes to work practices and other restrictions put in place by governments and health authorities in response to COVID-19 will continue to have an impact on business activities going forward.

COVID-19 has had a significant impact on the global economy and has resulted in a substantial weakening of global oil prices and global oil demand. The Corporation experienced reduced drilling activity in the second quarter of 2020 and the deterioration of the economic and industry conditions has materially impacted the second quarter financial results. For the three-month period ended June 30, 2020, the Corporation recognized a \$0.5 million impairment expense related to international EDR assets, and received \$1.1 million in government grants under the CEWS program. The status of the bad debt provision of \$4 million made in the first quarter of 2020 remains substantially unchanged. There are many variables and uncertainties regarding COVID-19, including the duration and magnitude of the disruption in the oil and natural gas industry. As such, it is not possible to precisely estimate the potential impact of the COVID-19 pandemic on the Corporation's financial condition and operations. Management has been proactive in mitigating these risks by aligning costs with projected revenues and protecting profit margins. The Corporation has restructured its business costs in line with decreasing drilling activity in North America. This includes the unfortunate necessity to decrease the size of its workforce as well as actions to lower labour rates, reduce rental costs, and maximize discounts and efficiencies within the supply chain. The Corporation will also continue to take advantage of various government assistance programs available for businesses in North America.

The Corporation has remained diligent in protecting its balance sheet and retains financial flexibility with significant liquidity on its credit facilities and no bank loans and borrowings outstanding at the end of the 2020-quarter. As at June 30, 2020, the Corporation has working capital of \$56.9 million and has approximately CAD \$65 million and USD \$15 million available to be drawn from its credit facilities. The Corporation has suspended new capital expenditures and as at June 30, 2020 has commitments to purchase drilling and other equipment for \$4.5 million, with delivery expected to occur by the end of the third quarter. The Corporation has also currently suspended all share repurchases under its Normal Course Issuer Bid ("NCIB"). Additional information regarding the risks, uncertainties and impact on the Corporation's business can be found throughout this MD&A, including under the headings "Capital Spending", "Operating Costs and Expenses", "Critical Accounting Estimates" and "Outlook".

Severance Payout

Beginning in March 2020 as a result of the negative impacts of COVID-19 to drilling activity, Management started to reduce the size of its workforce to align the Corporation's cost structure with lower activity levels. In the three and six-month periods ended June 30, 2020, this resulted in severance payouts of \$1.3 million and \$1.9 million, respectively, included in direct costs and selling, general & administrative ("SG&A") costs (2019 – nil).

Capital Spending

For the three-month period ended June 30, 2020, the Corporation spent \$1.4 million in capital expenditures, which is lower when compared to the \$9.1 million spent in the same 2019-quarter. Due to COVID-19's impact on rig counts in North America, the Corporation suspended any new capital expenditures in the second quarter of 2020. Capital expenditures in the 2020-quarter were primarily directed towards Velocity Real Time Systems ("Velocity") and other machine and equipment. For the six-month period ended June 30, 2020, the Corporation spent \$20.4 million in capital expenditures, which were primarily directed towards Atlas Higher Performance ("Atlas") Motors, PowerDrive Orbit Rotary Steerable Systems ("RSS"), and Velocity (2019 - \$20.4 million). Of the total capital expenditures in the 2020-period, \$16.6 million was spent growing the Corporation's fleet of drilling equipment and the remaining \$3.8 million was spent on maintenance of the current fleet of drilling and other equipment.

As at June 30, 2020, the Corporation has capital commitments to purchase drilling and other equipment for \$4.5 million, majority of which is maintenance capital, and which includes \$4 million for Velocity systems, \$0.3 million for performance drilling motors, and \$0.2 million for vehicles and other equipment.

In 2020, the Corporation expects to spend \$27.5 million in capital expenditures as compared to the previously forecasted \$30 million.

Normal Course Issuer Bid

During the third quarter of 2019, the Toronto Stock Exchange ("TSX") approved the renewal of PHX Energy's NCIB to purchase for cancellation, from time-to-time, up to a maximum of 3,280,889 common shares, representing 10 percent of the Corporation's public float of Common Shares as at July 31, 2019. The NCIB commenced on August 9, 2019 and will terminate on August 8, 2020. Purchases of common shares are to be made on the open market through the facilities of the TSX and through alternative trading systems. The price which PHX Energy is to pay for any common shares purchased is to be at the prevailing market price on the TSX or alternate trading systems at the time of such purchase. Pursuant to the current NCIB, subsequent to August 9, 2019, 2,524,500 common shares were purchased by the Corporation and cancelled as at December 31, 2019.

For the six-month period ended June 30, 2020, the Corporation made no common share repurchases (2019 – 1,625,000).

The Corporation intends to make an application to the TSX for renewal of its NCIB for a further one year term. The anticipated renewal of the NCIB remains subject to the review and approval of the TSX.

Financial Highlights

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

	Three-month periods ended June 30,			Six-month periods ended June 30,		
	2020	2019	% Change	2020	2019	% Change
Operating Results	<i>(unaudited)</i>	<i>(unaudited)</i>		<i>(unaudited)</i>	<i>(unaudited)</i>	
Revenue	46,769	82,984	(44)	149,788	175,104	(14)
Net loss	(4,899)	(2,020)	143	(8,220)	(3,087)	166
Loss per share – diluted	(0.09)	(0.04)	125	(0.15)	(0.05)	200
Adjusted EBITDA ⁽¹⁾	5,308	10,995	(52)	23,994	22,426	7
Adjusted EBITDA per share – diluted ⁽¹⁾	0.10	0.19	(47)	0.45	0.38	18
Adjusted EBITDA as a percentage of revenue ⁽¹⁾	11%	13%		16%	13%	
Cash Flow						
Cash flows from operating activities	37,251	21,244	75	48,381	30,944	56
Funds from operations ⁽¹⁾	3,157	9,785	(68)	23,948	19,884	20
Funds from operations per share – diluted ⁽¹⁾	0.06	0.17	(65)	0.45	0.34	32
Capital expenditures	1,438	9,090	(84)	20,430	20,397	-
Free cash flow ⁽¹⁾	573	4,806	(88)	17,338	10,756	61
Financial Position (unaudited)				Jun 30, '20	Dec 31, '19	
Working capital				56,869	68,393	(17)
Net debt ^{(1) (2)}				(14,628)	14,710	n.m.
Shareholders' equity				144,018	148,944	(3)
Common shares outstanding				53,251,420	53,246,420	-

n.m. – not meaningful

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

⁽²⁾ As at June 30, 2020, the Corporation had no bank loans and borrowing outstanding and was in a cash positive position.

Non-GAAP Measures

PHX Energy uses throughout this MD&A certain measures to analyze operational and financial performance that do not have standardized meanings prescribed under Canadian generally accepted accounting principles ("GAAP"). These non-GAAP measures include adjusted EBITDA, adjusted EBITDA per share, debt to covenant EBITDA, funds from operations, funds from operations per share, free cash flow, net debt 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, such measures may not be comparable. Please refer to the "Non-GAAP Measures" section following the Outlook section of this MD&A for applicable definitions and reconciliations.

Management's Discussion and Analysis

The following MD&A of the financial condition, results of operations and cash flow of PHX Energy Services Corp. ("PHX Energy" or the "Corporation") should be read in conjunction with the Corporation's 2019 annual report, including the MD&A, and audited consolidated financial statements and the accompanying notes contained therein as well as other sections contained within the Corporation's 2019 annual report, and the Corporation's 2020 unaudited interim second quarter report, including the unaudited condensed consolidated interim financial statements and the accompanying notes contained therein as well as other sections contained within the Corporation's 2020 second quarter report. 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 August 5, 2020.

PHX Energy's Interim Financial Report for the three-month and six-month periods ended June 30, 2020 and 2019 has been prepared in accordance with International Financial Reporting Standards ("IFRS"). The MD&A and Interim Financial Report was reviewed by PHX Energy's Audit Committee and approved by PHX Energy's Board of Directors ("Board") on August 5, 2020.

Cautionary Statement Regarding Forward-Looking Information and Statements

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

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

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

- The anticipated impact of COVID-19 on the Corporation's operations, results and the Corporation's planned responses thereto;
- The Corporation has commitments to purchase drilling and other equipment for \$4.5 million, with delivery expected to occur by the end of the third quarter;
- In 2020, the Corporation expects to spend \$27.5 million in capital expenditures; and
- The Corporation intends to make an application to the TSX for renewal of its NCIB for a further one year term. The anticipated renewal of the NCIB remains subject to the review and approval of the TSX.

