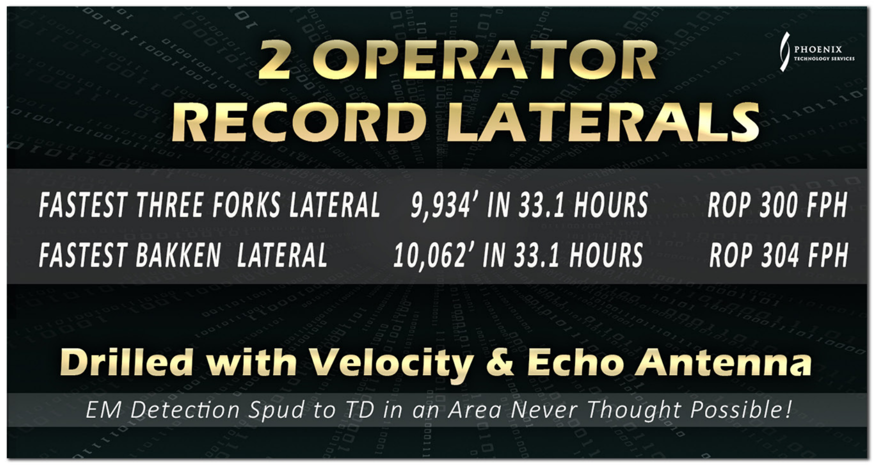
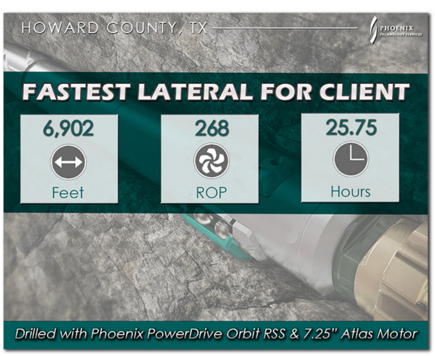
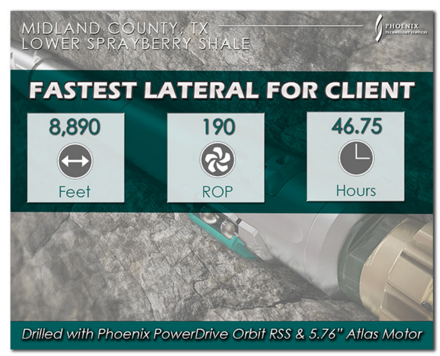
2020 ANNUAL REPORT







PHX
ENERGY SERVICES CORP.

Management's Discussion and Analysis

February 24, 2021

The following Management's Discussion and Analysis ("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 annual audited consolidated financial statements for the years ended December 31, 2020 and 2019, and the accompanying notes contained therein, as well as other sections contained within the Corporation's 2020 annual report. Readers can also obtain additional information on the Corporation from its most recent 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 February 24, 2021.

PHX Energy's audited annual financial statements for the years ended December 31, 2020 and 2019 have been prepared in accordance with International Financial Reporting Standards ("IFRS"). The MD&A and audited annual financial statements were reviewed by PHX Energy's Audit Committee and approved by PHX Energy's Board of Directors (the "Board") on February 24, 2021.

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 continuing impact of COVID-19 on the Corporation's operations, results and the Corporation's planned responses thereto;
- The anticipated closing of the transaction to sell the Russian division in the second quarter of 2021 and the terms of this transaction;
- Anticipated continuation of the Corporation's current dividend program;
- Equipment on order as at December 31, 2020 is expected to be delivered within the first half of 2021;
- PHX Energy currently anticipates that $15 million in capital expenditures will be spent in the 2021-year. The 2021 capital expenditure program is anticipated to principally be allocated toward maintaining the Corporation's high performance fleets;
- Peters & Co. Limited forecasts 2021 Canadian conventional capital spending to increase by approximately 19 percent over 2020;
- Capital spending for the most active operators in the US in 2020 was estimated by Peters & Co. Limited to be 48 percent lower than in 2019. They forecast in 2021 capital spending for the most active US operators will remain relatively flat.
- Planned expenditures are expected to be financed primarily by funds from operations. However, if a sustained period of market and commodity price uncertainty and financial market volatility persists in 2021, the Corporation's activity levels, cash flows and access to credit may be negatively impacted, in which event the proceeds from borrowing may be required to fund operations, and the expenditure level would be reduced accordingly;
- PHX Energy has made efforts to preserve its presence in Albania with minimal fixed costs anticipated during this dormant period; and,

The above are stated under the headings: "Overall Performance", "Industry Activity & Statistics", and "Cash Requirements for Capital Expenditures". In addition, all information contained within the "Critical Accounting Estimates and Judgments", "Financial Instruments", "Business Risk Factors" and "Outlook" sections of this MD&A may contain forward-looking information and 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 financing on acceptable terms to fund its planned expenditures, which are subject to change based on commodity prices; market conditions and future oil and natural gas prices; and potential timing delays. Although management considers these material factors, expectations, and assumptions to be reasonable based on information currently available to it, no assurance can be given that they will prove to be correct.

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

About PHX Energy Services Corp.

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

PHX Energy'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 fourth quarter of 2020, management, with approval from the Board, committed to a plan to sell the Russian division operating under the entity, Phoenix TSR LLC ("Phoenix TSR").

As at December 31, 2020, PHX Energy had 438 full-time employees (2019 – 835) and the Corporation utilized over 150 additional field consultants in 2020 (2019 – over 150).

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

Financial Highlights

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

	Three-month periods ended December 31,			Years ended December 31,		
	2020	2019	% Change	**2020**	2019	% Change
Operating Results – Continuing Operations	***(unaudited)***	*(unaudited)*				
Revenue	**54,805**	90,060	(39)	**233,734**	349,715	(33)
Earnings (loss)	**2,028**	(839)	n.m.	**(6,878)**	867	n.m.
Earnings (loss) per share – diluted	**0.04**	(0.02)	n.m.	**(0.13)**	0.02	n.m.
Adjusted EBITDA (1)	**8,502**	12,693	(33)	**39,217**	51,139	(23)
Adjusted EBITDA (1) per share – diluted	**0.17**	0.23	(26)	**0.75**	0.90	(17)
Adjusted EBITDA (1) as a percentage of revenue	**16%**	14%		**17%**	15%	
Cash Flow – Continuing Operations						
Cash flows from operating activities	**9,552**	9,741	(2)	**67,945**	51,972	31
Funds from operations (1)	**7,118**	11,814	(40)	**35,196**	48,037	(27)
Funds from operations per share – diluted (1)	**0.14**	0.21	(33)	**0.67**	0.84	(20)
Capital expenditures	**3,602**	5,417	(34)	**25,680**	34,007	(24)
Free cash flow (1)	**3,165**	6,737	(53)	**21,773**	31,011	(30)
Financial Position, December 31,						
Working capital (1)				**55,524**	68,393	(19)
Net Debt (1) (2)				**(25,746)**	14,710	n.m.
Shareholders' equity				**132,033**	148,944	(11)
Common shares outstanding				**50,625,920**	53,246,420	(5)

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 December 31, 2020, the Corporation had no bank loans outstanding and was in a cash positive position.

