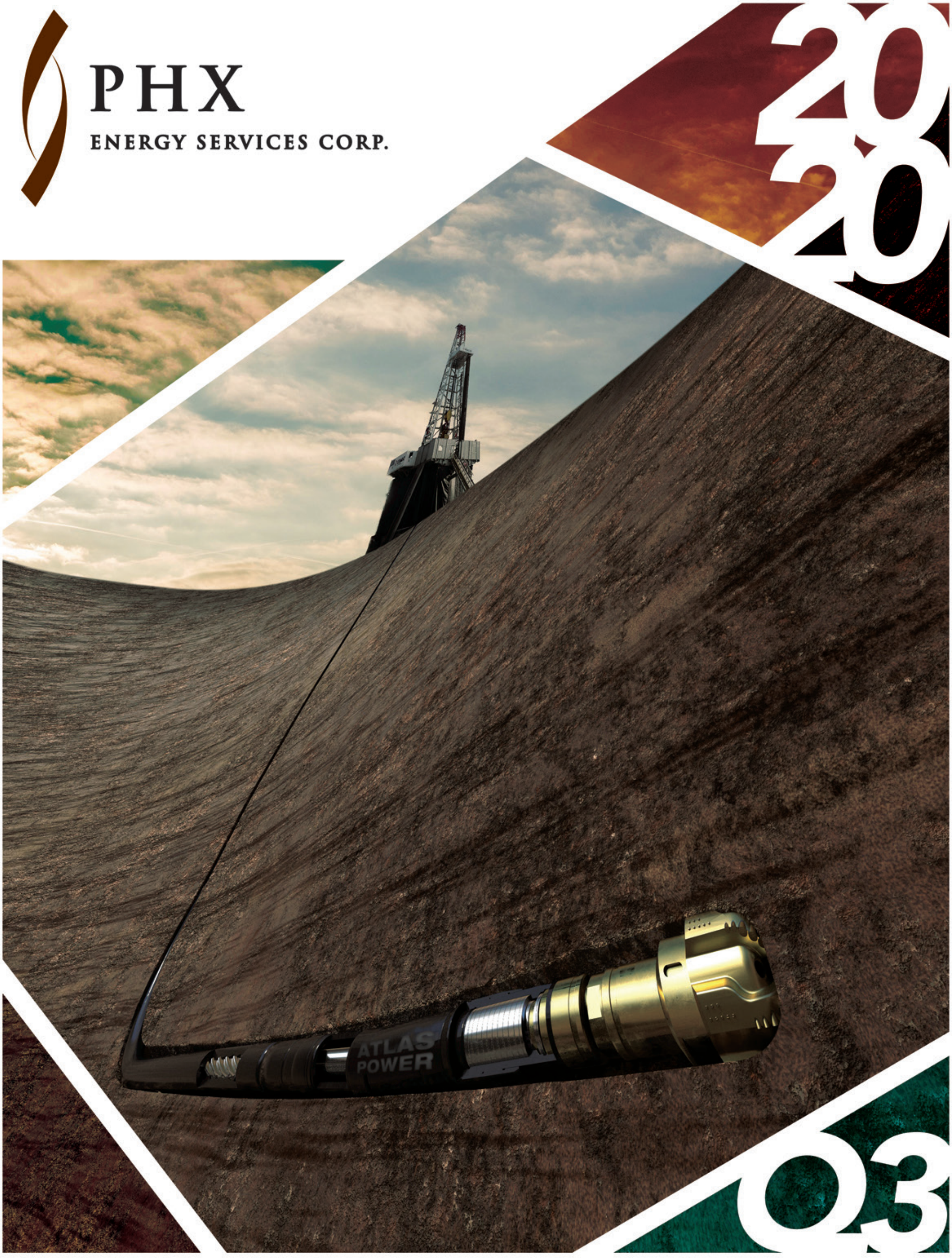
PHX

ENERGY SERVICES CORP.



PHX Energy Services Corp.

Third Quarter Report for the three and nine-month periods ended September 30, 2020 and 2019

Financial Results

In the third quarter of 2020, despite the ongoing challenges presented by the COVID-19 pandemic, the Corporation continued to achieve positive adjusted EBITDA. For the three-month period ended September 30, 2020, PHX Energy realized adjusted EBITDA of $7.5 million (19 percent of revenue) as compared to $15.5 million (17 percent of revenue) in the third quarter of 2019. Adjusted EBITDA in the 2020-quarter includes a $1.6 million recovery of bad debts and $1.3 million in government grants earned as part of the Canada Emergency Wage Subsidy ("CEWS") program.

For the three-month period ended September 30, 2020, due to the prolonged reduction in global industry activity, the Corporation's consolidated revenue decreased to the lowest level of quarterly revenue since the third quarter of 2016. Consolidated revenue in the 2020-quarter was $39.8 million, a decline of 57 percent from the $93.1 million in the corresponding 2019-quarter. In the third quarter of 2020, consolidated operating days decreased by 60 percent to 2,650, as compared to the 6,629 days in the 2019-quarter. Average consolidated revenue per day, excluding the motor rental division in the US, was $14,503, an 8 percent increase as compared to the 2019-quarter's average of $13,434.

During the third quarter of 2020, the Corporation's US activity continued to be impacted by the industry downturn that led the rig count to all-time lows. Despite the weak environment, the Corporation was resilient to this and experienced a smaller decline relative to the overall US market evidencing the positive reputation and capabilities of PHX Energy's high performance technology fleet. The US rig count fell 72 percent from 920 average rigs running per day in the third quarter of 2019 to 254 rigs in the 2020-quarter (Source: Baker Hughes). Whereas PHX Energy's US operating days declined by 55 percent in the third quarter of 2020 to 1,747 from 3,850 in the 2019-quarter and US segment revenue decreased 56 percent to $30.3 million from $68.3 million in the corresponding 2019-quarter. The US division's revenue in the 2020-quarter represented 76 percent of consolidated revenue.

The ongoing challenges and uncertainty in the Canadian industry persisted in the third quarter with activity levels falling to multi-decade lows. The rig count dropped 64 percent quarter-over-quarter with an average of 47 active rigs operating per day in the third quarter of 2020 (2019 - 132) (Source: Baker Hughes). In parallel to the industry activity, the Canadian segment's third quarter revenue declined by 63 percent in 2020 to $7 million relative to $19.1 million in the same 2019-quarter.