The above are stated under the headings: "Capital Spending", "Normal Corse Issuer Bid", "Responding to COVID-19" and "Cash Requirements for Capital Expenditures". In addition, statements regarding the expected impact of adopting Changes in Accounting Policies and all information contained under the headings "Responding to COVID-19", "Critical Accounting Estimates", "Business Risk Factors" and "Outlook" in 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; the continuing impact of COVID-19 on the global economy, specifically trade, manufacturing, supply chain and energy consumption, among other things and the resulting impact on the Corporation's operations and future results

which remain uncertain; 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 and maintain financing on acceptable terms to fund its ongoing operations and planned expenditures, which are subject to change based on commodity prices; market conditions and future oil and natural gas prices; and potential timing delays. Although Management considers these material factors, expectations, and assumptions to be reasonable based on information currently available to it, no assurance can be given that they will prove to be correct.

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

About PHX Energy Services Corp.

The Corporation, through its directional drilling subsidiary entities, provides horizontal and directional drilling technology and services to oil and natural gas producing companies in Canada, the US, Russia and Albania.

PHX Energy's Canadian directional drilling operations are conducted through Phoenix Technology Services LP. The Corporation maintains its corporate head office, research and development, Canadian sales, service and operational centres in Calgary, Alberta. In addition, PHX Energy has a facility in Estevan, Saskatchewan. PHX Energy's US operations, conducted through the Corporation's wholly-owned subsidiary, Phoenix Technology Services USA Inc. ("Phoenix USA"), is headquartered in Houston, Texas. Phoenix USA has sales and service facilities in Houston, Texas; Denver, Colorado; Casper, Wyoming; Midland, Texas; Bellaire, Ohio; and Oklahoma City, Oklahoma. Internationally, PHX Energy has sales offices and service facilities in Albania and Russia, and administrative offices in Nicosia, Cyprus; Dublin, Ireland; and Luxembourg City, Luxembourg.

In the first quarter of 2020, the Corporation closed substantially all of its operations in its Stream Services ("Stream") division which marketed electronic drilling recorder ("EDR") technology and services.

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

Results of Operations

Three and Six-Month Periods Ended June 30, 2020

Revenue

(Stated in thousands of dollars)

	Three-month periods ended June 30,			Six-month periods ended June 30,		
	2020	2019	% Change	2020	2019	% Change
Revenue	46,769	82,984	(44)	149,788	175,104	(14)

In the second quarter of 2020, PHX Energy recorded the lowest quarterly revenue since the fourth quarter of 2016. For the three-month period ended June 30, 2020, consolidated revenue decreased by 44 percent to \$46.8 million as compared to \$83 million in the second quarter of 2019. Due to COVID-19, drilling activity was significantly lower in the quarter and consolidated operating days decreased 46 percent from 5,567 days in the 2019-quarter to 2,990 days in the 2020-quarter. During the second quarter of 2020, the Western Texas Intermediate (“WTI”) crude oil price was 35 percent lower than in the 2019-quarter averaging USD \$37/bbl (2019-quarter – USD \$57/bbl) and the Western Canadian Select (“WCS”) oil prices decreased 54 percent averaging USD \$21/bbl (2019-quarter – USD \$46/bbl). Both the US and Canadian industry’s activity slowed quarter-over-quarter with the Canadian rig count declining 70 percent and the US rig count declining 60 percent. The US market remained significantly larger than the Canadian market, with an average of 378 active rigs operating per day in the US and an average of 25 active rigs operating per day in Canada. Throughout North America the vast majority of wells continued to be horizontal and directional representing approximately 95 percent of all activity (Source: Daily Oil Bulletin and Baker Hughes). PHX Energy’s average revenue per day, excluding the motor rental division in the US, increased from \$14,181 in the 2019-quarter to \$14,932 in the relative 2020-quarter.

For the six-month period ended June 30, 2020, the Corporation’s consolidated revenue decreased by 14 percent to \$149.8 million compared to \$175.1 million in the 2019-quarter. For the first half of the year, the industry rig counts declined 41 percent in the US and 17 percent in Canada. Consolidated operating days for PHX Energy decreased from 12,592 days in the 2019-period to 10,231 days in the corresponding 2020-period, a decline of 19 percent. For the six-month period ended June 30, 2020, the average consolidated revenue per day, excluding the motor rental division in the US, was \$14,000 as compared to \$13,214 in the 2019-period, an increase of 6 percent.

Operating Costs and Expenses

(Stated in thousands of dollars except percentages)

	Three-month periods ended June 30,			Six-month periods ended June 30,		
	2020	2019	% Change	2020	2019	% Change
Direct costs	44,876	72,261	(38)	128,230	151,051	(15)
Gross profit as a percentage of revenue	4%	13%		14%	14%	
Depreciation & amortization drilling and other equipment (included in direct costs)	7,912	10,118	(22)	15,817	20,284	(22)
Depreciation & amortization right-of-use asset (included in direct costs)	932	878	6	1,862	1,746	7
Gross profit as percentage of revenue excluding depreciation & amortization	23%	26%		26%	26%	

Direct costs are comprised of field and shop expenses, and include depreciation and amortization on the Corporation's equipment and right-of-use assets. For the three and six-month periods ended June 30, 2020, direct costs decreased to \$44.9 million and \$128.2 million, respectively, from \$72.3 million and \$151.1 million in the corresponding 2019-periods. Lower costs in the respective periods was mainly the result of lower drilling activity in the second quarter.

For the three-month period ended June 30, 2020, gross profit as a percent of revenue, excluding depreciation and amortization, decreased to 23 percent from 26 percent in the 2019-quarter. Lower profitability in the period was primarily due to the lower revenues that resulted from the reduced activity in all operating divisions of the Corporation. For the six-month period ended June 30, 2020, gross profit as a percent of revenue, excluding depreciation and amortization, was flat period-over-period at 26 percent.

For the three and six-month periods ended June 30, 2020, the Corporation's depreciation and amortization on drilling and other equipment was \$7.9 million and \$15.8 million, respectively, which is less than the \$10.1 million and \$20.3 million recorded in the corresponding 2019-periods. The decrease in depreciation and amortization of drilling and other equipment in the respective periods is mainly due to a large number of drilling and other equipment being fully depreciated in the fourth quarter of 2019.

(Stated in thousands of dollars except percentages)

	Three-month periods ended June 30,			Six-month periods ended June 30,		
	2020	2019	% Change	2020	2019	% Change
SG&A costs	7,332	11,394	(36)	14,334	24,596	(42)
Cash-settled share-based payments (included in SG&A costs)	1,410	1,095	29	(2,037)	4,030	n.m.
Equity-settled share-based payments (included in SG&A costs)	85	215	(60)	148	399	(63)
SG&A costs excluding equity and cash-settled share-based payments and provision for onerous contracts as a percentage of revenue	12%	12%		11%	12%	

n.m. – not meaningful

For the three and six-month period ended June 30, 2020, SG&A costs were \$7.3 million and \$14.3 million, respectively, as compared to \$11.4 million and \$24.6 million in the corresponding 2019-periods. Reduced SG&A costs in both periods is attributable to lower personnel costs due to the decline in drilling activity. For the six-month period ended June 30, 2020, the recovery in cash-settled share-based payments also reduced SG&A.

Cash-settled share-based payments relate to the Corporation's Retention Award Plan and are measured at fair value. For the three-month period ended June 30, 2020, the Corporation recognized \$1.4 million in cash-settled share-based payments, a 29 percent increase compared to \$1.1 million in the corresponding 2019-quarter. For the six-month period ended June 30, 2020, the Corporation recognized a recovery of \$2 million relating to cash-settled share-based payments compared to an expense of \$4 million in the same 2019-period. Fluctuations in the cash-settled share-based payments in the respective 2020-periods are primarily due to movements in the Corporation's share price in those periods, relative to share price movements in the same 2019-periods.

Equity-settled share-based payments relate to the amortization of the fair values of issued options by the Corporation using the Black-Scholes model. For both the three and six-month periods ended June 30, 2020, equity-settled share-based payments were \$0.1 million, as compared to \$0.2 million and \$0.4 million in the respective 2019-periods. Lower equity-settled share-based payments in both 2020-periods is due to stock option grants from prior years fully vesting in 2019 and 2020-years.

(Stated in thousands of dollars)

	Three-month periods ended June 30,			Six-month periods ended June 30,		
	2020	2019	% Change	2020	2019	% Change
Research & development expense	308	880	(65)	1,580	1,780	(11)

Research and development ("R&D") expenditures for the three and six-month periods ended June 30, 2020 were \$0.3 million (2019 - \$0.9 million) and \$1.6 million (2019 - \$1.8 million), respectively. Decreased R&D costs primarily relate to lower personnel costs resulting from the cost reduction measures taken by Management in response to the decline in activity.