Non-GAAP Measures

Throughout this MD&A, PHX Energy uses 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, rational for use, method of calculation and reconciliations where applicable.

Overall Performance

In 2020, PHX Energy strengthened its financial position, eliminated all bank loans, re-purchased shares under its Normal Course Issuer Bid ("NCIB"), operated with positive margins, and achieved positive adjusted EBITDA that was only 23 percent lower than 2019. However, like other service providers in the oil and natural gas sector, the Corporation suffered a significant decline in the demand for its services due to the negative impact of COVID-19 on commodity prices and the associated reduction in the industry's capital spending and drilling activity.

For the year ended December 31, 2020, the Corporation generated consolidated revenue from continuing operations of $233.7 million, 33 percent lower than the $349.7 million generated in 2019 and consolidated operating days related to continuing operations decreased by 35 percent to 15,676 days in the 2020-year as compared to 23,952 days in the 2019-year. Aligning the Corporation's cost structure with activity levels was a key strategy and numerous cost-reducing initiatives were implemented. As a result of the Corporation's successful execution of these measures during the year, PHX Energy's adjusted EBITDA as a percentage of revenue improved to 17 percent of revenue in the 2020-year from 15 percent in the 2019-year. For the year ended December 31, 2020, the Corporation realized an adjusted EBITDA from continuing operations of $39.2 million which is 23 percent lower than the $51.1 million reported in 2019. Adjusted EBITDA in the 2020-year includes a provision of $1.5 million for bad debts and $5.4 million in government grants earned as part of the Canada Emergency Wage Subsidy ("CEWS") and the Canada Emergency Rental Subsidy ("CERS") programs.

For the year ended December 31, 2020, PHX Energy reported a loss from continuing operations of $6.9 million compared to earnings from continuing operations of $0.9 million in the 2019-year. The loss incurred during the 2020-year included pre-tax charges of $10.7 million related to impairment losses on goodwill and drilling and other equipment, and $1.9 million in severance costs.

The Corporation continued to maintain a strong financial position ending the 2020-year with a cash and cash equivalents balance of $25.7 million and no bank loans outstanding. For the year ended December 31, 2020, the Corporation's free cash flow was $21.8 million as compared to $31 million realized in the 2019-year.

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 the delivery of 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 fourth quarter of 2020 compared to 2019 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. As at December 31, 2020, the Corporation has working capital of $55.5 million and has approximately CAD $65 million and USD $15 million available from its credit facilities, subject to a borrowing base limit of $76 million. The Corporation minimized new capital expenditures in 2020 wherever it is was prudent to do so and will continue with a conservative approach to spending in 2021. Additional information regarding the risks, uncertainties and impact of COVID-19 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", "Business Risk factors – Impact of Pandemics – COVID-19", and "Outlook".

Assets Held for Sale and Discontinued Operations

In the fourth quarter of 2020, management, with approval from the Board, committed to a plan to sell the Russian division, Phoenix TSR. As at December 31, 2020, the operations of Phoenix TSR had not been sold, however, management anticipates the operations will be sold early in the second quarter of 2021. Accordingly, for the year ended December 31, 2020, net assets with a carrying value of $3.5 million owned by Phoenix TSR have been classified as assets held for sale and liabilities directly associated with assets held for sale and the financial results of Phoenix TSR have been presented as discontinued operations. The decision to sell the division is not anticipated to have a significant impact on the continuing operations of the Corporation. For the three-month period ended December 31, 2020, the Russian division incurred adjusted EBITDA of negative $48 thousand (2019 – negative $0.3 million). For the 2020-year, the Russian division incurred adjusted EBITDA of $0.7 million (2019 – negative $0.8 million). While the closing of this transaction is expected in the second quarter of 2021, there can be no assurance that the sale of the Russian division will be complete on the terms anticipated or at all.

Capital Spending

For the year ended December 31, 2020, the Corporation spent $25.7 million in capital expenditures, as compared to $34 million in capital expenditures in the previous year. Due to COVID-19's impact on rig counts in North America, the Corporation reduced new capital expenditures at the beginning of the second quarter of 2020. Capital expenditures in the 2020-year were primarily directed towards Atlas High Performance ("Atlas") Motors, Velocity Real Time Systems ("Velocity"), and PowerDrive Orbit Rotary Steerable Systems ("RSS"). Of the total capital expenditures, $17.7 million was spent on growing the Corporation's fleet of drilling equipment (2019 - $22.7 million) and the remaining $8 million was spent on maintenance of the current fleet of drilling and other equipment (2019 - $11.3 million).

As at December 31, 2020, the Corporation has capital commitments to purchase drilling and other equipment for $11.5 million, $7 million of which is growth capital and includes $5.7 million for performance drilling motors, $3.8 million for Velocity systems, $1.1 million for RSS, and $0.9 million for other equipment. PHX Energy currently anticipates that $15 million in capital expenditures will be spent in the 2021-year of which $8 million will be for maintenance of existing drilling and other equipment and $7 million for growth capital.

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 approximately 400 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.

Dividends

In light of the Corporation's balance sheet strength and improving adjusted EBITDA margins, in December 2020, the Board approved the reinstatement of the Corporation's quarterly dividend program. Dividends are only declared once they are approved by the Board. The Board reviews the Corporation's dividend policy on a quarterly basis. On December 7, 2020, PHX Energy declared a cash dividend of $0.025 per common share, and $1.3 million was paid on January 15, 2021 to shareholders of record at the close of business on December 31, 2020.

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, subsequent to August 14, 2020, 2,670,500 common shares were purchased by the Corporation and cancelled as at December 31, 2020. Subsequent to December 31, 2020, the Corporation purchased and cancelled the remaining 460,888 common shares eligible for repurchase under the current NCIB program.

The Corporation's previous NCIB commenced on August 9, 2019 and terminated on August 8, 2020. Pursuant to the previous NCIB, the 2,524,500 common shares eligible for repurchase were purchased and cancelled by the Corporation in the second half of 2019.

PHX Energy has continued to use NCIBs as an additional tool to enhance total long-term shareholder returns in conjunction with management's disciplined capital allocation strategy. In 2020, the Corporation purchased and cancelled 5 percent of its total common shares outstanding as at December 31, 2019, representing 11 percent of funds from operations.