The Corporation continued to maintain a strong balance sheet position, and as at September 30, 2020 had a cash and cash equivalents balance of $18.9 million with no bank loans and borrowings outstanding. For the three-month period ended September 30, 2020, the Corporation's free cash flow decreased to $2.5 million as compared to $11.6 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 continued to experience reduced drilling activity in the third quarter of 2020 due to the prevailing economic and industry conditions driven by COVID-19. 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 impact of the COVID-19 pandemic on the Corporation's financial condition and operations. Management has been proactive in mitigating these risks, aligning costs with projected revenues and protecting profit margins. Management restructured its business costs, primarily during the second quarter, in line with decreasing drilling activity in North America, which included 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 continues to monitor, evaluate and adjust its business costs in line with drilling activity in North America and will continue to implement changes as required. In addition, the Corporation will continue to utilize 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 September 30, 2020, the Corporation has working capital of $56.4 million and has approximately CAD $65 million and USD $15 million available from its credit facilities, subject to a borrowing base limit of $67 million. The Corporation has minimized new capital expenditures wherever it is prudent to do so. 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".

Capital Spending

For the three-month period ended September 30, 2020, the Corporation spent $1.8 million in capital expenditures, which was lower when compared to the $8.4 million spent in the same 2019-quarter. Due to COVID-19's impact on rig counts in North America, the Corporation significantly reduced new capital expenditures at the beginning of the second quarter of 2020. Capital expenditures in the third quarter of 2020 were primarily directed towards Velocity Real Time Systems ("Velocity") and Atlas High Performance ("Atlas") Motors. For the nine-month period ended September 30, 2020, the Corporation spent $22.2 million in capital expenditures (2019 - $28.8 million), which were primarily directed towards Atlas motors, PowerDrive Orbit Rotary Steerable Systems ("RSS"), and Velocity. Of the total capital expenditures in the 2020-period, $16.8 million was spent growing the Corporation's fleet of drilling equipment and the remaining $5.4 million was spent on maintenance of the current fleet of drilling and other equipment.

As at September 30, 2020, the Corporation has capital commitments to purchase drilling and other equipment for $3.5 million, majority of which is maintenance capital, and which includes $3 million for Velocity systems, $0.3 million for performance drilling motors, and $0.2 million for other equipment.

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

Capital expenditures since 2015 have primarily been dedicated toward expanding and growing the capacity of the high performance fleets. In addition to the Corporation's fleet of conventional measurement while drilling ("MWD") systems and drilling motors, the Corporation possesses 350 Atlas motors, comprised of various configurations including its 7.25", 5.13", 5.76", 8" and 9" Atlas motors, 77 Velocity systems, and 18 PowerDrive Orbit RSS, the largest independent fleet in North America.

Normal Course Issuer Bid

During the third quarter of 2020, 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 3,131,388 common shares, representing 10 percent of the Corporation's public float of Common Shares as at July 31, 2020. The NCIB commenced on August 14, 2020 and will terminate on August 13, 2021. Purchases of common shares are to be made on the open market through the facilities of the TSX and through alternative trading systems. The price which PHX Energy is to pay for any common shares purchased is to be at the prevailing market price on the TSX or alternate trading systems at the time of such purchase.

Pursuant to the current NCIB, in the three-month period ended September 30, 2020, 2,270,600 common shares were purchased by the Corporation and cancelled.

Financial Highlights

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

	Three-month periods ended September 30,			Nine-month periods ended September 30,		
	2020	2019	% Change	**2020**	2019	% Change
Operating Results	***(unaudited)***	*(unaudited)*		***(unaudited)***	*(unaudited)*	
Revenue	**39,776**	93,099	(57)	**189,564**	268,204	(29)
Net income (loss)	**(1,505)**	2,594	n.m.	**(9,725)**	(494)	n.m.
Earnings (loss) per share – diluted	**(0.03)**	0.05	n.m.	**(0.18)**	(0.01)	n.m.
Adjusted EBITDA [(1)]	**7,469**	15,536	(52)	**31,462**	37,961	(17)
Adjusted EBITDA per share – diluted [(1)]	**0.14**	0.27	(48)	**0.59**	0.66	(11)
Adjusted EBITDA as a percentage of revenue [(1)]	**19%**	17%		**17%**	14%	
Cash Flow						
Cash flows from operating activities	**9,400**	9,721	(3)	**57,781**	40,665	42
Funds from operations [(1)]	**5,481**	14,669	(63)	**29,429**	34,554	(15)
Funds from operations per share – diluted [(1)]	**0.10**	0.26	(62)	**0.55**	0.60	(8)
Capital expenditures	**1,816**	8,444	(78)	**22,245**	28,840	(23)
Free cash flow [(1)]	**2,544**	11,569	(78)	**19,883**	22,326	(11)
Financial Position (unaudited)				**Sep 30, '20**	Dec 31, '19	
Working capital				**56,416**	68,393	(18)
Net debt [(1)] [(2)]				**(18,889)**	14,710	n.m.
Shareholders' equity				**135,497**	148,944	(9)
Common shares outstanding				**50,980,820**	53,246,420	(4)

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 September 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 third 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 third 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 November 4, 2020.

PHX Energy's Interim Financial Report for the three-month and nine-month periods ended September 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 November 4, 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 $3.5 million, with delivery expected to occur by the end of the year; and,
- In 2020, the Corporation expects to spend $27.5 million in capital expenditures.

The above are stated under the headings: "Capital Spending", "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, United States, Russia and Albania.

PHX Energy's Canadian directional drilling operations are conducted through Phoenix Technology Services LP. The Corporation maintains its corporate head office, research and development, Canadian sales, service and operational centres in Calgary, Alberta. In addition, PHX Energy 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; Casper, Wyoming; Midland, Texas; and Oklahoma City, Oklahoma. Internationally, PHX Energy has sales offices and service facilities in Albania and Russia, and administrative offices in Nicosia, Cyprus 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 Nine-Month Periods Ended September 30, 2020

Revenue

(Stated in thousands of dollars)

	Three-month periods ended September 30,			Nine-month periods ended September 30,		
	2020	2019	% Change	**2020**	2019	% Change
Revenue	**39,776**	93,099	(57)	**189,564**	268,204	(29)

Industry activity across all of the Corporation's operating segments remained weak as depressed oil prices and the impact of COVID-19 carried through the third quarter of 2020. For the three-month period ended September 30, 2020, consolidated revenue was $39.8 million as compared to $93.1 million in the third quarter of 2019, a decrease of 57 percent. US revenue as a percentage of total consolidated revenue remained steady at 76 percent for the 2020-quarter compared to 73 percent in 2019. Consolidated operating days decreased 60 percent to 2,650 days as compared to 6,629 days in the 2019-quarter. PHX Energy's average revenue per day, excluding the motor rental division in the US, increased from $13,434 in the 2019-quarter to $14,503 in the relative 2020-period.