(Stated in thousands of dollars)

	Three-month periods ended June 30,			Six-month periods ended June 30,		
	2020	2019	% Change	2020	2019	% Change
Finance expense	176	400	(56)	529	784	(33)
Finance expense lease liability	683	629	9	1,226	1,275	(4)

Finance expenses relate to interest charges on the Corporation's long-term and short-term bank facilities. For the three and six-month periods ended June 30, 2020, finance charges decreased to \$0.2 million (2019 - \$0.4 million) and \$0.5 million (2019 - \$0.8 million), respectively. In the second quarter of 2020, the Corporation paid down all bank loans and borrowings outstanding, resulting in lower interest charges in the respective periods.

Finance expense lease liability relates to interest expenses incurred on lease liabilities. For the three-month period ended June 30, 2020, finance expense lease liability increased by 9 percent to \$0.7 million.

(Stated in thousands of dollars)

	Three-month periods ended June 30,		Six-month periods ended June 30,	
	2020	2019	2020	2019
Net gain on disposition of drilling equipment	(470)	(1,596)	(2,409)	(2,876)
Foreign exchange (gains) losses	(357)	246	(230)	512
Provision for (Recovery of) bad debts	(51)	280	3,952	326
Other expenses (income)	(878)	(1,070)	1,313	(2,038)

Net gain on disposition of drilling equipment is comprised of gains on 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 asset retirements that were made before the end of the equipment's useful life and self-insured downhole equipment losses. For the three and six-month periods ended June 30, 2020, the Corporation recognized gain on dispositions of \$0.5 million and \$2.4 million, respectively, which are lower compared to the \$1.6 million and \$2.9 million gain on dispositions realized in the respective 2019-periods. The Corporation had fewer occurrences of downhole equipment losses in the second quarter of 2020 resulting in a lower net gain on disposition of drilling equipment.

Foreign exchange gains and losses relate to unrealized and realized exchange fluctuations in the period. For the three and six-month periods ended June 30, 2020, the Corporation recognized foreign exchange gains of \$0.4 million and \$0.2 million, respectively, relative to foreign exchange losses of \$0.2 million and \$0.5 million in the corresponding 2019-periods. Gains in the 2020-periods primarily relate to settlement of CAD-denominated intercompany payable in the US segment.

Provision for bad debts for the six-month period ended June 30, 2020 were higher because of provisions recognized in the first quarter of 2020. Greater provisions in 2020 reflect increased credit risks of the Corporation's customers as a result of the unparalleled decline in energy demand and the resulting supply imbalance stemming from global impacts of COVID-19.

(Stated in thousands of dollars)

	Three-month periods ended June 30,			Six-month periods ended June 30,		
	2020	2019	% Change	2020	2019	% Change
Impairment loss	481	-	n.m.	10,730	-	n.m.

n.m. – not meaningful

For the three and six-month periods ended June 30, 2020, the Corporation recognized \$0.5 million and \$10.7 million in impairment losses, respectively (2019 – nil). In the first quarter of 2020, due to COVID-19 and the decline in global oil and natural gas prices, the Corporation determined that indicators of impairment existed in its Canadian, US, and International segments. Goodwill that was allocated to PHX Energy's Canadian segment was tested for impairment, and as a result, the Corporation recognized an impairment expense of \$8.9 million equivalent to the full amount of goodwill. The Corporation also determined no further economic benefits are expected from the future use or future disposal of Stream's EDR equipment. The Corporation has substantially closed all of its operations in Stream. As a result, EDR equipment with a carrying amount of \$1.2 million was derecognized, as well as working capital of \$0.1 million. In the second quarter of 2020, additional international EDR equipment and inventory of \$0.5 million were identified as impaired and derecognized.

(Stated in thousands of dollars, except percentages)

	Three-month periods ended June 30,		Six-month periods ended June 30,	
	2020	2019	2020	2019
Provision for (Recovery of) income taxes	(1,309)	510	67	744
Effective tax rates	n.m.	n.m.	n.m.	n.m.

n.m. – not meaningful

For the three and six-month periods ended June 30, 2020, the Corporation recognized a recovery of income taxes of \$1.3 million (2019 - \$0.5 million provision) and provision for income taxes of \$0.1 million (2019 - \$0.7 million), respectively. Deferred taxes in the 2020 and 2019-periods were impacted by unrecognized deferred tax assets with respect to deductible temporary differences in the Canadian jurisdictions.

Segmented Information

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

Canada

(Stated in thousands of dollars)

	Three-month periods ended June 30,			Six-month periods ended June 30,		
	2020	2019	% Change	2020	2019	% Change
Revenue	4,562	10,664	(57)	29,166	35,528	(18)
Reportable segment profit (loss) before tax	(2,869)	(3,856)	(26)	424	(4,251)	(110)

For the three and six-month periods ended June 30, 2020, Canadian revenue was \$4.6 million and \$29.2 million, respectively, compared to revenue of \$10.7 million and \$35.5 million in the same 2019-periods. The decrease in revenue in both 2020-periods was primarily due to lower Canadian activity levels. For the three-month period ended June 30, 2020, operating days declined 63 percent to 408 days, compared to 1,097 days in the relative 2019-quarter. The decline in the Canadian segment's activity was less than that of the industry, which can be attributed to the Corporation's positive reputation in the Canadian market and strong operational performance. The industry's horizontal and directional drilling activity contracted 74 percent as measured by drilling days shrinking from 7,348 days in the 2019-quarter to 1,947 days in the 2020-quarter (Source: Daily Oil Bulletin). The Canadian segment's average revenue per day in the second quarter of 2020 was \$10,873 compared to \$8,860 in the 2019-quarter.

During the second quarter of 2020, the Corporation remained active in the Montney and Duvernay in addition to also having a Potash project.

For the six-month period ended June 30, 2020, operating days declined 20 percent to 3,053 days, compared to 3,834 days in the same 2019-period. The Canadian industry activity decreased 14 percent to 18,737 horizontal and directional drilling days reported in the first half of 2020 as compared to 21,846 horizontal and directional drilling days in 2019 (Sources: Daily Oil Bulletin).

Despite the decline in activity, the Canadian segment's reportable segment loss before tax decreased for the three and six-month periods ended June 30, 2020. Improved profitability is mainly attributed to higher average revenue per day, lower depreciation expense, and reduced repair costs for drilling and other equipment.

United States

(Stated in thousands of dollars)

	Three-month periods ended June 30,			Six-month periods ended June 30,		
	2020	2019	% Change	2020	2019	% Change
Revenue	38,423	67,137	(43)	112,737	130,133	(13)
Reportable segment income (loss) before tax	(1,239)	5,079	(124)	9,156	9,123	-

For the three-month period ended June 30, 2020, US segment revenue declined by 43 percent to \$38.4 million as compared to \$67.1 million in the corresponding 2019-quarter. The US division's revenue represented 82 percent of consolidated revenue in the second quarter of 2020 (2019 - 81 percent). PHX Energy's US drilling activity decreased by 44 percent in the quarter to 2,172 days compared to 3,903 days in the same 2019-quarter. The US industry rig count dropped far more sharply, with 60 percent fewer rigs operating per day. There was an average of 378 active horizontal and directional rigs per day in the 2020-quarter compared to an average of 939 active horizontal and directional rigs per day in the 2019-quarter (Source: Baker Hughes). PHX Energy's US division gained market share in the challenging downturn environment which is a testament to the superior operational performance of personnel and the Corporation's high performance fleet. Phoenix USA continued to be active in the Permian, Granite Wash, SCOOP/STACK, Marcellus, Bakken and Niobrara basins. For the three-month period ended June 30, 2020, average revenue per day, excluding the Corporation's US motor rental division, rose slightly by 2 percent to \$16,774 relative to \$16,409 in the corresponding 2019-quarter. Reportable segment income decreased from \$5.1 million in the 2019-quarter to a loss of \$1.2 million in the second quarter of 2020. This reduced profitability primarily resulted from the drop in activity in the US.

In the first half of 2020, Phoenix USA's revenue was \$112.7 million, a decrease of 13 percent compared to the \$130.1 million in the same 2019-period. Drilling activity for the six-month period ended June 30, 2020 declined by 19 percent to 6,200 days as compared to 7,652 days in the same 2019-period. In comparison, US industry activity, as measured by the average number of horizontal and directional rigs running on a daily basis, fell by twice as much from 960 rigs in the first half of 2019 to an average of 564 rigs in the comparable 2020-period (Source: Baker Hughes). For the six-month period ended June 30, 2020, Phoenix USA's average revenue per day, excluding the Corporation's motor rental division, was \$17,292, which is 7 percent higher than the \$16,181 in the 2019-period. The increase in average revenue per day was mainly realized in the first quarter of 2020 and was primarily a result of increased utilization of the fleet of high performance technologies. For the six-month period ended June 30, 2020, despite lower revenues, PHX Energy's US division realized reportable segment income of \$9.2 million, the same level of reportable segment income realized in the corresponding 2019-period. The strong volume of activity and profitability in the first quarter of 2020 greatly contributed to this result.