Key Drivers of the Corporation's Business

PHX Energy considers the following to be the key drivers of its business:

- World demand for natural gas and oil commodities directly affect oil and natural gas prices. These in turn have a direct impact on the Corporation's customers' level of cash flows and their ability to fund capital drilling programs with the use of debt or equity financing, ultimately impacting PHX Energy's activity levels.
- New drilling technologies must be continually developed for the Corporation to further expand and meet the ongoing demands from its customers, oil and natural gas producing companies, for greater operating efficiencies.
- Superior customer service and satisfaction must be delivered and achieved consistently in order to retain business.
- The Corporation must attract, train and retain key personnel in order to ensure future growth.

Key Performance Measures

There are several performance measures that are used by the Corporation to assess its performance relative to its strategies and goals, the most significant of which are:

- Adjusted EBITDA(1) and adjusted EBITDA(1) as a percentage of revenue;
- gross profit margin;
- net debt (1),
- the reliability of the Corporation's equipment and ability to provide high quality services in the field, and
- health and safety performance targets.

(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.

Industry Activity and Statistics

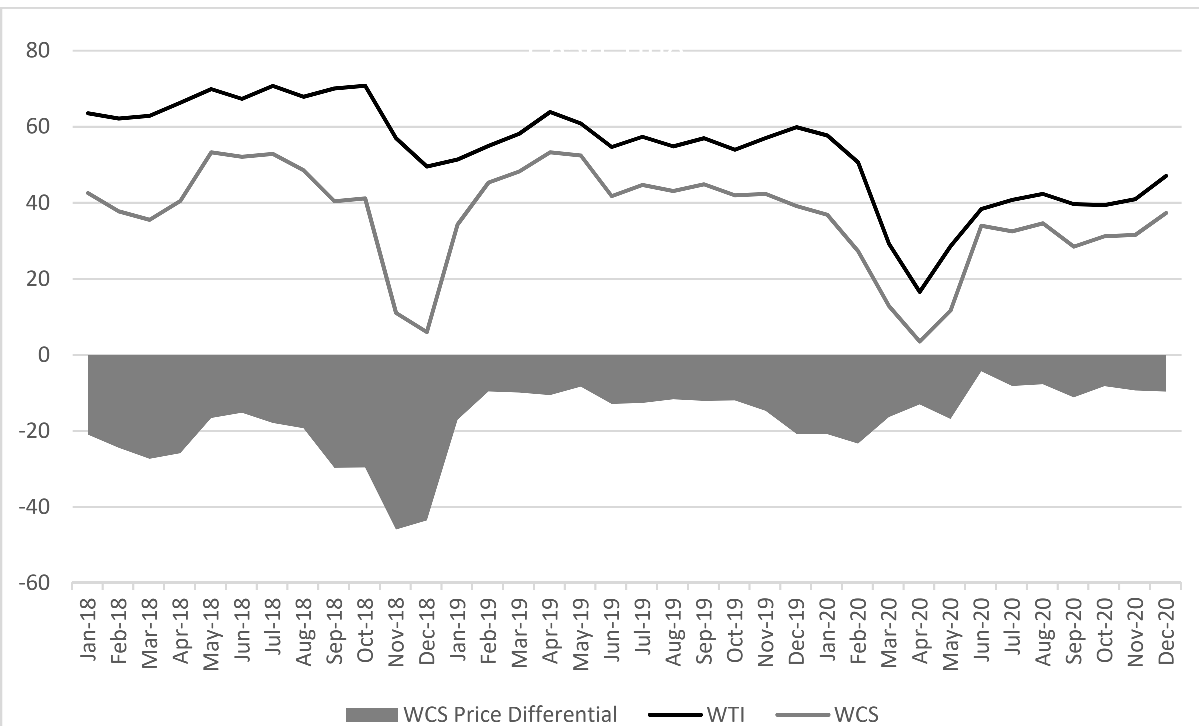
In 2020, the North American industry experienced the worst downturn in its history with rig counts dropping to all-time lows. This unprecedented decline and volatility were, in part, the result of COVID-19's impact on the global economy, energy demand and the decline in commodity prices.

Commodity Price Trends

The COVID-19 pandemic's impact on the global economy and energy demand led the already historically weak commodity prices to fall further. The average Western Texas Intermediate ("WTI") price was approximately USD $39 for the year (2019 – USD $57), which is the lowest it has been since 2002. The average price of Western Canadian Select ("WCS") was USD $27 in 2020 (2019 – USD $44). The average differential between WTI and WCS remained relatively consistent with the prior year and was USD $12 in both 2020 and 2019. (Source: Peters & Co. Limited, Energy Statistics, 12-31-2020 and Alberta Government Economic Dashboard - https://economicdashboard.alberta.ca/OilPrice).

WTI and WCS Crude Oil and WCS Differential ($US/bbl)

Source: Alberta Government Economic Dashboard - https://economicdashboard.alberta.ca/OilPrice



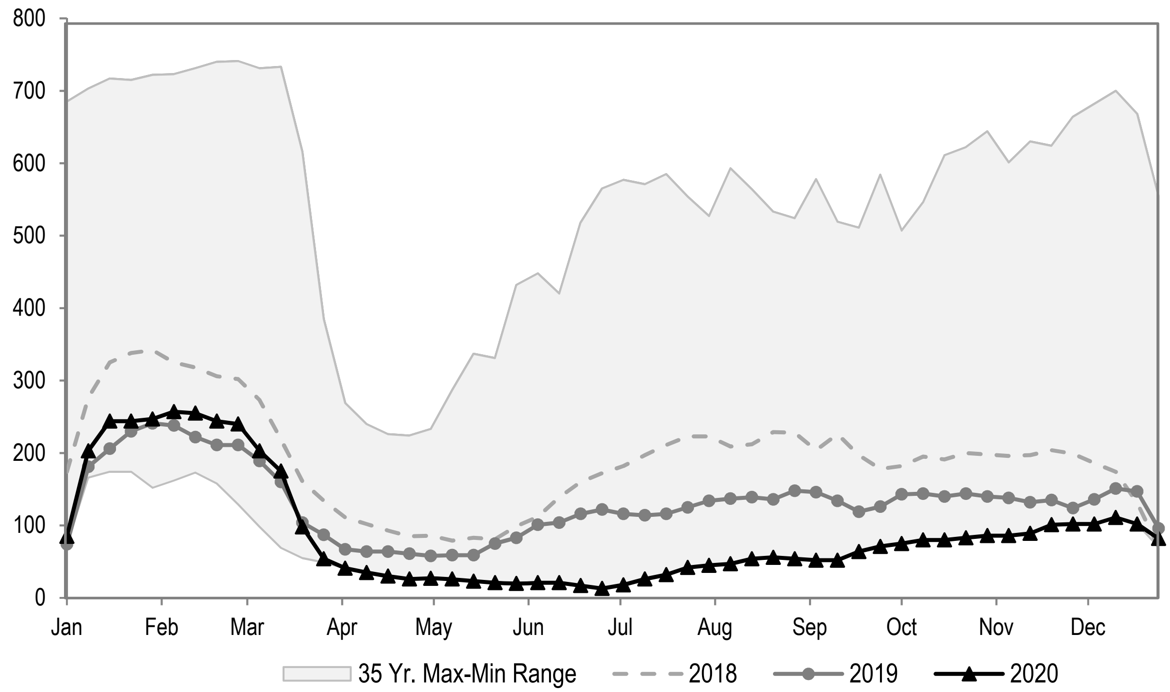
Natural gas commodity prices over the past few years have experienced significant volatility and 2020 added to the uncertainty of the natural gas market. The Henry Hub spot price in 2020 averaged USD $1.98 in 2020 (2019 – USD $2.57) while AECO-