During the third quarter of 2020, Western Texas Intermediate ("WTI") spot crude oil price and Western Canadian Select ("WCS") oil prices were 27 percent lower than in the 2019-quarter. WTI averaged USD $41/bbl (2019 quarter – USD $56/bbl) and WCS oil prices averaged USD $32/bbl (2019 – USD $44/bbl). Due to pressure on the oil prices, Canadian and US rig counts declined quarter-over-quarter, with the US operating an average of 254 rigs per day in the third quarter as compared to 920 rigs per day in the 2019-period, and Canada operating an average of 47 rigs per day as compared to 130 rigs per day in the 2019-period. Throughout North America the vast majority of the wells continued to be dominated by horizontal and directional drilling which represented 95 percent of drilling activity in the third quarter of 2020. (Source: Daily Oil Bulletin and Baker Hughes).

For the nine-month period ended September 30, 2020, the Corporation's consolidated revenue decreased by 29 percent to $189.6 million compared to $268.2 million in the 2019-period. There were 12,881 consolidated operating days in the nine-month period ended September 30, 2020, which is 33 percent lower than the 19,221 days reported in the 2019-period. Excluding the motor rental division in the US, the average consolidated revenue per day for the 2020 nine-month period was $14,104, an increase of 6 percent compared to the average of $13,290 in the 2019-period.

Operating Costs and Expenses

(Stated in thousands of dollars except percentages)

	Three-month periods ended September 30,			Nine-month periods ended September 30,		
	2020	2019	% Change	**2020**	2019	% Change
Direct costs	**35,607**	77,090	(54)	**163,837**	228,141	(28)
Gross profit as a percentage of revenue	**10%**	17%		**14%**	15%	
Depreciation & amortization drilling and other equipment (included in direct costs)	**6,977**	9,894	(29)	**22,794**	30,178	(24)
Depreciation & amortization right-of-use asset (included in direct costs)	**861**	896	(4)	**2,723**	2,641	3
Gross profit as percentage of revenue excluding depreciation & amortization	**30%**	29%		**27%**	27%	

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 nine-month periods ended September 30, 2020, direct costs decreased by 54 percent and 28 percent, respectively. In both 2020-periods, the Corporation incurred lower labour costs, less equipment repair expenses and fewer equipment rentals primarily due to decreased activity levels in all operating regions.

For the three and nine-month periods ended September 30, 2020, gross profit as a percentage of revenue, excluding depreciation and amortization, was 30 percent and 27 percent, respectively, which are the same levels as in the corresponding 2019-periods. Despite reduced activity, profitability was sustained as a result of Management's efforts to align the cost structure as well as continued close monitoring of expenses.

For the three and nine-month periods ended September 30, 2020, the Corporation's depreciation and amortization on drilling and other equipment decreased by 29 percent and 24 percent, respectively. In line with the 2020 capital expenditure program, the decrease in depreciation and amortization of drilling and other equipment in the respective periods is mainly due to slower replacement of fully depreciated fixed assets.

(Stated in thousands of dollars except percentages)

	Three-month periods ended September 30,			Nine-month periods ended September 30,		
	2020	2019	% Change	**2020**	2019	% Change
SG&A costs	**6,204**	10,616	(42)	**20,537**	35,212	(42)
Cash-settled share-based payments (included in SG&A costs)	**888**	1,078	(18)	**(1,149)**	5,108	(122)
Equity-settled share-based payments (included in SG&A costs)	**66**	160	(59)	**214**	559	(62)
SG&A costs excluding equity and cash-settled share-based payments and provision for onerous contracts as a percentage of revenue	**13%**	10%		**11%**	11%	

For the three and nine-month periods ended September 30, 2020, SG&A costs were $6.2 million and $20.5 million, respectively, as compared to $10.6 million and $35.2 million in the corresponding 2019-periods. The decrease in SG&A costs in both periods mainly relates to the lower number of personnel required to support reduced drilling activity and the decline in cash-settled share-based payments, particularly in the 2020 nine-month period. In addition, reduced SG&A costs also resulted from initiatives carried out to restrict costs which included tightened policies on travel, entertainment, and marketing related costs.

Cash-settled share-based payments relate to the Corporation's Retention Award Plan and are measured at fair value. For the three-month period ended September 30, 2020, cash-settled share-based payments decreased by 18 percent to $0.9 million from $1.1 million in the 2019-quarter. For the nine-month period ended September 30, 2020, cash-settled share-based payments decreased by 122 percent to a recovery of $1.1 million from an expense of $5.1 million in the same 2019-period. Changes in cash-settled share-based payments in the respective periods are mainly attributable to fluctuations in the Corporation's share price period-over-period.

Equity-settled share-based payments relate to the amortization of the fair values of issued options by the Corporation using the Black-Scholes model. For the three and nine-month periods ended September 30, 2020, equity-settled share-based payments decreased by 59 percent and 62 percent, respectively, as compared to the corresponding 2019-periods, generally due to stock option grants from prior years fully vesting in 2019 and 2020-years.

(Stated in thousands of dollars)

	Three-month periods ended September 30,			Nine-month periods ended September 30,		
	2020	2019	% Change	**2020**	2019	% Change
Research & development expense	**216**	1,193	(82)	**1,796**	2,973	(40)

Research and development ("R&D") expenditures for the three and nine-month periods ended September 30, 2020 were $0.2 million (2019 - $1.2 million) and $1.8 million (2019 - $3 million), respectively. The decrease in R&D costs primarily relate to lower personnel costs resulting from certain R&D initiatives being scaled down in response to cost reduction measures taken by Management.

(Stated in thousands of dollars)

	Three-month periods ended September 30,			Nine-month periods ended September 30,		
	2020	2019	% Change	**2020**	2019	% Change
Finance expense	**133**	306	(57)	**661**	1,090	(39)
Finance expense lease liability	**573**	622	(8)	**1,799**	1,897	(5)

Finance expenses relate to interest charges on the Corporation's long-term and short-term bank facilities. For the three and nine-month periods ended September 30, 2020, finance charges decreased to $0.1 million (2019 - $0.3 million) and $0.7 million (2019 - $1.1 million), respectively. In the second quarter of 2020, the Corporation paid down all bank loans and borrowings outstanding and over the course of the third quarter of 2020, maintained minimal levels of borrowing, resulting in decreased interest charges in the respective 2020 periods.

Finance expense lease liability relates to interest expenses incurred on lease liabilities. For the three and nine-month periods ended September 30, 2020, finance expense lease liability decreased by 8 percent and 5 percent, respectively, reflecting the reduction in lease liabilities as lease obligations are fulfilled.