International

(Stated in thousands of dollars)

	Three-month periods ended June 30,			Six-month periods ended June 30,		
	2020	2019	% Change	2020	2019	% Change
Revenue	3,784	5,183	(27)	7,885	9,443	(16)
Reportable segment income (loss) before tax	(207)	170	n.m.	18	65	(72)

n.m. – not meaningful

For the three-month period ended June 30, 2020, the International segment's revenue was \$3.8 million, a 27 percent decrease over the \$5.2 million in the 2019-quarter. PHX Energy generated 8 percent of its consolidated revenue from its International operations in the 2020-quarter versus 6 percent in the second quarter of 2019. For the six-month period ended June 30, 2020, the International segment's revenue was \$7.9 million, a 16 percent decrease compared to \$9.4 million in the same 2019-period. The decrease in revenue in both 2020-periods is mainly a result of Albania operations being temporarily suspended since the first quarter of 2020.

For the three-month period ended June 30, 2020, the Russia division's revenue grew by 24 percent to \$3.8 million as compared to \$3.1 million in the 2019-quarter. The division's operating days rose to 410 days in the 2020-quarter compared to 312 days in the corresponding 2019-quarter, a 31 percent increase.

For the three and six-month periods ended June 30, 2020, the International segment recognized reportable segment loss of \$0.2 million (2019 - \$0.2 income) and reportable segment income of \$18,000 (2019 - \$0.1 million), respectively. Lower margins in both 2020-periods were mainly due to suspended operations in Albania.

Summary of Quarterly Results

(Stated in thousands of dollars except per share amounts)

	Jun-20	Mar-20	Dec-19	Sept-19	Jun-19	Mar-19	Dec-18	Sept-18
Revenue	46,769	103,020	93,853	93,099	82,984	92,121	92,335	85,033
Net income (loss)	(4,899)	(3,321)	(1,720)	2,594	(2,020)	(1,067)	(18,355)	3,743
Loss per share – basic	(0.09)	(0.06)	(0.03)	0.05	(0.04)	(0.02)	(0.32)	0.06
Loss per share – diluted	(0.09)	(0.06)	(0.03)	0.05	(0.04)	(0.02)	(0.32)	0.06
Adjusted EBITDA ⁽¹⁾	5,308	18,686	12,399	15,536	10,995	11,431	14,736	13,934
Funds from operations ⁽¹⁾	3,157	20,792	11,344	14,669	9,785	10,100	12,803	11,461

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

Liquidity

(Stated in thousands of dollars)

	Three-month periods ended June 30,		Six-month periods ended June 30,	
	2020	2019	2020	2019
Funds from operations	3,157	9,785	23,948	19,884
			June 30, '20	Dec. 31, '19
Working capital			56,869	68,393

For the three-month period ended June 30, 2020, the Corporation's funds from operations decreased to \$3.2 million from \$9.8 million in the 2019-quarter. The decrease was primarily due to lower profitability in the US segment. In the first half of 2020, the Corporation generated higher funds from operations of \$23.9 million compared to \$19.9 million in the 2019-period. This increase was mainly due to strong profitability realized in the US segment in the first quarter of 2020.

As at June 30, 2020, the Corporation had working capital of \$56.9 million, which is \$11.5 million lower than the \$68.4 million reported at December 31, 2019, mainly due to lower revenue and activity in the second quarter of 2020.

Investing Activities

For the three-month period ended June 30, 2020, PHX Energy used \$5.6 million net cash in investing activities as compared to \$7.5 million in the same 2019-quarter, and received proceeds of \$1.2 million relating to the involuntary disposal of drilling equipment in well bores as compared to \$3.5 million in the corresponding 2019-quarter. In the second quarter of 2020, the Corporation spent \$1.4 million on capital expenditures compared to \$9.1 million in the 2019-quarter. The expenditures in the 2020-quarter were comprised of:

- \$1 million in MWD systems and spare components; and
- \$0.4 million in machinery and equipment and other assets.

The capital expenditure program undertaken in the period was financed generally from cash flow from operating activities. Of the total capital expenditures in the 2020-quarter \$0.2 million was used to grow the Corporation's fleet of drilling equipment and the remaining \$1.2 million was used to maintain the current fleet of drilling and other equipment.

The change in non-cash working capital balance of \$5.3 million (use of cash) for the three-month period ended June 30, 2020, relates to the net change in the Corporation's trade payables that are associated with the acquisition of capital assets. This compares to \$2 million (use of cash) for the three-month period ended June 30, 2019.

Financing Activities

The Corporation reported cash flows used in financing activities of \$24.2 million in the three-month period ended June 30, 2020 as compared to \$10.3 million in the 2019-period. In the 2020-quarter the Corporation:

- made net payments of \$23.5 million to its syndicated facilities; and
- made payments of \$0.7 million towards lease liability.

Capital Resources

As of June 30, 2020, the Corporation had nothing drawn on its syndicated and operating facilities, and a cash balance of \$14.6 million. As at June 30, 2020, the Corporation had approximately CAD \$65 million and USD \$15 million available to be drawn from its credit facilities. The credit facilities are secured by substantially all of the Corporation's assets.

As at June 30, 2020, the Corporation was in compliance with all its financial covenants.

Cash Requirements for Capital Expenditures

Historically, the Corporation has financed its capital expenditures and acquisitions through cash flows from operating activities, debt and equity. The 2020 capital expenditures are expected to be \$27.5 million, subject to quarterly review of the Board.

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 2020, 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.

As at June 30, 2020, the Corporation has commitments to purchase drilling and other equipment for \$4.5 million, with delivery expected to occur by the end of the third quarter.

Off-Balance Sheet Arrangements

The Corporation had no off-balance sheet arrangements as at June 30, 2020 and 2019.

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, 2019. 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.

In March 2020, COVID-19 was declared a pandemic by the World Health Organization. In addition, global commodity prices have declined significantly due to a disputes between major oil producing countries combined with the impact of COVID-19. Governments worldwide, including those in Canada and the US have enacted emergency measures to combat the spread of the virus. These measures, which include the implementation of travel bans, self-imposed quarantine periods and social distancing, have caused material disruption to businesses globally resulting in an economic slowdown. Governments and central banks have reacted with significant monetary and fiscal interventions designed to stabilize economic conditions; however, the success of these interventions is not currently determinable. The current challenging economic climate may have significant adverse impacts on the Corporation including, but not exclusively:

- material declines in revenue, utilization rates, and cash flows, as the Corporation's customers are concentrated in the oil and natural gas industry;
- declines in revenue and operating activities could result in increased impairment charges, inability to comply with debt covenants and restrictions in lending agreements, and reduced capital programs;
- increased risk of non-payment of accounts receivable and customer defaults;
- additional future restructuring charges as the Corporation aligns its structure and personnel to the dynamic environment.

The situation is dynamic and the ultimate duration and magnitude of the impact on the economy and the financial effect on the Corporation is not known at this time. Estimates and judgements made by Management in the preparation of the condensed consolidated interim financial statements are increasingly difficult and subject to a higher degree of measurement uncertainty during this volatile period.

In preparing the 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, 2019.

Changes in Accounting Policies

The condensed consolidated interim financial statements have been prepared utilizing the same accounting policies and methods as the consolidated financial statements of the Corporation for the year ended December 31, 2019, unless specified.

New Accounting Policy

Government grants received are recognized when there is reasonable assurance that the Corporation will comply with the relevant conditions and the grant will be received. Grants are recognized in profit or loss on a systematic basis as the entity recognizes as expenses the costs that the grants are intended to compensate. A grant that is compensation for expenses or losses already incurred, or for which there are no future related costs, is recognized in profit or loss in the period in which it becomes receivable.

Government grants of \$1.1 million relating to the CEWS program were included in the consolidated statement of comprehensive loss for the three-month period ended June 30, 2020.

Business Risk Factors

Other than as described in this MD&A in connection with the potential and ongoing impact of COVID-19, the business risk factors applicable to the Corporation have not materially changed since December 31, 2019. Refer to the "Business Risk Factors" section of the MD&A in PHX Energy's 2019 annual report as well as in the Corporation's most recent Annual Information Form filed on SEDAR at www.sedar.com.