C spot averaged CAD $2.24 in 2020 (2019 – CAD $1.78). Although, the Canadian gas prices did strengthen year-over-year, there is an oversupply in this market. (Source Peters & Co. Limited, Winter 2021 Energy Overview 01-12-21 and Peters & Co. Limited, Energy Statistics, 12-31-2020).

Canadian Industry

WCSB Active Drilling Rig Count

Source: Baker Hughes, North American Rotary Rig Count, 12-31-20



The Canadian market has been challenged for some time and has experienced weak activity levels for several years. In 2020, when COVID-19 became a global pandemic it compounded these challenges and the rig counts plummeted to new 35-year lows. In 2020, there was an average of 89 active rigs per day which is 34 percent fewer than the 134 rigs operating on average in 2019. Horizontal and directional drilling continues to be the norm in the industry, and combined, horizontal and directional wells represented 95 percent of the total 2020 industry drilling days (2019 – 96 percent). Oil well drilling represented 52 percent of the Canadian industry's average active rig count in 2020 which is slightly less than the 62 percent in 2019. (Source: Daily Oil Bulletin, hz-dir days 201231, 01-09-2020 and Baker Hughes, North American Rotary Rig Count, 12-31-20).

Canadian producers' conventional capital spending also declined approximately 31 percent year-over-year according to Peters & Co. Limited, and they forecast that 2021 conventional capital spending to increase by approximately 19 percent, which would still be below capital spending in 2019. (Source: Peters & Co. Limited, Winter 2021 Energy Overview, 01-12-21).

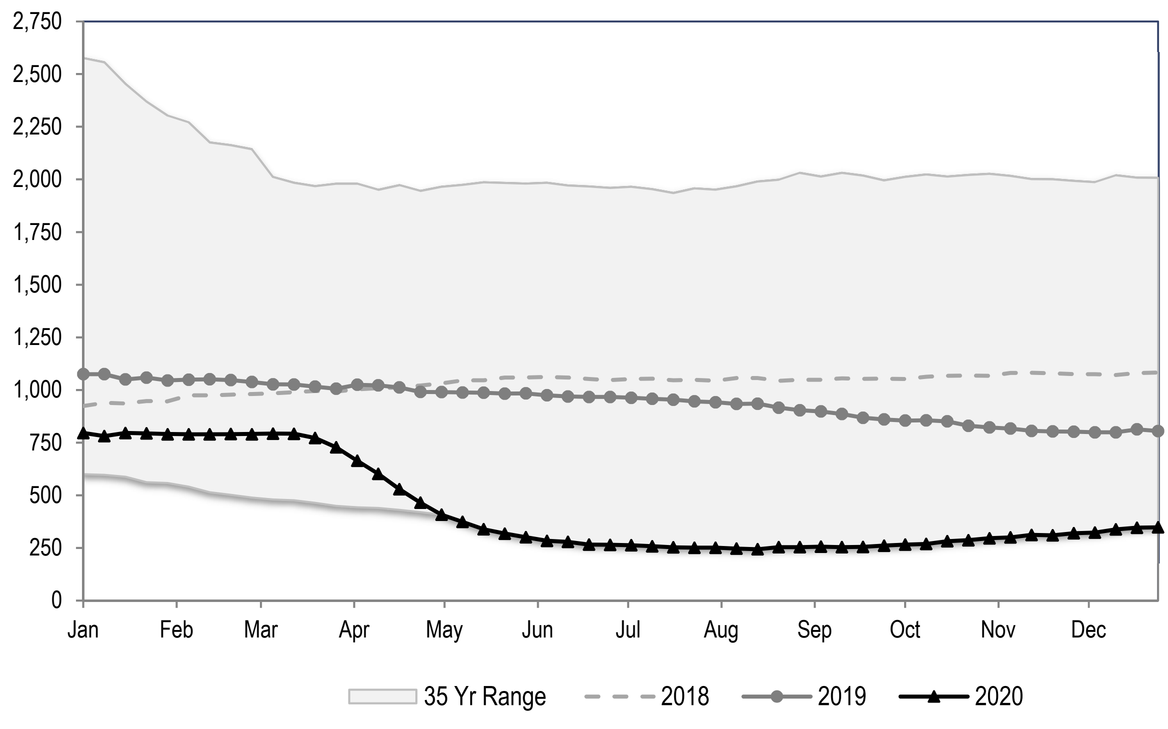
US Industry

The COVID-19 pandemic also caused the US rig counts to fall to historic lows, with active rigs per day reaching their lowest level in history during the summer. The average rig count fell 51 percent to 433 rigs operating per day in the 2020-year, as compared to an average of 889 rigs in 2019. From mid-March to August the number of active rigs fell 70 percent. A recovery did begin in late August with the rig count increasing by an average of 5 rigs per week however in December activity remained 57 percent below the year prior. The Permian basin continued to be the largest area of activity in the US, representing 51 percent of the average active rigs in 2020 (2019 - 47 percent). Horizontal and directional drilling continued to represent 95 percent of active rigs (2019 - 94 percent). (Source: Peters & Co. Limited, Energy Overview 2020, 01-13-20 and Baker Hughes, North American Rotary Rig Count, 01-24-20).

Capital spending for the most active operators in the US in 2020 was estimated by Peters & Co. Limited to be 48 percent lower than in 2019. They forecast in 2021 capital spending for the most active US operators will remain relatively flat. (Source: Peters & Co. Limited, Energy Overview 2020, 01-13-20).