(Stated in thousands of dollars)

	Three-month periods ended September 30,		Nine-month periods ended September 30,	
	2020	2019	**2020**	2019
Net gain on disposition of drilling equipment	**(136)**	(514)	**(2,545)**	(3,390)
Foreign exchange losses (gains)	**226**	44	**(3)**	557
Provision for (Recovery of) bad debts	**(1,608)**	62	**2,344**	388
Other income	**(1,518)**	(408)	**(204)**	(2,445)

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 nine-month periods ended September 30, 2020, the Corporation recognized gain on dispositions of $0.1 million and $2.5 million, respectively, compared to the $0.5 million and $3.4 million gain on dispositions realized in the respective 2019-periods. In both 2020-periods, the Corporation had fewer occurrences of downhole equipment losses resulting in 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 nine-month periods ended September 30, 2020, the Corporation recognized foreign exchange losses of $0.2 million and foreign exchange gains of $3 thousand, respectively, relative to foreign exchange losses of $44 thousand and $0.6 million in the corresponding 2019-periods. The foreign exchange losses in the 2020-quarter primarily relate to the settlement of CAD-denominated intercompany payable in the US segment.

For the nine-month period ended September 30, 2020, the provision for bad debts was $2.3 million compared to $0.4 million in the 2019 nine-month period. The higher amount in 2020 resulted from provisions recognized in the first quarter of the year. Greater provisions in 2020 reflect increased credit risks of the Corporation's customers that stemmed primarily from the global impacts of COVID-19. During the third quarter of 2020, PHX Energy recognized a bad debt recovery of $1.6 million relating to certain receivables in the international segment.

(Stated in thousands of dollars)

	Three-month periods ended September 30,			Nine-month periods ended September 30,		
	2020	2019	% Change	**2020**	2019	% Change
Impairment loss	**-**	-	n.m.	**10,730**	-	n.m.

n.m. – not meaningful

For the nine-month period ended September 30, 2020, the Corporation recognized $10.7 million in impairment losses (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. As at September 30, 2020, management determined no indicators of impairment exist, from the time when impairment testing was last completed.

(Stated in thousands of dollars, except percentages)

	Three-month periods ended September 30,		Nine-month periods ended September 30,	
	2020	2019	**2020**	2019
Provision for (Recovery of) income taxes	**66**	1,086	**133**	1,830
Effective tax rates	**n.m.**	n.m.	**n.m.**	n.m.

n.m. – not meaningful

Provisions for income taxes for the three and nine-month periods ended September 30, 2020 were $66 thousand and $0.1 million, respectively, as compared to $1.1 million and $1.8 million in the respective 2019-periods. 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. Lower provisions in both 2020-periods was mainly due to decreased profits in the Corporation's operating regions.

Segmented Information

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

Canada

(Stated in thousands of dollars)

	Three-month periods ended September 30,			Nine-month periods ended September 30,		
	2020	2019	% Change	**2020**	2019	% Change
Revenue	**7,044**	19,123	(63)	**36,210**	54,651	(34)
Reportable segment profit (loss) before tax	**(328)**	(77)	n.m.	**95**	(4,328)	n.m.

n.m. – not meaningful

For the three and nine-month periods ended September 30, 2020, the Corporation's Canadian revenue was $7 million and $36.2 million, respectively, in comparison to revenue of $19.1 million and $54.7 million in the corresponding 2019-periods, a decrease of 63 percent and 34 percent, respectively. The decrease in PHX Energy's Canada segment revenue was mainly due to lower industry drilling activity. For the three-month period ended September 30, 2020, the Corporation's Canadian operating days declined 65 percent to 721 operating days, compared to 2,056 days in the relative 2019-quarter. The decline in the Canadian segment's activity was consistent with the decline in industry activity. The industry's horizontal and directional drilling activity contracted 70 percent as measured by drilling days shrinking from 12,109 days in the 2019-quarter to 3,649 days in the 2020-quarter (Source: Daily Oil Bulletin). For the nine-month period ended September 30, 2020, operating days declined 36 percent to 3,774 days, compared to 5,890 days in the same 2019-period. The Canadian industry activity decreased 35 percent to 22,183 horizontal and directional drilling days reported in the nine-month period of 2020 as compared to 33,955 horizontal and directional drilling days in 2019 (Sources: Daily Oil Bulletin).

During the third quarter of 2020, the Corporation remained active in the Montney and Duvernay.

Despite the decline in revenue in the 2020-periods, reportable segment loss in the third quarter of 2020 was minimized to $0.3 million and in the 2020 nine-month period, reportable segment income of $0.1 million was realized compared to a loss of $4.3 million in the corresponding 2019-period. The increase in profitability in the 2020 nine-month period is mainly attributable to lower depreciation, less equipment repair costs, and grants earned from the CEWS program of $2.1 million.

United States

(Stated in thousands of dollars)

	Three-month periods ended September 30,			Nine-month periods ended September 30,		
	2020	2019	% Change	**2020**	2019	% Change
Revenue	**30,337**	68,265	(56)	**143,074**	198,399	(28)
Reportable segment income before tax	**678**	6,623	(90)	**9,835**	15,746	(38)

PHX Energy's US operations continued to gain market share and remain profitable in a quarter when the industry hit its lowest activity level in history. In the third quarter of 2020, revenue from PHX Energy's US operations decreased by 56 percent to $30.3 million from $68.3 million in the 2019-quarter. The US division's revenue represented 76 percent of consolidated revenue in the third quarter of 2020 (2019 - 73 percent). Lower revenue in the 2020-quarter mainly resulted from the significantly reduced industry rig count. The US industry rig count for the third quarter of 2020 saw horizontal and directional rigs running per day decrease by 72 percent from an average of 920 horizontal and directional drilling rigs running per day during the 2019-quarter to 254 in the 2020-quarter. (Source: Baker Hughes). In comparison, the Corporation's US activity only declined 55 percent in this challenging environment, decreasing from 3,850 operating days in the 2019-quarter to 1,747 in the 2020-quarter. During the third quarter of 2020, Phoenix USA remained active in the Permian, Granite Wash, SCOOP/STACK, Marcellus, Bakken and Niobrara basins.

For the three-month period ended September 30, 2020, average revenue per day, excluding the Corporation's US motor rental division, decreased 3 percent to $16,597 relative to $17,032 in the corresponding 2019-quarter. Reportable segment income decreased from $6.6 million in the 2019-quarter to $0.7 million in the third quarter of 2020. This reduced profitability primarily resulted from the drop in activity in the US.

For the nine-month period ended September 30, 2020, Phoenix USA's revenue declined to $143.1 million, a decrease of 28 percent compared to the $198.4 million recognized in the 2019-period. Operating days for the nine-month period ended September 30, 2020 declined by 31 percent to 7,946 days as compared to 11,502 days in the same 2019-period. PHX Energy's operations showed resilience to the industry downturn as the Corporation's activity decline was not as sharp as the industry's and Phoenix USA gained market share. US industry activity, as measured by the average number of horizontal and directional rigs running on a daily basis, fell 49 percent from 930 rigs in the corresponding 2019 period to an average of 477 rigs in the comparable 2020-period (Source: Baker Hughes).