COVID-19 discussed throughout the MD&A presents additional significant risks to the Corporation. Refer to the sections "Responding to COVID-19", "Critical Accounting Estimates" and "Outlook" for information on the impact of COVID-19.

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

Internal Controls Over Financial Reporting

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

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

There were no changes in the Corporation's ICFR that occurred during the period beginning on April 1, 2020 and ended on June 30, 2020 that have materially affected, or are reasonably likely to materially affect, the Corporation's ICFR.

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

Outstanding Corporation Share Data

<i>(In thousands of shares)</i>	As at August 5, 2020
Common shares outstanding	53,251,420
Dilutive securities:	
Options	3,490,267
Corporation shares – diluted	56,741,687

Outlook

The challenges of this unprecedented time in our history intensified during the second quarter of 2020 and the COVID-19 pandemic and severe industry downturn impacted our financial and operational results. However, diligent cost management strategies and entering this period with a healthy balance sheet allowed us to end the quarter with net cash and no bank debt.

Our top priority remains the health and safety of our stakeholders and as the pandemic has evolved, we have remained diligent in following guidance provided by government and health authorities. We have remained operational, although at lower activity levels, while the policies and procedures we implemented ensure we are operating in the safest manner possible. We continue to monitor the situation, adapt our contingency planning and act when additional precautionary measures can be taken.

As rig counts slid to historically low levels in North America, our competitive advantages helped lessen the decline in our activity as compared to the industry. This demonstrates the resiliency of our operations which is created by our unwavering focus on strong marketing relationships, unmatched drilling performance and industry leading technologies. That said this is the harshest downturn we have ever experienced, and it is anticipated to persist through 2020 and possibly into 2021 with only a very gradual recovery. In Canada, although we are now starting to come out of spring break up with a slight uptick in active

rigs, we don't foresee a meaningful industry recovery in the near future as there are many challenges that persist in this market. Similarly, although the US industry is at historical lows, it seems unlikely that rig counts will begin to climb upward in the foreseeable future given the current economic and industry conditions.

For the remainder of 2020, we foresee our operations generating greatly reduced activity quarter-over-quarter. In the US we anticipate that our operations will be slower for the third and fourth quarter when compared to the second quarter. Whereas in Canada, the third and fourth quarters will show an increase in relation to the second quarter only as a result of the industry exiting spring break up. That said, this is a very volatile time surrounded with uncertainty and the industry and economic conditions can change rapidly. We will continue to diligently work to maintain a cost structure aligned with our operations activity and protect our healthy financial position. With the strength of our fleet of technology and operational performance, we believe we will continue to be market leaders in our sector, and this will be reflected in our market share in both Canada and the US.

Knowing the cyclical nature of this industry, one of our ongoing strategies has been to position ourselves for the next downturn. This meant protecting and building balance sheet strength, maintaining low or no bank debt and focusing on being a vital provider in Operators' drive for drilling efficiency. We believe we are positioned operationally and financially to outlast and survive this downturn and to grow when the market does recover, without significant capital commitments. What we have also learned from past downturns is that with each recovery wells are drilled much quicker and more efficiently than before. The directional drilling market still remains saturated with competitors, and the brutal nature of this downturn is likely to shrink the competitive landscape as the opportunity for those without high performance technologies has significantly shrunk. We are in the enviable position to outlast this unprecedented time with a strong team of personnel, a fleet comprised of some of the top technologies in our sector and a healthy financial position.

Michael Buker
President
August 5, 2020

Non-GAAP Measures

Adjusted EBITDA

Adjusted EBITDA, defined as earnings before finance expense, finance expense lease liability, income taxes, depreciation and amortization, impairment losses on drilling and other equipment and goodwill, equity share-based payments, severance payouts relating to the Corporation's restructuring cost, and unrealized foreign exchange gains or losses, does not have a standardized meaning and is not a financial measure that is recognized under GAAP. However, Management believes that adjusted EBITDA provides supplemental information to net earnings that is useful in evaluating the results of the Corporation's principal business activities before considering certain charges, how it was financed and how it was taxed in various countries. Starting in the first quarter of 2020, due to the impact of COVID-19 and the downturn in the oil and natural gas industry, the Corporation included impairment expenses and severance costs, which were not present in the relative 2019-quarter. Severance costs related to restructuring were not present, and therefore were not included in the 2019 Annual Report. 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 June 30,		Six-month periods ended June 30,	
	2020	2019	2020	2019
Net loss	(4,899)	(2,020)	(8,220)	(3,087)
Add (deduct):				
Depreciation and amortization drilling and other equipment	7,912	10,118	15,817	20,284
Depreciation and amortization right-of-use asset	932	878	1,862	1,746
Impairment loss	481	-	10,730	-
Severance expense	1,348	-	1,931	-
Provision for (Recovery of) income taxes	(1,309)	510	67	744
Finance expense	176	400	529	784
Finance expense lease liability	683	629	1,226	1,275
Equity-settled share-based payments	85	215	148	399
Unrealized foreign exchange (gain) loss	(101)	265	(96)	281
Adjusted EBITDA as reported	5,308	10,995	23,994	22,426

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

Funds from Operations

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

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

(Stated in thousands of dollars)

	Three-month periods ended June 30,		Six-month periods ended June 30,	
	2020	2019	2020	2019
Cash flows from operating activities	37,251	21,244	48,381	30,944
Add (deduct):				
Changes in non-cash working capital	(33,644)	(11,436)	(24,288)	(11,454)
Interest paid	84	218	288	495
Income taxes paid (received)	(534)	(241)	(433)	(101)
Funds from (used in) operations	3,157	9,785	23,948	19,884

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.

Free Cash Flow

Free cash flow is defined as funds from operations (as defined above) less maintenance capital expenditures and cash payment on leases. This non-GAAP measure does not have a standardized meaning and is not a financial measure recognized under GAAP. Management uses free cash flow as an indication of the Corporation's ability to generate funds from its operations to support operations and maintain the Corporation's drilling and other equipment. This performance measure is useful to investors for assessing the Corporation's operating and financial performance, leverage and liquidity. 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 free cash flow 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 funds from operations to free cash flow:

(Stated in thousands of dollars)

	Three-month periods ended June 30,		Six-month periods ended June 30,	
	2020	2019	2020	2019
Funds from operations ⁽¹⁾	3,157	9,785	23,948	19,884
Deduct:				
Maintenance capital expenditures	(1,228)	(3,590)	(3,787)	(6,298)
Cash payment on leases	(1,356)	(1,389)	(2,823)	(2,830)
Free cash flow	573	4,806	17,338	10,756

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

Debt to Covenant EBITDA Ratio

Debt is represented by loans and borrowings. Covenant EBITDA, for purposes of the calculation of this covenant ratio, is represented by net earnings for a rolling four quarter period, adjusted for finance expense and finance expense lease liability, provision for income taxes, depreciation and amortization, equity-settled share-based payments, impairment losses on drilling and other equipment and goodwill, unrealized foreign exchange gains or losses, and IFRS 16 adjustment to restate cash payments to expense, subject to the restrictions provided in the amended credit agreement.

Working Capital

Working capital is defined as the Corporation's current assets less its current liabilities and is used to assess the Corporation's short-term liquidity. This non-GAAP measure does not have a standardized meaning and is not a financial measure recognized under GAAP. Management uses working capital to provide insight as to the Corporation's ability to meet obligations as at the reporting date. PHX Energy's method of calculating working capital may differ from that of other organizations and, accordingly, it may not be comparable to that of other companies.

Net Debt

Net debt is defined as the Corporation's syndicate loans and borrowings and operating facility borrowings less cash and cash equivalents. This non-GAAP measure does not have a standardized meaning and is not a financial measure recognized under GAAP. Management uses working capital to provide insight as to the Corporation's ability to meet obligations as at the reporting date. PHX Energy's method of calculating working capital may differ from that of other organizations and, accordingly, it may not be comparable to that of other companies.