US Active Drilling Rig Count

Baker Hughes, North American Rotary Rig Count, 12-31-20



Results of Continuing Operations

Three-Month Period and Year Ended December 31, 2020

Revenue

(Stated in thousands of dollars)

	Three-month periods ended December 31,			Years ended December 31,		
	2020	2019	% Change	**2020**	2019	% Change
Revenue	**54,805**	90,060	(39)	**233,734**	349,715	(33)

The negative impact of the COVID-19 pandemic on global oil demand and industry activity persisted through the fourth quarter of 2020. For the three-month period ended December 31, 2020, consolidated revenue decreased by 39 percent to $54.8 million compared to $90.1 million in the corresponding 2019-quarter. Consolidated operating days decreased by 32 percent to 3,956 days in the fourth quarter of 2020 from 5,789 days in the 2019-quarter. Average consolidated revenue per day for the three-month period ended December 31, 2020, excluding the motor rental division in the US, decreased to $13,520 which is 9 percent lower compared to the $14,827 realized in the fourth quarter of 2019. US revenue represented 77 percent of total consolidated revenue in the 2020 three-month period compared to 80 percent in the corresponding 2019-quarter.

Prior to COVID 19, the Canadian and US industries were on divergent paths, with the Canadian industry already facing challenges and low activity levels whereas the US had a more stable industry environment. As a result, the US rig count's decline was far steeper in the fourth quarter of 2020 than that of the Canadian rig count. In the US, the rig count declined by 61 percent from an average of 794 active rigs per day in the 2019-quarter to an average of 311 in the 2020-quarter. In Canada the quarter-over-quarter decrease was 36 percent with 89 active rigs per day in the fourth quarter of 2020 (2019 - 138 rigs). The Permian basin remained the most active play in North America representing 38 percent of the North American rig count. There was an average of 153 active Permian rigs in the fourth quarter of 2020, which is 53 percent lower than in the fourth quarter of 2019. Horizontal and directional drilling continues to dominate the market representing approximately 94 percent of the drilling activity in the US and 97 percent of activity in Canada. (Source: Daily Oil Bulletin and Baker Hughes).

For the year ended December 31, 2020, PHX Energy's consolidated revenue decreased by 33 percent to $233.7 million from revenue of $349.7 million in 2019. US revenue as a percentage of consolidated revenue was 79 percent for the 2020-year compared to 77 percent in 2019. There were 15,676 consolidated operating days in the 2020-year, which is 35 percent lower compared to the 23,952 days generated in 2019. Average consolidated revenue per day for the year ended December 31, 2020, excluding the motor rental division in the US, increased by 3 percent to $14,322 from $13,891 in 2019. Despite the industry downturn and decline in operating activity, the average revenue per day improved due to the increased efficiencies and greater utilization of PHX Energy's high performance technologies.

Operating Costs and Expenses

(Stated in thousands of dollars except percentages)

	Three-month periods ended December 31,			Years ended December 31,		
	2020	2019	% Change	**2020**	2019	% Change
Direct costs	**47,123**	77,635	(39)	**201,698**	296,832	(32)
Gross profit as a percentage of revenue	**14%**	14%		**14%**	15%	
Depreciation & amortization (included in direct costs)	**6,453**	9,170	(30)	**27,975**	37,827	(26)
Depreciation & amortization right-of-use asset (included in direct costs)	**838**	889	(6)	**3,555**	3,503	1
Gross profit as percentage of revenue excluding depreciation & amortization	**27%**	25%		**27%**	27%	

Direct costs are comprised of field and shop expenses and include depreciation and amortization of the Corporation's equipment and right-of-use assets. For the three-month period and year ended December 31, 2020, direct costs decreased by 39 and 32 percent, respectively, primarily as a result of lower activity in all of the Corporation's operating segments. In addition, for the 2020 three and twelve-month periods, government grants of $1.6 million and $3 million, respectively, that were earned as part of the CEWS and CERS programs, were recognized by the Corporation in direct costs.

The Corporation's depreciation and amortization on drilling and other equipment for the three-month period and year ended December 31, 2020, decreased by 30 percent and 26 percent, respectively, mainly due to the slower replacement of fully depreciated fixed assets.

Gross profit as a percentage of revenue excluding depreciation and amortization for the three-month period ended December 31, 2020 increased to 27 percent of revenue from 25 percent in the comparable 2019-period. On an annual basis, gross profit as a percentage of revenue excluding depreciation and amortization was flat at 27 percent in both 2020 and 2019. Despite the volatility in oil prices and the significant reduction in activity levels, management was able to maintain gross profit margins through government grant support, effective cost restructuring, and maintaining cost efficiencies in all major aspects of the Corporation's operations, particularly related to equipment repair costs and equipment rentals. Many difficult decisions, including reductions to staff levels and employee compensation, were made throughout the year, which resulted in $0.9 million of severance costs being incurred and included in direct costs in 2020.

(Stated in thousands of dollars except percentages)

	Three-month periods ended December 31,			Years ended December 31,		
	2020	2019	% Change	**2020**	2019	% Change
Selling, general and administrative ("SG&A") costs	**7,833**	9,966	(21)	**26,855**	43,391	(38)
Equity-settled share-based payments (included in SG&A costs)	**28**	52	(46)	**242**	612	(60)
Cash-settled share-based payments (included in SG&A costs)	**3,033**	1,743	74	**1,889**	6,819	(72)
SG&A costs excluding share- based payments as a percentage of revenue	**9%**	9%		**11%**	10%	

For the three-month period and year ended December 31, 2020, SG&A costs were $7.8 million and $26.9 million, respectively, as compared to $10 million and $43.4 million in the corresponding 2019-periods. The decrease in SG&A costs in both 2020-periods was mainly due to reduced personnel related costs and tightened policies on travel, entertainment, and marketing related costs as part of the Corporation's strategy to align its cost structure with lower activity in all regions. Included in SG&A costs for the year ended December 31, 2020 were severance payments of $1 million. For the 2020 three and twelve-month periods, government grants of $1.1 million and $1.9 million, respectively, that were earned as part of the CEWS and CERS programs were recognized by the Corporation in SG&A costs.

Cash-settled share-based payments relate to the Corporation's Retention Award Plan and are measured at fair value. In the 2020-quarter, the related compensation expense recognized by PHX Energy increased 74 percent to $3 million as compared to $1.7 million in the 2019-quarter. For the year ended December 31, 2020, the compensation expense related to cash-settled share-based retention awards is $1.9 million, a decrease of 72 percent compared to the 2019-year's expense of $6.8 million. Changes in cash-settled share-based payments in the 2020-periods are mainly attributable to fluctuations in the Corporation's share price period-over-period. There were 3,487,297 cash-settled share-based retention awards outstanding as at December 31, 2020 (2019 – 3,555,634).

Equity-settled share-based payments relate to the amortization of the fair values of issued options of the Corporation using the Black-Scholes model. For the three-month period and year ended December 31, 2020, equity-settled share-based payments decreased to $28 thousand and $0.2 million, respectively, compared to $52 thousand and $0.6 million in the same 2019-periods. The lower equity-settled share-based payments in both 2020-periods are largely due to previously granted options that fully vested in the 2019 and 2020-years and fewer options granted in recent years.