For the nine-month period ended September 30, 2020, Phoenix USA's average revenue per day, excluding the Corporation's motor rental division, was $17,139, which is 4 percent higher than the $16,465 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 Corporation's high performance technologies. For the nine-month period ended September 30, 2020, despite lower revenues, PHX Energy's US division realized reportable segment income of $9.8 million (2019 – $15.7 million). The strong volume of activity and profitability in the first quarter of 2020 and lower depreciation expense greatly contributed to this result.

International

(Stated in thousands of dollars)

	Three-month periods ended September 30,			Nine-month periods ended September 30,		
	2020	2019	% Change	**2020**	2019	% Change
Revenue	**2,395**	**5,711**	(58)	**10,280**	**15,154**	(32)
Reportable segment income (loss) before tax	**(1,464)**	**304**	n.m.	**(1,447)**	**369**	n.m.

n.m. – not meaningful

For the three-month period ended September 30, 2020, the International segment's revenue was $2.4 million, a 58 percent decrease from the $5.7 million in the 2019-quarter. PHX Energy generated 6 percent of its consolidated revenue from its International operations in the 2020-quarter which is the same percentage as in the third quarter of 2019. For the nine-month period ended September 30, 2020, the International segment's revenue was $10.3 million, a 32 percent decrease compared to $15.2 million in the same 2019-period. The decrease in revenue in both 2020-periods is mainly a result of Albanian operations being suspended since the first quarter of 2020.

For the three-month period ended September 30, 2020, the Russian division's revenue was 23 percent lower compared to the 2019-quarter. The division had fewer operating days in the 2020-quarter, generating 183 days compared to 455 in the 2019-quarter. The decrease in activity was partially offset by an improvement in MWD rental revenue.

For the three and nine-month periods ended September 30, 2020, the International segment recognized reportable segment losses of $1.5 million and $1.4 million, respectively, compared to reportable segment income in 2019 of $0.3 million and $0.4 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)

	Sep-20	Jun-20	Mar-20	Dec-19	Sept-19	Jun-19	Mar-19	Dec-18
Revenue	**39,776**	46,769	103,019	93,853	93,099	82,984	92,121	92,335
Net income (loss)	**(1,505)**	(4,899)	(3,321)	(1,720)	2,594	(2,020)	(1,067)	(18,355)
Loss per share – basic	**(0.03)**	(0.09)	(0.06)	(0.03)	0.05	(0.04)	(0.02)	(0.32)
Loss per share – diluted	**(0.03)**	(0.09)	(0.06)	(0.03)	0.05	(0.04)	(0.02)	(0.32)
Adjusted EBITDA (1)	**7,469**	5,308	18,686	12,399	15,536	10,995	11,431	14,736
Funds from operations (1)	**5,481**	3,157	20,791	11,344	14,669	9,785	10,100	12,803

(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 September 30,		Nine-month periods ended September 30,	
	2020	**2019**	**2020**	**2019**
Funds from operations(1)	**5,481**	14,669	**29,429**	34,554

	September 30, '20	Dec. 31, '19
Working capital (1)	**56,416**	68,393

(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.

Funds from operations decreased from $14.7 million in the 2019 third quarter to $5.5 million in the corresponding 2020-quarter. For the nine-month period ended September 30, 2020, funds from operations decreased to $29.4 million from $34.6 million in the comparable 2019-period. The decrease in funds from operations in both 2020-periods was generally due to the decline in activity levels in all of the Corporation's operating segments that resulted primarily from the continued weak commodity prices and the impact of the COVID-19 on the general economy in the third quarter of 2020.

As at September 30, 2020, the Corporation had working capital of $56.4 million, which is $12 million lower than the $68.4 million reported at December 31, 2019. The decrease in working capital was mainly due to the lower level of trade receivables at September 30, 2020 which resulted largely from decreased revenue in the 2020-periods.

Investing Activities

Net cash used in investing activities for the three-month period ended September 30, 2020 was $1.3 million as compared to $4.4 million in 2019. In the third quarter of 2020, PHX Energy added $1.8 million in drilling and other equipment (2019 - $8.4 million) and received proceeds from involuntary disposal of drilling equipment in well bores of $0.8 million (2019 - $5.8 million). The expenditures in the 2020-quarter included:

- $1.7 million in MWD systems and spare components; and
- $0.1 million in downhole performance drilling motors.

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 $0.1 million was used to grow the Corporation's fleet of drilling equipment and the remaining $1.7 million was used to maintain the current fleet of drilling and other equipment.

The change in non-cash working capital balance of $0.3 million (use of cash) for the three-month period ended September 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 $1.6 million (use of cash) for the three-month period ended September 30, 2019.

Financing Activities

The Corporation reported cash flows used in financing activities of $3.9 million in the three-month period ended September 30, 2020 as compared to $6.1 million in the 2019-period. In the 2020-quarter the Corporation:

- repurchased 2,270,600 common shares for $3.2 million under the NCIB; and
- made payments of $0.7 million towards lease liability.

Capital Resources

As of September 30, 2020, the Corporation had nothing drawn on its syndicated and operating facilities, and a cash balance of $18.9 million. As at September 30, 2020, the Corporation had approximately CAD $65 million and USD $15 million available from its credit facilities. The credit facilities are subject to a borrowing base limit which is $67 million as at September 30, 2020. The credit facilities are secured by substantially all of the Corporation's assets.

As at September 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 September 30, 2020, the Corporation has commitments to purchase drilling and other equipment for $3.5 million, with delivery expected to occur by the end of the year.

Off-Balance Sheet Arrangements

The Corporation had no off-balance sheet arrangements as at September 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 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.

Included in the consolidated statement of comprehensive loss for the three and nine-month periods ended September 30, 2020 are government grants relating to the CEWS program of $1.3 million and $2.4 million, respectively.

Business Risk Factors

Other than as described in this MD&A in connection with the potential and ongoing impact of COVD-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 July 1, 2020 and ended on September 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

(In thousands of shares)	**As at November 4, 2020**
Common shares outstanding	50,980,820
Dilutive securities:	
Options	3,440,267
Corporation shares – diluted	54,421,087

Outlook

During the third quarter, we achieved positive adjusted EBITDA, gained market share and maintained a cash positive position with zero bank debt despite the global COVID-19 pandemic and muted demand for energy continuing to impact our financial results. We remained diligently focused on cost management strategies and operational excellence which allowed us to produce these achievements in an extremely challenging environment.

With the prolonged duration of this pandemic, safety remains at the forefront of our activities. As new waves of COVID-19 develop, we continue to monitor the situation and the safety and health guidelines set out by government and health officials, adapting our operations and protocols as needed.