Definitions

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

Condensed Consolidated Statements of Financial Position

(unaudited)

	June 30, 2020	December 31, 2019
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 14,627,990	\$ 10,582,296
Trade and other receivables	34,990,544	93,641,885
Inventories	34,618,956	30,826,700
Prepaid expenses	2,828,889	2,569,046
Current tax assets	444,245	-
Total current assets	87,510,624	137,619,927
Non-current assets:		
Drilling and other equipment (Note 5)	83,526,554	78,416,229
Right-of-use asset	31,016,794	32,825,964
Intangible assets	17,555,275	18,901,559
Goodwill (Note 6)	-	8,876,351
Deferred tax assets	927,479	613,355
Total non-current assets	133,026,102	139,633,458
Total assets	\$ 220,536,726	\$ 277,253,385
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Operating facility (Note 7)	\$ -	\$ 11,395,835
Lease liability	2,552,968	2,765,633
Trade and other payables	28,088,570	54,892,277
Current tax liability	-	172,766
Total current liabilities	30,641,538	69,226,511
Non-current liabilities:		
Lease liability	38,568,114	39,753,860
Loans and borrowings (Note 7)	-	13,896,400
Deferred tax liability	7,308,872	5,432,527
Total non-current liabilities	45,876,986	59,082,787
Equity:		
Share capital (Note 8a)	251,219,748	251,815,183
Contributed surplus	10,087,914	10,854,650
Retained earnings	(136,122,738)	(127,902,593)
Accumulated other comprehensive income	18,833,278	14,176,847
Total equity	144,018,202	148,944,087
Total liabilities and equity	\$ 220,536,726	\$ 277,253,385

See accompanying notes to unaudited condensed consolidated interim financial statements.

Condensed Consolidated Statements of Comprehensive Loss

(unaudited)

	Three-month periods ended June 30,		Six-month periods ended June 30,	
	2020	2019	2020	2019
Revenue	\$ 46,768,641	\$ 82,983,644	\$ 149,788,436	\$ 175,104,348
Direct costs	44,876,434	72,260,718	128,230,485	151,050,936
Gross profit	1,892,207	10,722,926	21,557,951	24,053,412
Expenses:				
Selling, general and administrative expenses	7,331,672	11,394,219	14,333,809	24,596,157
Research and development expenses	307,528	880,017	1,579,945	1,779,603
Finance expense	175,529	400,025	528,599	783,625
Finance expense lease liability	683,495	628,522	1,226,015	1,274,683
Other income (Note 9)	(878,353)	(1,069,532)	1,313,166	(2,037,788)
Impairment Loss (Notes 5 and 6)	480,868	-	10,729,587	-
	8,100,739	12,233,251	29,711,121	26,396,280
Loss before income taxes	(6,208,532)	(1,510,325)	(8,153,170)	(2,342,868)
Provision for (Recovery of) income taxes				
Current	(543,809)	120,312	(746,574)	468,784
Deferred	(765,264)	389,463	813,549	275,413
	(1,309,073)	509,775	66,975	744,197
Net loss	(4,899,459)	(2,020,100)	(8,220,145)	(3,087,065)
Other comprehensive income (loss)				
Foreign currency translation	(3,916,078)	(1,803,995)	4,656,431	(2,662,069)
Total comprehensive loss for the period	\$ (8,815,537)	\$ (3,824,095)	\$ (3,563,714)	\$ (5,749,134)
Loss per share – basic	\$ (0.09)	\$ (0.04)	\$ (0.15)	\$ (0.05)
Loss per share – diluted	\$ (0.09)	\$ (0.04)	\$ (0.15)	\$ (0.05)

See accompanying notes to unaudited condensed consolidated interim financial statements.

Condensed Consolidated Statements of Changes in Equity

(unaudited)

Six-month period ended	Share Capital		Contributed Surplus	Accumulated Other Comprehensive Income	Retained Earnings	Total Equity
June 30, 2020	Number	Amount (\$)				
Balance, December 31, 2019	53,246,420	\$ 251,815,183	\$ 10,854,650	\$ 14,176,847	\$ (127,902,593)	\$ 148,944,087
Issuance of share capital	5,000	7,750	-	-	-	7,750
Surrender value of options exercised	-	(1,518,042)	-	-	-	(1,518,042)
Share-based payments	-	-	148,121	-	-	148,121
Fair value of options exercised	-	914,857	(914,857)	-	-	-
Net loss	-	-	-	-	(8,220,145)	(8,220,145)
Foreign currency translation	-	-	-	4,656,431	-	4,656,431
Balance, June 30, 2020	53,251,420	\$ 251,219,748	10,087,914	18,833,278	(136,122,738)	144,018,202

Six-month period ended	Share Capital		Contributed Surplus	Accumulated Other Comprehensive Income	Retained Earnings	Total Equity
June 30, 2019	Number	Amount (\$)				
Balance, December 31, 2018	57,963,720	\$ 265,760,391	\$ 10,631,982	\$ 17,406,514	\$ (120,060,233)	\$ 173,738,654
Adjustment Initial application of IFRS 16	-	-	-	-	(5,629,240)	(5,629,240)
Issuance of share capital	45,000	87,750	-	-	-	87,750
Common Shares repurchased	(1,625,000)	(5,345,437)	-	-	-	(5,345,437)
Share-based payments	-	-	399,057	-	-	399,057
Fair value of options exercised	-	42,826	(42,826)	-	-	-
Net loss	-	-	-	-	(3,087,065)	(3,087,065)
Foreign currency translation	-	-	-	(2,662,069)	-	(2,662,069)
Balance, June 30, 2019	56,383,720	\$ 260,545,530	10,988,213	14,744,445	(128,776,538)	157,501,650

See accompanying notes to unaudited condensed consolidated interim financial statements.

Condensed Consolidated Statements of Cash Flows

(unaudited)

	Three-month periods ended June 30,		Six-month periods ended June 30,	
	2020	2019	2020	2019
Cash flows from operating activities:				
Net loss	\$ (4,899,459)	\$ (2,020,100)	\$ (8,220,145)	\$ (3,087,065)
Adjustments for:				
Depreciation and amortization	7,911,639	10,117,493	15,816,701	20,284,764
Depreciation and amortization right-of-use asset	932,456	878,319	1,862,434	1,745,522
Impairment loss	480,868	-	10,729,587	-
Provision for (Recovery of) income taxes	(1,309,073)	509,775	66,975	744,197
Unrealized foreign exchange loss (gain)	(100,843)	264,934	(96,331)	281,009
Gain on disposition of drilling equipment	(470,042)	(1,596,318)	(2,408,571)	(2,876,496)
Equity-settled share-based payments	84,909	215,100	148,121	399,057
Finance expense	175,529	400,025	528,599	783,625
Provision for (Recovery of) bad debts	(50,744)	279,567	3,951,754	326,138
Provision for inventory obsolescence	401,356	735,901	1,569,240	1,283,302
Interest paid	(84,191)	(217,750)	(288,061)	(495,288)
Income taxes received	534,325	240,811	432,964	100,871
Change in non-cash working capital	33,644,453	11,436,637	24,287,613	11,454,051
Net cash from operating activities	37,251,183	21,244,394	48,380,880	30,943,687
Cash flows from investing activities:				
Proceeds on disposition of drilling equipment	1,167,246	3,510,292	4,634,959	6,044,065
Acquisition of drilling and other equipment	(1,437,742)	(9,090,137)	(20,429,840)	(20,396,683)
Change in non-cash working capital	(5,337,067)	(1,958,066)	(77,183)	(3,713,201)
Net cash used in investing activities	(5,607,563)	(7,537,911)	(15,872,064)	(18,065,819)
Cash flows from financing activities:				
Proceeds from (Repayment of) loans and borrowings	(23,362,800)	(2,700,200)	(13,960,400)	4,487,700
Repayment of operating facility	(159,666)	(2,196,552)	(11,395,835)	(6,790,317)
Payments of Lease Liability	(672,708)	(760,281)	(1,596,595)	(1,555,344)
Surrender Value Cash Payment	-	-	(1,518,042)	-
Repurchase of shares under the NCIB	-	(4,674,837)	-	(5,345,437)
Proceeds from issuance of share capital	-	-	7,750	87,750
Net cash used in financing activities	(24,195,174)	(10,331,870)	(28,463,122)	(9,115,648)
Net increase in cash and cash equivalents	7,448,446	3,374,613	4,045,694	3,762,220
Cash and cash equivalents, beginning of period	7,179,544	4,031,025	10,582,296	3,643,418
Cash and cash equivalents, end of period	\$ 14,627,990	\$ 7,405,638	\$ 14,627,990	\$ 7,405,638

See accompanying notes to unaudited condensed consolidated interim financial statements.

Notes to the Condensed Consolidated Financial Statements

For the three and six-month periods ended June 30, 2020 and 2019

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 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, 2019.