(Stated in thousands of dollars)

	Three-month periods ended December 31,			Years ended December 31,		
	2020	2019	% Change	**2020**	2019	% Change
Research and development expense	**148**	896	(83)	**1,944**	3,869	(50)

Research and development ("R&D") expenditures during the quarter and year ended December 31, 2020 were $0.1 million and $1.9 million, respectively, compared to $0.9 million and $3.9 million in the corresponding 2019-periods. PHX Energy's R&D focus continues to be on developing new technologies, improving reliability of equipment, and reducing costs to operations. The decrease in R&D expenditures in both 2020-periods is primarily due to the reduction of personnel related costs in the R&D department as part of management's cost alignment initiatives. R&D expenses for the three-month period and year ended December 31, 2020 also included government grants of $0.3 million and $0.5 million, respectively, earned as part of the CEWS program.

(Stated in thousands of dollars)

	Three-month periods ended December 31,			Years ended December 31,		
	2020	2019	% Change	**2020**	2019	% Change
Finance expense	**105**	333	(68)	**748**	1,423	(47)
Finance expense lease liability	**562**	612	(8)	**2,361**	2,508	(6)

Finance expenses relate to interest charges on the Corporation's long-term and short-term bank facilities. For the quarter and year ended December 31, 2020, the Corporation's finance expense decreased by 68 percent and 47 percent, respectively, relative to the same 2019-periods. Lower finance expenses in the 2020-periods are primarily due to the repayment of all bank loans in the first half of 2020.

Finance expense lease liability relates to interest expenses incurred on lease liabilities. For the three-month period and year ended December 31, 2020, finance expense lease liability decreased by 8 percent and 6 percent, respectively, reflecting the reduction in lease liabilities as lease obligations are fulfilled.

(Stated in thousands of dollars)

	Three-month periods ended December 31,		Years ended December 31,	
	2020	2019	**2020**	2019
Net gain on disposition of drilling equipment	**(1,236)**	(883)	**(3,694)**	(3,163)
Foreign exchange (gain) loss	**90**	(44)	**(82)**	(520)
Provision for (recovery of) bad debts	**(238)**	-	**1,530**	388
Other income	**(1,384)**	(927)	**(2,246)**	(3,295)

Net gain on disposition of drilling equipment typically result from insurance programs undertaken whereby proceeds for the lost equipment are at current replacement values, which are higher than the respective equipment's book value. The recognized gain is net of losses, which typically result from asset retirements that were made before the end of the equipment's useful life and self-insured downhole equipment losses. During the quarter and year ended December 31, 2020, the Corporation recognized $1.2 million and $3.7 million gain on dispositions, respectively, compared to $0.9 million and $3.2 million in the corresponding 2019-periods.

Foreign exchange gains and losses relate to unrealized and realized exchange fluctuations in the period. In the fourth quarter of 2020, the Corporation recognized $0.1 million in foreign exchange loss compared to a $44 thousand foreign exchange gain in the 2019-period. For the year ended December 31, 2020 and 2019, the Corporation reported foreign exchange gains of $0.1 million and $0.5 million, respectively. The foreign exchange loss in the 2020-quarter was primarily due to the revaluation of USD-denominated cash equivalents in the Canada segment whereas the decrease in foreign exchange gain in the 2020-year primarily relate to the settlement of CAD-denominated intercompany payable in the US segment.

In the fourth quarter of 2020, PHX Energy recovered $0.2 million of bad debts that primarily relate to US receivables. For the year ended December 31, 2020, the provision for bad debts was $1.5 million compared to $0.4 million in the 2019-period. The provisions recognized in 2020 reflect the increased credit risks of the Corporation's customers that stemmed primarily from the global impacts of COVID-19.

(Stated in thousands of dollars)

	Three-month periods ended December 31,			Years ended December 31,		
	2020	2019	% Change	**2020**	2019	% Change
Impairment loss on goodwill and drilling and other equipment	**-**	500	(100)	**10,730**	500	n.m.

n.m. – not meaningful

For the year ended December 31, 2020, the Corporation recognized $10.7 million in impairment losses (2019 - $0.5 million). In the first quarter of 2020, due to the negative impact of 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 loss of $8.9 million equivalent to the full amount of goodwill. The Corporation also determined that no further economic benefits are expected from the future use or future disposal of Stream Services ("Stream") electronic drilling recorder ("EDR") equipment. The Corporation has substantially closed all of its operations in Stream. As a result, EDR equipment and inventory with a combined carrying amount of $1.8 million were derecognized.

On December 31, 2020, the Corporation performed an assessment for impairment indicators in accordance with IFRS and determined that there were no impairment indicators warranting a further impairment test. In the comparative year ended December 31, 2019, the impairment loss of $0.5 million was related to Stream's EDR equipment.

(Stated in thousands of dollars except percentages)

	Three-month periods ended December 31,		Years ended December 31,	
	2020	2019	**2020**	2019
Provision for (Recovery of) income taxes	**(1,610)**	1,883	**(1,476)**	3,621
Effective tax rates	**n.m.**	n.m.	**18**	n.m.

n.m. – not meaningful

The recovery of income taxes for the three-month period and year ended December 31, 2020 was $1.6 million (2019 - $1.9 million provision) and $1.5 million (2019 - $3.6 million provision), respectively. The effective tax rates for the three-month period and year ended December 31, 2020 were lower than expected mainly due to unrecognized deferred tax assets of $0.5 million related to deductible temporary differences in the international jurisdiction.

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

	Three-month periods ended December 31,			Years ended December 31,		
	2020	2019	% Change	**2020**	2019	% Change
Earnings (loss) from continuing operations	**2,028**	(839)	n.m.	**(6,878)**	867	n.m.
Earnings (loss) per share – diluted	**0.05**	(0.02)	n.m.	**(0.13)**	0.02	n.m.
Adjusted EBITDA[(1)]	**8,502**	12,693	(33)	**39,217**	51,139	(23)
Adjusted EBITDA[(1)] per share – diluted	**0.17**	0.23	(26)	**0.75**	0.90	(17)
Adjusted EBITDA[(1)] as a percentage of revenue	**16%**	14%		**17%**	15%	

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.

For the three-month period and year ended December 31, 2020, the Corporation's adjusted EBITDA as a percentage of revenue increased to 16 percent and 17 percent, respectively, from 14 percent and 15 percent in the corresponding 2019-periods. The improvement in adjusted EBITDA as a percentage of revenue was mainly due to the cost saving initiatives implemented by management over the course of 2020 and the support from government grants.