While the rig counts in North America fell to all-time lows during the third quarter, our strong reputation continued to position us as one of the most active providers in our sector. Today we work for 12 of the largest 15 operators in the US market. In this depressed environment, client mix is even more vital than ever as fewer operators account for a larger portion of the active rigs. In the US, the industry decline was greater than that experienced by our operations and in Canada we paralleled the industry decline. This resilience in a down market is testament to our strong marketing relationships, the performance of our premium technology and the expertise of our personnel.

We continue to focus on our strategic initiatives that are positioning us to outlast and survive this downturn and to grow when a meaningful market recovery occurs. Our priorities remain focused on building our balance sheet strength, maintaining positive adjusted EBITDA and cash flows despite declining revenue and activity and protecting our position as a technology leader. We continue to monitor, evaluate and adjust our business costs in line with drilling activity in North America and will continue to implement changes as required.

In the fourth quarter rig counts are slightly increasing, and our activity levels are also seeing a slight uptick from the third quarter as we have gained additional work from both existing and new clients. We are hopeful this trend will continue into 2021, given the recent strength in natural gas prices. That said, this is a very volatile time surrounded with uncertainty and conditions can change rapidly. Although we are in an enviable position both operationally and financially, any recovery will be gradual, and challenges, such as pricing pressure, will remain especially if the competitive landscape in our sector does not change.

We believe we are positioned to grow and protect our place both as an operational and financial leader in our sector as we all navigate the road ahead.

Michael Buker
President
November 4, 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 September 30,		Nine-month periods ended September 30,	
	2020	2019	**2020**	2019
Net income (loss)	**(1,505)**	2,594	**(9,725)**	(494)
Add (deduct):				
Depreciation and amortization drilling and other equipment	**6,977**	9,894	**22,794**	30,178
Depreciation and amortization right-of-use asset	**861**	896	**2,723**	2,642
Impairment loss	**-**	-	**10,730**	-
Severance expense	**102**	-	**2,033**	-
Provision for income taxes	**66**	1,086	**133**	1,830
Finance expense	**133**	306	**661**	1,090
Finance expense lease liability	**573**	622	**1,799**	1,897
Equity-settled share-based payments	**66**	160	**214**	559
Unrealized foreign exchange (gain) loss	**196**	(22)	**100**	259
Adjusted EBITDA as reported	**7,469**	15,536	**31,462**	37,961

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

Funds from Operations

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

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

(Stated in thousands of dollars)

	Three-month periods ended September 30,		Nine-month periods ended September 30,	
	2020	2019	**2020**	2019
Cash flows from operating activities	**9,400**	9,721	**57,781**	40,665
Add (deduct):				
Changes in non-cash working capital	**(3,989)**	4,699	**(28,277)**	(6,756)
Interest paid	**47**	172	**335**	668
Income taxes paid (received)	**23**	77	**(410)**	(23)
Funds from operations	**5,481**	14,669	**29,429**	34,554

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 September 30,		Nine-month periods ended September 30,	
	2020	2019	**2020**	2019
Funds from operations [1]	**5,481**	14,669	**29,429**	34,554
Deduct:				
Maintenance capital expenditures	**(1,691)**	(1,658)	**(5,478)**	(7,956)
Cash payment on leases	**(1,246)**	(1,442)	**(4,068)**	(4,272)
Free cash flow	**2,544**	11,569	**19,883**	22,326

[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)

	September 30, 2020	December 31, 2019
ASSETS		
Current assets:		
Cash and cash equivalents	**$ 18,889,321**	$ 10,582,296
Trade and other receivables	**30,231,680**	93,641,885
Inventories	**31,089,870**	30,826,700
Prepaid expenses	**2,119,286**	2,569,046
Current tax assets	**449,254**	-
Total current assets	**82,779,411**	137,619,927
Non-current assets:		
Drilling and other equipment (Note 5)	**76,545,462**	78,416,229
Right-of-use asset	**29,912,917**	32,825,964
Intangible assets	**16,906,645**	18,901,559
Goodwill (Note 6)	**-**	8,876,351
Deferred tax assets	**670,800**	613,355
Total non-current assets	**124,035,824**	139,633,458
Total assets	**$ 206,815,235**	$ 277,253,385
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Operating facility (Note 7)	**$ -**	$ 11,395,835
Lease liability	**3,316,277**	2,765,633
Trade and other payables	**23,046,780**	54,892,277
Current tax liability	**-**	172,766
Total current liabilities	**26,363,057**	69,226,511
Non-current liabilities:		
Lease liability	**36,821,093**	39,753,860
Loans and borrowings (Note 7)	**-**	13,896,400
Deferred tax liability	**8,134,294**	5,432,527
Total non-current liabilities	**44,955,387**	59,082,787
Equity:		
Share capital (Note 8a)	**248,027,502**	251,815,183
Contributed surplus	**10,153,802**	10,854,650
Retained earnings	**(137,627,915)**	(127,902,593)
Accumulated other comprehensive income	**14,943,402**	14,176,847
Total equity	**135,496,791**	148,944,087
Total liabilities and equity	**$ 206,815,235**	$ 277,253,385

See accompanying notes to unaudited condensed consolidated interim financial statements.

Condensed Consolidated Statements of Comprehensive Loss

(unaudited)

	Three-month periods ended September 30,		Nine-month periods ended September 30,	
	2020	2019	**2020**	2019
Revenue	**$ 39,775,807**	$ 93,099,227	**$ 189,564,243**	$ 268,203,575
Direct costs	**35,606,558**	77,089,805	**163,837,043**	228,140,741
Gross profit	**4,169,249**	16,009,422	**25,727,200**	40,062,834
Expenses:				
Selling, general and administrative expenses	**6,203,506**	10,615,982	**20,537,315**	35,212,139
Research and development expenses	**216,019**	1,193,183	**1,795,964**	2,972,786
Finance expense	**132,827**	306,097	**661,426**	1,089,722
Finance expense lease liability	**573,301**	622,196	**1,799,316**	1,896,879
Other income (Note 9)	**(1,517,516)**	(407,597)	**(204,350)**	(2,445,385)
Impairment loss (Notes 5 and 6)	**-**	-	**10,729,587**	-
	5,608,137	12,329,861	**35,319,258**	38,726,141
Earnings (loss) before income taxes	**(1,438,888)**	3,679,561	**(9,592,058)**	1,336,693
Provision for (Recovery of) income taxes				
Current	**4,786**	121,492	**(741,788)**	590,276
Deferred	**61,503**	964,563	**875,052**	1,239,976
	66,289	1,086,055	**133,264**	1,830,252
Net earnings (loss)	**(1,505,177)**	2,593,506	**(9,725,322)**	(493,559)
Other comprehensive income (loss)				
Foreign currency translation	**(3,889,876)**	1,001,351	**766,555**	(1,660,718)
Total comprehensive income (loss) for the period	**$ (5,395,053)**	$ 3,594,857	**$ (8,958,767)**	$ (2,154,277)
Loss per share – basic	**$ (0.03)**	$ 0.05	**$ (0.18)**	$ (0.01)
Loss per share – diluted	**$ (0.03)**	$ 0.05	**$ (0.18)**	$ (0.01)

See accompanying notes to unaudited condensed consolidated interim financial statements.