These condensed consolidated interim financial statements were authorized by the Board of Directors on August 5, 2020.

b) Basis of Measurement

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

c) Functional and Presentation Currency

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

d) Use of Estimates and Judgments

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

In March 2020, the COVID-19 outbreak was declared a pandemic by the World Health Organization. In addition, global commodity prices have declined significantly due to a disputes between major oil producing countries combined with the impact of the COVID-19 pandemic. Governments worldwide, including those in Canada and the US have enacted emergency measures to combat the spread of the virus. These measures, which include the implementation of travel bans, self-imposed quarantine periods and social distancing, have caused material disruption to businesses globally resulting in an economic slowdown. Governments and central banks have reacted with significant monetary and fiscal interventions designed to stabilize economic conditions; however, the success of these interventions is not currently determinable. The current challenging economic climate may have significant adverse impacts on the Corporation including, but not exclusively:

- material declines in revenue, utilization rates, and cash flows, as the Corporation's customers are concentrated in the oil and natural gas industry;
- declines in revenue and operating activities could result in increased impairment charges, inability to comply with debt covenants and restrictions in lending agreements, and reduced capital programs;
- increased risk of non-payment of accounts receivable and customer defaults; and
- additional future restructuring charges as the Corporation aligns its structure and personnel to the dynamic environment.

The situation is dynamic and the ultimate duration and magnitude of the impact on the economy and the financial effect on the Corporation is not known at this time. Estimates and judgements made by Management in the preparation of the condensed consolidated interim financial statements are increasingly difficult and subject to a higher degree of measurement uncertainty during this volatile period.

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, 2019.

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, 2019, unless specified.

a) New Accounting Policy

Government grants received are recognized when there is reasonable assurance that the Corporation will comply with the relevant conditions and the grant will be received. Grants are recognized in profit or loss on a systematic basis as the entity recognizes as expenses the costs that the grants are intended to compensate. A grant that is compensation for expenses or losses already incurred, or for which there are no future related costs, is recognized in profit or loss in the period in which it becomes receivable.

Government grants of \$1.1 million relating to the Canadian Emergency Wage Subsidy program were included in the consolidated statement of comprehensive loss for the three-month period ended June 30, 2020.

4. Operating Segments

The Corporation provides horizontal and directional drilling 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 June 30,	2020	2019	2020	2019	2020	2019	2020	2019
Total revenue	4,562	10,664	38,423	67,137	3,784	5,183	46,769	82,984
Reportable segment profit (loss) before income taxes	(2,869)	(3,856)	(1,239)	5,079	(207)	170	(4,315)	1,393

(Stated in thousands of dollars)

	Canada		United States		International		Total	
Six-month periods ended June 30,	2020	2019	2020	2019	2020	2019	2020	2019
Total revenue	29,166	35,528	112,737	130,133	7,885	9,443	149,788	175,104
Reportable segment profit (loss) before income taxes	424	(4,251)	9,156	9,123	18	65	9,598	4,937

(Stated in thousands of dollars)

	Canada		United States		International		Total	
As at June 30,	2020	2019	2020	2019	2020	2019	2020	2019
Drilling and other equipment	17,000	23,465	62,846	61,242	3,681	5,522	83,527	90,229
Goodwill	-	8,876	-	-	-	-	-	8,876

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

	Three-month periods ended June 30,		Six-month periods ended June 30,	
	2020	2019	2020	2019
Reportable segment loss before income taxes	(4,315)	1,393	9,598	4,937
Corporate:				
Selling, general and administrative expenses	1,124	2,064	2,373	5,479
Research and development expenses	308	880	1,580	1,780
Finance expense	176	400	529	784
Finance expense lease liability	683	629	1,226	1,275
Impairment expense	481	-	10,730	-
Other income	(878)	(1,070)	1,313	(2,038)
Loss before income taxes	(6,209)	(1,510)	(8,153)	(2,343)

5. Drilling and Other Equipment

a) Stream Drilling and Other Equipment Derecognition

During the first quarter of 2020, the Corporation determined no further economic benefits are expected from the future use or future disposal of EDR equipment in the Stream Services division ("Stream"). The Corporation has closed substantially all of its operations in Stream. For the three-month period ended June 30, 2020, EDR equipment with a carrying amount of \$0.2 million was derecognized. For the six-month period ended June 30, 2020, EDR equipment with a carrying amount of \$1.4 million was derecognized.

b) Impairment Analysis

As at March 31, 2020, the Corporation determined indicators of impairment existed in the Canadian, US, and International segments due to challenges in the oil and natural gas industry as result of COVID-19. As such, an impairment test was performed in the US and International CGUs. Refer to Note 6 Goodwill for details on the Canada CGU impairment test. The recoverable amounts for US and International CGUs was based on value in use determined by discounting expected future cash flows to be generated from the continued use of the assets within the CGUs. The cash flows used in the calculation were discounted using a discount rate, which was estimated using the weighted-average cost of capital formula and adjusted for risks specific to the CGU. As at June 30, 2020, management determined no indicators of impairment exist, from the time when impairment testing was last completed.

As at March 31, 2020, in the US CGU, the following key assumptions were used in the discounted cash flow projection:

- 2020 forecasted earnings before interest, taxes, depreciation and amortization ("EBITDA") is expected to decrease 46 percent relative to 2019 results. Revenues in 2020 are expected to decline 44 percent relative to 2019 revenues, expenses are forecasted to decrease in line with forecasted EBITDA. Average revenue growth for the five years subsequent to 2020 is 18 percent.
- Terminal revenue forecasted is the average revenue from the year 2020 to 2025, which reflects the cyclical nature of revenues in the oil and natural gas industry.
- Terminal growth rate of 2.5 percent based on Management's estimate, which is consistent with the assumptions that a market participant would make.
- The after-tax discount rate derived from the weighted average cost of capital is 14.9 percent, which reflects current market assessments of the time value of money and risks specific to the US CGU.

The estimated recoverable amount of the US CGU exceeded its carrying amount by \$45.6 million. Management identified that an increase of 5 percent to the discount rate or a reduction of 6 percent to average revenue growth in the five-year business plan could cause the carrying amount of the US CGU to exceed the recoverable amount.

As at March 31, 2020, in the International CGU, the following key assumptions were used in the discounted cash flow projection:

- Subsequent to the 2020-year, estimated revenues are expected to increase annually on average by 10 percent in the five-year business plan.
- Terminal growth rate of 2.5 percent based on Management's estimate, which is consistent with the assumptions that a market participant would make.

- The after-tax discount rate derived from the weighted average cost of capital is 15.6 percent, which reflects the current market assessments of the time value of money and risks specific to the International CGU.

The estimated recoverable amount of the International CGU exceeded its carrying amount by \$6 million. Management identified that an increase of 12 percent to the discount rate or a reduction of 18 percent to average revenue growth in the five-year business plan could cause the carrying amount of the International CGU to exceed the recoverable amount.

The values assigned to the key assumptions for US and International CGUs represent management's assessment of future trends in the service industry and are based on both external sources and internal sources (historical data).

c) Acquisitions and Disposals

During the six-month period ended June 30, 2020, the Corporation acquired assets with a cost of \$20.4 million (2019 - \$20.4 million).

Assets with a carrying amount of \$2.2 million (2019 - \$3.2 million) were disposed of as a result of tools lost down hole and scrapped assets, resulting in a net gain on disposition of \$2.4 million (2019 - \$2.9 million), which is included in other income in the condensed consolidated statement of comprehensive loss.

d) Capital Commitments

As at June 30, 2020, the Corporation has commitments to purchase drilling and other equipment for \$4.5 million, delivery is expected to occur by the end of the third quarter.

6. Goodwill

Goodwill is not amortized but is tested for impairment at the end of each year, or more frequently if events or changes in circumstances indicate that the asset might be impaired. As at March 31, 2020, the Corporation determined indicators of impairment existed due to challenges in the oil and natural gas industry as result of COVID-19. As such, an impairment test was performed relating to goodwill.

For the purpose of impairment testing, goodwill is allocated to the Corporation's CGUs, which represent the lowest levels within the Corporation at which goodwill is monitored for internal management purposes.

As at March 31, 2020, the full carrying amount of goodwill of \$8.9 million (2019 - \$8.9 million) was allocated to the Canadian CGU. The recoverable amount was based on its value in use determined by discounting expected future cash

flows to be generated from the continuing use of the assets within the CGU. The cash flows used in the calculation were discounted using a discount rate, which was estimated using the weighted-average cost of capital formula and adjusted for risks specific to the CGU. The following key assumptions were used in the discounted cash flow projection:

- 2020 forecasted EBITDA is in line with 2019 results. Revenues in 2020 are expected to decline 36 percent relative to 2019 revenues, expenses are forecasted to decrease in line with forecasted EBITDA. Average revenue growth for the five years subsequent to 2020 is 20 percent.
- Terminal revenue forecasted is the average revenue from the year 2020 to 2025, which reflects the cyclical nature of revenues in the oil and natural gas industry.
- Terminal growth rate of 2.5 percent based on Management's estimate, which is consistent with the assumptions that a market participant would make.
- The after-tax discount rate derived from the weighted average cost of capital is 14.9 percent, which reflects current market assessments of the time value of money and risks specific to the Canadian CGU.