Earnings from continuing operations in the 2020-quarter increased to $2 million as compared to a loss of $0.8 million in the 2019-quarter. The 2020-quarter earnings from continuing operations included $0.2 million of net bad debts recovery and $3 million in government grants earned as part of the CEWS and CERS programs. The 2019-quarter net loss included impairment loss of $0.5 million. For the year ended December 31, 2020, loss from continuing operations was $6.9 million compared to earnings of $0.9 million in the 2019-year. The loss incurred during the 2020-year included $10.7 million of impairment loss and $5.4 million of government grants earned as part of the CEWS and CERS programs.

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, mainly in Albania.

Canada

(Stated in thousands of dollars)

	Three-month periods ended December 31,			Years ended December 31,		
	2020	2019	% Change	**2020**	2019	% Change
Revenue	**12,821**	17,273	(26)	**48,676**	71,923	(32)
Reportable segment profit (loss) before tax [(1)]	**3,823**	(1,587)	n.m.	**3,916**	(5,917)	n.m.

n.m. - not meaningful
(1) Includes adjustments to intercompany transactions.

The Canadian oil and gas industry continued to face many challenges and in 2020 rig counts fell to the lowest levels in history. Despite these challenges, PHX Energy's Canadian operations remained resilient, focused on maintaining market share and providing superior drilling performance while protecting its margins through operational efficiencies and cost saving measures.

For the three-month period and year ended December 31, 2020, the Corporation's Canadian revenue was $12.8 million and $48.7 million, respectively, in comparison to revenue of $17.3 million and $71.9 million generated in the corresponding 2019-periods, a decrease of 26 percent and 32 percent, respectively. During the 2020-quarter, the Corporation's Canadian operating days decreased by 22 percent to 1,411 from 1,810 in the 2019-quarter. In comparison, total industry horizontal and directional drilling activity, as measured by drilling days decreased by 34 percent in the 2020-quarter to 7,509 days, compared to the 2019-quarter's 11,459 days. (Source: Daily Oil Bulletin). During the fourth quarter of 2020, the Corporation remained active in Montney, Glauconite, Frobisher, Cardium, Viking, Bakken, Torquay, and Scallion. For the year ended December 31, 2020, the Corporation's Canadian operating days was 5,184, that is 33 percent lower compared to 7,700 days generated in the 2019-year. This was in line with the industry's activity decline of 35 percent. The Canadian industry horizontal and directional drilling days decreased to 26,619 days in the 2020-year as compared to 45,414 days in 2019 (Source: Daily Oil Bulletin).

Reportable segment profit before tax for the three-month period ended December 31, 2020 increased to a profit of $3.8 million from a loss of $1.6 million in the 2019-period. For the year ended December 31, 2020, reportable segment profit increased to a profit of $3.9 million from a loss of $5.9 million in 2019. The increase in profitability in the 2020-periods is mainly attributable to lower depreciation, reduced operating expenses that resulted from cost reduction initiatives, and grants earned from the CEWS and CERS programs recognized in the Canada segment directly.

United States

(Stated in thousands of dollars)

	Three-month periods ended December 31,			Years ended December 31,		
	2020	2019	% Change	**2020**	2019	% Change
Revenue	**41,984**	71,629	(41)	**185,058**	270,028	(31)
Reportable segment profit before tax (1)	**(2,442)**	5,153	n.m.	**7,393**	20,899	(65)

n.m. – not meaningful
(1) Includes adjustments to intercompany transactions.

The US segment delivered positive earnings for the year ended December 31, 2020 despite limited emergency government aid, and the reduction in drilling activity associated with economic uncertainties.

For the three-month period ended December 31, 2020, the US segment's revenue decreased by 41 percent to $42 million from $71.6 million generated in the 2019-period. The decrease in revenue was mainly a result of the Corporation's US operating days declining by 34 percent to 2,546 days from 3,847 days in the 2019-quarter. This is far less than the 61 percent drop in industry activity with the number of horizontal and directional rigs running per day falling to 293 in the fourth quarter of 2020 from 761 rigs in the comparative 2019-quarter. (Source Baker Hughes). As uncertainties related to the economic impact of COVID-19 continued to subdue activity levels, pricing pressures remained present in the directional sector and the average revenue per day, excluding the US motor rental division, decreased 10 percent to $15,977 per day compared to $17,793 for the 2019-period.

In the fourth quarter of 2020, horizontal and directional drilling continued to represent the majority of the industry rig count averaging 94 percent of operating rigs. PHX Energy's activities were concentrated in oil well drilling which is consistent with its focus on the Permian basin, the most active play in the US market. In addition to the Permian, Phoenix USA remained active in the Granite Wash, SCOOP/STACK, Marcellus, Bakken and Niobrara basins.

For the year ended December 31, 2020, US revenue decreased 31 percent to $185.1 million from $270 million reported in the 2019-year. The Corporation's US operating days in the 2020 twelve-month period decreased by 32 percent to 10,492 days compared to 15,348 in 2019. In comparison, US industry activity, as measured by the average number of horizontal and directional drilling rigs running on a daily basis, fell by 51 percent to 412 rigs in 2020 compared to 843 rigs in 2019. (Source: Baker Hughes). Excluding the motor rental division, Phoenix USA's average revenue per day remained flat at $16,857 compared to $16,798 in the 2019-year. The consistency in the average day rates year-over-year and the difference between the industry's activity decline versus Phoenix USA's over the course of 2020 is evidence of Phoenix USA's positive brand reputation coupled with increased utilization of the Corporation's high performance technologies.

Reportable segment profit before tax for the three-month period ended December 31, 2020 decreased to a loss of $2.4 million from a profit of $5.2 million reported in the 2019-quarter. For the year ended December 31, 2020, reportable segment profit before tax decreased 65 percent to $7.4 million from $20.9 million in 2019. The significant decline in profitability realized in the 2020-periods were primarily a result of substantially lower drilling activity experienced in the US during the year.

International – Continuing Operations

(Stated in thousands of dollars)

	Three-month periods ended December 31,			Years ended December 31,		
	2020	2019	% Change	**2020**	2019	% Change
Revenue	**-**	1,158	n.m.	**-**	7,764	n.m.
Reportable segment profit (loss) before tax	**(209)**	204	n.m.	**(1,513)**	2,757	n.m.

n.m. - not meaningful

The International segment information and discussion for the three-month periods and years ended December 31, 2020 and 2019 only include the operations in the Albanian division. The financial results of the Russian division have been presented as discontinued operations.

Throughout 2020, due to economic uncertainties and reduced local drilling activity levels, PHX Energy's operations in Albania remained suspended. For the three-month period and year ended December 31, 2020, reportable segment loss before tax were $0.2 million and $1.5 million, respectively, as compared to reportable segment profit before tax of $0.2 million and $2.8 million in corresponding 2019-periods. The expenses in the 2020-periods were incurred primarily to keep personnel and equipment on standby for anticipated resumption of drilling activity in 2021.