Condensed Consolidated Statements of Changes in Equity

(unaudited)

Nine-month period ended September 30, 2020	**Share Capital Number**		**Share Capital Amount ($)**		**Contributed Surplus**		**Accumulated Other Comprehensive Income**		**Retained Earnings**		**Total Equity**
Balance, December 31, 2019	**53,246,420**	**$**	**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**
Common Shares repurchased	**(2,270,600)**		**(3,192,246)**		**-**		**-**		**-**		**(3,192,246)**
Surrender value of options exercised	**-**		**(1,518,042)**		**-**		**-**		**-**		**(1,518,042)**
Share-based payments	**-**		**-**		**214,009**		**-**		**-**		**214,009**
Fair value of options exercised	**-**		**914,857**		**(914,857)**		**-**		**-**		**-**
Net loss	**-**		**-**		**-**		**-**		**(9,725,322)**		**(9,725,322)**
Foreign currency translation	**-**		**-**		**-**		**766,555**		**-**		**766,555**
Balance, September 30, 2020	**50,980,820**		**248,027,502**		**10,153,802**		**14,943,402**		**(137,627,915)**		**135,496,791**

Nine-month period ended September 30, 2019	Share Capital Number		Share Capital Amount ($)		Contributed Surplus		Accumulated Other Comprehensive Income		Retained Earnings		Total Equity
Balance, December 31, 2018	57,963,720	$	265,760,391	$	10,631,982	$	17,406,514	$	(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	(3,039,400)		(9,324,191)		-		-		-		(9,324,191)
Share-based payments	-		-		559,317		-		-		559,317
Fair value of options exercised	-		42,826		(42,826)		-		-		-
Net loss	-		-		-		-		(493,559)		(493,559)
Foreign currency translation	-		-		-		(1,660,718)		-		(1,660,718)
Balance, September 30, 2019	54,969,320	$	256,566,776		11,148,473		15,745,796		(126,183,032)		157,278,013

See accompanying notes to unaudited condensed consolidated interim financial statements.

Condensed Consolidated Statements of Cash Flows

(unaudited)

	Three-month periods ended September 30,		Nine-month periods ended September 30,	
	2020	2019	**2020**	2019
Cash flows from operating activities:				
Net earnings (loss)	**$ (1,505,177)**	$ 2,593,506	**$ (9,725,322)**	$ (493,559)
Adjustments for:				
Depreciation and amortization	**6,977,324**	9,893,523	**22,794,025**	30,178,287
Depreciation and amortization right-of-use asset	**860,942**	895,878	**2,723,376**	2,641,400
Impairment loss	**-**	-	**10,729,587**	-
Provision for income taxes	**66,289**	1,086,055	**133,264**	1,830,252
Unrealized foreign exchange loss (gain)	**196,489**	(21,904)	**100,158**	259,105
Gain on disposition of drilling equipment	**(136,060)**	(513,628)	**(2,544,631)**	(3,390,124)
Equity-settled share-based payments	**65,888**	160,260	**214,009**	559,317
Finance expense	**132,827**	306,097	**661,426**	1,089,722
Provision for (Recovery of) bad debts	**(1,608,021)**	61,590	**2,343,733**	387,728
Provision for inventory obsolescence	**431,190**	207,958	**2,000,430**	1,491,260
Interest paid	**(47,314)**	(172,424)	**(335,375)**	(667,712)
Income taxes received (paid)	**(23,362)**	(77,482)	**409,602**	23,389
Change in non-cash working capital	**3,988,970**	(4,698,171)	**28,276,583**	6,755,880
Net cash from operating activities	**9,399,985**	9,721,258	**57,780,865**	40,664,945
Cash flows from investing activities:				
Proceeds on disposition of drilling equipment	**837,528**	5,779,886	**5,472,487**	11,823,951
Acquisition of drilling and other equipment	**(1,815,513)**	(8,443,739)	**(22,245,353)**	(28,840,422)
Acquisition of intangible assets	**-**	(66,180)	**-**	(66,180)
Change in non-cash working capital	**(295,943)**	(1,631,833)	**(373,126)**	(5,345,034)
Net cash used in investing activities	**(1,273,928)**	(4,361,866)	**(17,145,992)**	(22,427,685)
Cash flows from financing activities:				
Proceeds from (repayment of) loans and borrowings	**-**	(1,308,700)	**(13,960,400)**	3,179,000
Proceeds from (repayment of) operating facility	**-**	9,827	**(11,395,835)**	(6,780,490)
Payments of lease liability	**(672,480)**	(819,493)	**(2,269,075)**	(2,374,837)
Surrender value cash payment	**-**	-	**(1,518,042)**	-
Repurchase of shares under the NCIB	**(3,192,246)**	(3,978,754)	**(3,192,246)**	(9,324,191)
Proceeds from issuance of share capital	**-**	-	**7,750**	87,750
Net cash used in financing activities	**(3,864,726)**	(6,097,120)	**(32,327,848)**	(15,212,768)
Net increase (decrease) in cash and cash equivalents	**4,261,331**	(737,728)	**8,307,025**	3,024,492
Cash and cash equivalents, beginning of period	**14,627,990**	7,405,638	**10,582,296**	3,643,418
Cash and cash equivalents, end of period	**$ 18,889,321**	$ 6,667,910	**$ 18,889,321**	$ 6,667,910

See accompanying notes to unaudited condensed consolidated interim financial statements.

Notes to the Condensed Consolidated Financial Statements

For the three and nine-month periods ended September 30, 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, Russia and Albania. 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 November 4, 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 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 have been difficult and are 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.

For the three and nine-month periods ended September 30, 2020, government grants relating to the Canadian Emergency Wage Subsidy program of $1.3 million and $2.4 million, respectively, were included in the consolidated statement of comprehensive loss.