The values assigned to the key assumptions represent Management's assessment of future trends in the service industry and are based on both external sources and internal sources (historical data).

The estimated recoverable amount of the Canadian CGU was less than its carrying amount by \$8.9 million. The Corporation recognized impairment expense equivalent to the full amount of goodwill as at March 31, 2020.

7. Loans and Borrowings

(Stated in thousands of dollars)

	Currency	Amount of Facility	Date of Maturity	Currency	Carrying Amount at June 30, 2020	Currency	Carrying Amount at December 31, 2019
Operating Facility	CAD	15,000	Due on demand	CAD	-	CAD	11,396
Syndicated Facility	CAD	50,000	December 11, 2022	CAD	-	CAD	10,000
US Operating Facility	USD	15,000	December 11, 2022	USD	-	USD	3,000

Under the syndicated loan agreement, the Corporation is required to maintain certain financial covenants. As at June 30, 2020 the Corporation was in compliance with all its financial covenants as follows:

Ratio	Covenant	June 30, 2020
Debt to covenant EBITDA	< 3.0x	-
Interest coverage ratio	> 3.0x	32.31

The Corporation has CAD \$65 million and USD \$15 million available to be drawn from its credit facilities as at June 30, 2020.

The credit facilities are secured by substantially all of the Corporation's assets.

8. Share Capital

a) Authorized and Issued Shares

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

	Number		Amount
Balance as at January 1, 2019	57,963,720	\$	265,760,391
Common Shares repurchased	(4,762,300)		(14,071,163)
Issued shares pursuant to share option plan	45,000		125,955
Balance as at December 31, 2019	53,246,420	\$	251,815,183
Surrender value of options exercised	-		(608,724)
Issued shares pursuant to share option plan	5,000		13,289
Balance as at June 30, 2020	53,251,420	\$	251,219,748

b) Share Option Program (Equity-Settled)

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

Summary of option grants in 2020

Number	Exercise Price	Expiration Date	Fair Value
150,000	\$ 2.19	March 5, 2025	\$ 0.78
100,000	2.09	March 5, 2025	0.82
250,000			

The Corporation values all of its share options using the Black-Scholes model. The Corporation's determination of fair value of options on the date of grant is affected by the Corporation's share price as well as assumptions regarding a number of variables. For the options granted during 2020 these variables include, but are not limited to, the Corporation's expected share price volatility over the term of the options of 46 percent, forfeiture rate of nil, and a risk free interest rate of 0.81 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 six-month periods ended June 30, 2020, the Corporation recognized total compensation expense of \$0.1 million (2019 - \$0.2 million and \$0.4 million, respectively) for share options granted between 2016 and 2019.

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

	2020		2019	
	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price
Outstanding, beginning of period	4,783,601	\$ 3.35	5,291,101	\$ 3.89
Granted	250,000	2.15	250,000	2.81
Exercised	(5,000)	1.55	(45,000)	1.95
Forfeited / cancelled	(870,834)	1.69	-	-
Expired	(667,500)	6.88	(200,000)	15.81
Outstanding, end of period	3,490,267	3.00	5,296,101	3.41
Options exercisable, end of period	2,990,262	3.11	4,056,091	3.51

The 820,834 options forfeited in the first quarter of 2020 were surrendered to the Corporation and payment was made to the option holders equal to the excess of the five-day weighted average share price at date of surrender over the exercise price of the option. The Corporation paid \$1.5 million to the option holders as part of the surrender which was reflected in share capital.

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

Options Outstanding					Options Exercisable	
Original Exercise Price	Number	Weighted-Average Remaining Contractual Life	Weighted- Average Exercise Price		Number	Weighted-Average Exercise Price
\$ 1.55	180,000	0.68 yrs	\$ 1.55		180,000	\$ 1.55
1.71	175,000	2.13 yrs	1.71		175,000	1.71
1.79	575,000	2.13 yrs	1.79		575,000	1.79
1.95	165,267	1.29 yrs	1.95		148,600	1.95
2.00	200,000	2.69 yrs	2.00		133,332	2.00
2.09	100,000	4.68 yrs	2.09		-	2.09
2.19	150,000	4.68 yrs	2.19		-	2.19
2.81	200,000	3.69 yrs	2.81		66,664	2.81
2.83	50,000	3.69 yrs	2.83		16,666	2.83
3.41	25,000	1.40 yrs	3.41		25,000	3.41
4.06	1,255,000	1.67 yrs	4.06		1,255,000	4.06
4.15	415,000	1.67 yrs	4.15		415,000	4.15
	3,490,267	2.12 yrs	\$ 3.00		2,990,262	\$ 3.11

c) Retention Award Plan

The retention award plan results in eligible participants receiving cash compensation in relation to the value of a specified number of underlying notional retention awards. The retention award plan has two types of awards Restricted Awards (RAs) and Performance Awards (PAs). RAs vest evenly over a period of three-years. Upon vesting and subsequent exercise, the holder is entitled to receive a cash payment based on the fair value of the underlying shares determined using the five-day weighted-average trading price of the shares ending immediately prior to the exercise date plus accrued re-invested dividends.

PAs vesting and subsequent exercise is similar to RAs, except a payout multiplier is applied to the final payout. The payout multiplier is linked solely to total shareholder return on the Corporation's common shares relative to returns on securities of members of the Corporation's peer comparison group over the applicable vesting period and can range from a payout of zero percent to 200 percent. For the six-month period ended June 30, 2020, 750,000 PAs were granted (2019 – 750,000), 566,668 PAs settled at a weighted average payout multiplier of 175 percent (2019 – 566,668), no PAs were forfeited (2019 - nil), and as at June 30, 2020, 1,500,000 PAs were outstanding (2019 – 1,316,668).

The Corporation recorded a total of \$2 million compensation recovery relating to these plans for the six-month period ended June 30, 2020 (2019 – \$4 million expense). The recovery is included in selling, general and administrative

expense and has a corresponding liability included in trade and other payables. There were 3,726,844 RAs and PAs outstanding as at June 30, 2020 (2019 – 3,596,709).

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

	2020	2019
RAs and PAs outstanding, beginning of year	3,555,634	3,443,456
Granted	1,683,259	1,415,113
Settled	(1,428,707)	(1,231,191)
Forfeited / cancelled	(83,342)	(30,669)
RAs and PAs outstanding, end of year	3,726,844	3,596,709

d) Normal Course Issuer Bid

During the third quarter of 2019, the TSX approved the renewal of PHX Energy's Normal Course Issuer Bid ("NCIB") to purchase for cancellation, from time-to-time, up to a maximum of 3,280,889 common shares, representing 10 percent of the Corporation's public float of Common Shares as at July 31, 2019. The NCIB commenced on August 9, 2019 and will terminate on August 8, 2020. Purchases of common shares are to be made on the open market through the facilities of the TSX and through alternative trading systems. The price which PHX Energy is to pay for any common shares purchased is to be at the prevailing market price on the TSX or alternate trading systems at the time of such purchase. Pursuant to the current NCIB, subsequent to August 9, 2019, 2,524,500 common shares were purchased by the Corporation and cancelled as at December 31, 2019.

For the six-month period ended June 30, 2020, the Corporation made no common share repurchases (2019 – 1,625,000).

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

9. Other Income

(Stated in thousands of dollars)

	Three-month periods ended June 30,		Six-month periods ended June 30,	
	2020	2019	2020	2019
Net gain on disposition of drilling equipment	(470)	(1,596)	(2,409)	(2,876)
Foreign exchange losses (gains)	(357)	246	(230)	512
Provision for (Recovery of) bad debts	(51)	280	3,952	326
Other expenses (income)	(878)	(1,070)	1,313	(2,038)

The Corporation recognized higher provisions for bad debts due to increased credit risks of its customers as a result of the unparalleled energy demand decline and the resulting supply imbalance stemming from global impacts of COVID-19.

10. Fair Values of Financial Instruments

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

Corporate Information

Board of Directors

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

Officers

John Hooks
CEO

Michael Buker
President

Cameron Ritchie
Sr. Vice President Finance and CFO
Corporate Secretary

Craig Brown
Sr. Vice President Engineering and
Technology

Jeffery Shafer
Sr. Vice President Sales and Marketing

Daniel Blanchard
Vice President Executive Sales

Legal Counsel

Burnet, Duckworth & Palmer LLP
Calgary, Alberta

Auditors

KPMG LLP
Calgary, Alberta

Bankers

HSBC Bank Canada
Calgary, Alberta

Transfer Agent

Computershare Trust Company of Canada
Calgary, Alberta