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 September 30,	**2020**	2019	**2020**	2019	**2020**	2019	**2020**	2019
Total revenue	**7,044**	19,123	**30,337**	68,265	**2,395**	5,711	**39,776**	93,099
Reportable segment profit (loss) before income taxes	**(328)**	(77)	**678**	6,623	**(1,464)**	304	**(1,114)**	6,850

(Stated in thousands of dollars)

	Canada		United States		International		Total	
Nine-month periods ended September 30,	**2020**	2019	**2020**	2019	**2020**	2019	**2020**	2019
Total revenue	**36,210**	54,651	**143,074**	198,399	**10,280**	15,154	**189,564**	268,204
Reportable segment profit (loss) before income taxes	**95**	(4,328)	**9,835**	15,746	**(1,447)**	369	**8,483**	11,787

(Stated in thousands of dollars)

	Canada		**United States**		**International**		**Total**	
As at September 30,	**2020**	2019	**2020**	2019	**2020**	2019	**2020**	2019
Drilling and other equipment	**16,620**	23,537	**57,105**	56,547	**2,820**	4,947	**76,545**	85,031
Goodwill	**-**	8,876	**-**	-	**-**	-	**-**	8,876

Reconciliation of reportable segment profit and other material items

(Stated in thousands of dollars)

	Three-month periods ended September 30,		Nine-month periods ended September 30,	
	2020	2019	**2020**	2019
Reportable segment profit (loss) before income taxes	**(1,114)**	6,850	**8,483**	11,787
Corporate:				
Selling, general and administrative expenses	**921**	1,457	**3,293**	6,935
Research and development expenses	**216**	1,193	**1,796**	2,973
Finance expense	**133**	306	**661**	1,090
Finance expense lease liability	**573**	622	**1,799**	1,897
Impairment loss	**-**	-	**10,730**	-
Other income	**(1,518)**	(408)	**(204)**	(2,445)
Earnings (loss) before income taxes	**(1,439)**	3,680	**(9,592)**	1,337

5. Drilling and Other Equipment

a) Stream Drilling and Other Equipment Derecognition

The Corporation has 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 nine-month period ended September 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 September 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 nine-month period ended September 30, 2020, the Corporation acquired assets with a cost of $22.2 million (2019 - $28.8 million).

Assets with a carrying amount of $2.9 million (2019 - $8.4 million) were disposed of as a result of tools lost down hole and scrapped assets, resulting in a net gain on disposition of $2.5 million (2019 - $3.4 million), which is included in other income in the condensed consolidated statement of comprehensive loss.

d) Capital Commitments

As at September 30, 2020, the Corporation has commitments to purchase drilling and other equipment for $3.5 million, delivery is expected to occur by the end of the fourth 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 September 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 September 30, 2020 the Corporation was in compliance with all its financial covenants as follows:

Ratio	Covenant	**September 30, 2020**
Debt to covenant EBITDA	< 3.0x	**-**
Interest coverage ratio	> 3.0x	**36.37**

The Corporation has CAD $65 million and USD $15 million available to be drawn from its credit facilities as at September 30, 2020. The credit facilities are subject to a borrowing base limit. As at September 30, 2020, the borrowing base limit is $67 million.

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
Common Shares repurchased	**(2,270,600)**		**(3,192,246)**
Surrender value of options exercised	**-**		**(608,724)**
Issued shares pursuant to share option plan	**5,000**		**13,289**
Balance as at September 30, 2020	**50,980,820**	**$**	**248,027,502**

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.

<u>Summary of option grants in 2020</u>

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 nine-month periods ended September 30, 2020, the Corporation recognized total compensation expense of $0.1 million and $0.2 million, respectively (2019 - $0.2 million and $0.6 million, respectively) for share options granted between 2017 and 2020.

A summary of the status of the plan as at September 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	**(920,834)**	**1.75**	-	-
Expired	**(667,500)**	**6.88**	(200,000)	15.81
Outstanding, end of period	**3,440,267**	**3.00**	5,296,101	3.41
Options exercisable, end of period	**3,190,262**	**3.05**	4,796,093	3.54

In the first quarter of 2020, 820,834 options were forfeited and surrendered to the Corporation. 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 September 30, are as follows:

Options Outstanding				Options Exercisable	
Original Exercise Price	Number	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number	Weighted-Average Exercise Price
$ 1.55	155,000	0.43 yrs	$ 1.55	155,000	$ 1.55
1.71	175,000	1.88 yrs	1.71	175,000	1.71
1.79	575,000	1.88 yrs	1.79	575,000	1.79
1.95	165,267	1.03 yrs	1.95	165,267	1.95
2.00	200,000	2.44 yrs	2.00	200,000	2.00
2.09	100,000	4.43 yrs	2.09	33,332	2.09
2.19	150,000	4.43 yrs	2.19	49,998	2.19
2.81	200,000	3.44 yrs	2.81	133,332	2.81
2.83	50,000	3.44 yrs	2.83	33,333	2.83
3.41	25,000	1.15 yrs	3.41	25,000	3.41
4.06	1,230,000	1.42 yrs	4.06	1,230,000	4.06
4.15	415,000	1.42 yrs	4.15	415,000	4.15
	3,440,267	1.88 yrs	$ 3.00	3,190,262	$ 3.05

c) Retention Award Plan

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

PAs vesting and subsequent exercise is similar to RAs, except a payout multiplier is applied to the final payout. The payout multiplier is linked solely to total shareholder return on the Corporation’s common shares relative to returns on securities of members of the Corporation’s peer comparison group over the applicable vesting period and can range from a payout of zero percent to 200 percent. For the nine-month period ended September 30, 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 September 30, 2020, 1,500,000 PAs were outstanding (2019 – 1,316,668).

The Corporation recorded a total of $1.1 million compensation recovery relating to these plans for the nine-month period ended September 30, 2020 (2019 – $5.1 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 3,491,241 RAs and PAs outstanding as at September 30, 2020 (2019 – 3,636,199).

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

	2020	2019
RAs and PAs outstanding, beginning of year	**3,555,634**	3,443,456
Granted	**1,683,259**	1,622,897
Settled	**(1,645,142)**	(1,399,485)
Forfeited / cancelled	**(102,510)**	(30,669)
RAs and PAs outstanding, end of year	**3,491,241**	3,636,199

d) Normal Course Issuer Bid

During the third quarter of 2020, 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 3,131,388 common shares, representing 10 percent of the Corporation's public float of Common Shares as at July 31, 2020. The NCIB commenced on August 14, 2020 and will terminate on August 13, 2021. 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, 2,270,600 common shares were purchased by the Corporation and cancelled in the third quarter of 2020.

The Corporation's previous NCIB commenced on August 9, 2019 and terminated on August 8, 2020. Pursuant to the previous NCIB, 2,524,500 common shares were purchased by the Corporation and cancelled as at September 30, 2019.

9. Other Income

(Stated in thousands of dollars)

	Three-month periods ended September 30,		Nine-month periods ended September 30,	
	2020	2019	**2020**	2019
Net gain on disposition of drilling equipment	**(136)**	(514)	**(2,545)**	(3,390)
Foreign exchange losses (gains)	**226**	44	**(3)**	557
Provision for (Recovery of) bad debts	**(1,608)**	62	**2,344**	388
Other income	**(1,518)**	(408)	**(204)**	(2,445)

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

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