Discontinued Operations

In the fourth quarter of 2020, management, with approval from the Board, committed to a plan to sell the Russian division operating under the entity, Phoenix TSR. Accordingly, for the year ended December 31, 2020, net assets with a carrying value of $3.5 million owned by Phoenix TSR have been classified as assets held for sale and liabilities directly associated with assets held for sale and the financial results of Phoenix TSR have been presented as discontinued operations.

For the three-month period and year ended December 31, 2020, discontinued operations include revenue of $1.9 million and $12.7 million, respectively, as compared to $2.7 million and $12.3 million in the corresponding 2019-periods. In the 2020 three-month and twelve-month periods, loss from discontinued operations before tax was $5 thousand and $0.8 million, respectively, as compared to $0.8 million and $2.9 million in the corresponding 2019-periods.

Liquidity

(Stated in thousands of dollars)

	Three-month periods ended December 31,		Years ended December 31,	
	2020	2019	**2020**	2019
Funds from operations(1)	**7,118**	11,814	**35,196**	48,037

	Dec. 31, '20	Dec. 31, '19
Working capital(1)	**55,524**	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 $11.8 million in the 2019-quarter to $7.1 million in the three-month period ended December 31, 2020. For the year ended December 31, 2020, funds from operations decreased to $35.2 million from $48 million in 2019. The decrease in funds from operations in both 2020-periods was mainly due to lower activity levels and resulting decline in profitability during these periods.

As at December 31, 2020, the Corporation had working capital of $55.5 million, which was $12.9 million lower than the $68.4 million reported at December 31, 2019. The decrease in working capital was largely due to the lower level of trade receivables at December 31, 2020, which resulted from lower revenue in the fourth quarter of 2020 compared to the fourth quarter of 2019.

Cash Flow and Dividends

In December 2020, PHX Energy reinstated a quarterly dividend program. The Board of the Corporation will continually review the dividend program and take into consideration, without limitation, the Corporation's financial performance, forecasted activity levels and the industry outlook. The actual amount of future quarterly dividends, if any, remains subject to the approval of and declaration by the Board. The Board reviews the Corporation's dividend policy in conjunction with their review of quarterly financial and operating results. The Corporation's ability to maintain the current level of dividends to its shareholders is dependent upon the realization of cash flow from operations, among other considerations, and if the Corporation does not meet its budgeted cash flow from operations, dividends to shareholders may be reduced or suspended entirely.

For the three-month period and year ended December 31, 2020, dividends of $1.3 million (2019 – $nil) were financed from the Corporation's funds from operations.

Investing Activities

Net cash used in investing activities for continuing operations for the year ended December 31, 2020 was $19.1 million as compared to $27.1 million in 2019. During 2020, the Corporation spent $25.7 million on capital expenditures directed towards drilling and other equipment (2019 - $34 million) and received proceeds of $7.2 million primarily from involuntary disposal of drilling equipment in well bores (2019 - $13.9 million). The 2020 expenditures comprised of:

- $10.8 million in downhole performance drilling motors;
- $7.5 million in MWD systems and spare components; and
- $7.4 million in RSS tools, machining and equipment, and other assets.

The capital expenditure program undertaken in the year was financed generally from cash flow from operating activities. Of the total capital expenditures in the 2020-year, $17.7 million was used to grow the Corporation's fleet of drilling equipment and the remaining $8 million was used to maintain the current fleet of drilling and other equipment.

The change in non-cash working capital balances of $0.6 million (use of cash) for the year ended December 31, 2020, relates to the net change in the Corporation's trade payables that are associated with the acquisition of capital assets. This compares to a $6.8 million (use of cash) for the year ended December 31, 2019.

Capital Expenditures

PHX Energy has maintained a strategy of preserving cash flows, however, in light of anticipated future activity at the end of 2019, the Corporation had capital commitment obligations to fulfil in the first quarter of 2020, prior to the onset of the downturn caused by COVID-19. Of the $25.7 million capital expenditures, $18.9 million was incurred in the first quarter of 2020. As drilling activity declined substantially after the first quarter, management took effective steps to align capital expenditure with operations and ensure the preservation of cash flows and strengthening of the balance sheet.

Financing Activities

For the year ended December 31, 2020, net cash used in financing activities for continuing operations was $33.6 million as compared to $17 million in 2019. In the 2020-year, the Corporation:

- repurchased 2,670,500 shares for $3.8 million under its NCIB program;
- made payments of $3 million towards its lease liability; and,
- made payments of $25.4 million to its syndicated facilities.

Capital Resources

As of December 31, 2020, the Corporation had nothing drawn on its syndicated and operating facilities, and a cash balance of $25.7 million. Subject to a borrowing base limit of $76 million, the Corporation had CAD $65 million and USD $15 million available from its credit facilities as at December 31, 2020. The credit facilities are secured by substantially all of the Corporation's assets.

As at December 31, 2020, the Corporation was in compliance with all its financial covenants as follows:

Ratio	Covenant	**As at December 31, 2020**
Debt to covenant EBITDA (1)	<3.0x	**-**
Interest coverage ratio	>3.0x	**37.6**

(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.

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 2021 capital expenditures are expected to be $15 million, subject to quarterly review by 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 and commodity price uncertainty and financial market volatility persists in 2021, the Corporation's activity levels, cash flows and access to credit may be negatively impacted, and the expenditure level would be adjusted accordingly. Conversely, if future growth opportunities present themselves, the Corporation would look at expanding this planned capital expenditure amount.

As at December 31, 2020, the Corporation has capital commitments to purchase drilling and other equipment for $11.5 million, with delivery expected to occur within the first half of 2021.

Off-Balance Sheet Arrangements

The Corporation had no off-balance sheet arrangements as at December 31, 2020 and 2019.

Proposed Transactions

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

In the fourth quarter of 2020, PHX Energy entered into a preliminary sale and purchase agreement with Well Tech Services Ltd. for the sale of Phoenix TSR. The transaction is expected to be completed early in the second quarter of 2021, subject to entering into of definitive documentation and satisfaction of certain conditions.

For the year ended December 31, 2021, the Corporation has currently budgeted to spend $15 million in capital expenditures.

Critical Accounting Estimates and Judgments

The preparation of the consolidated financial statements in conformity with IFRS requires management to make 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.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

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 consolidated financial statements have been difficult and are subject to a higher degree of measurement uncertainty during this volatile period.

Assumptions and estimation uncertainties that have a significant risk of material adjustment in the context of these financial statements include the following:

- estimated recoverable amount including certain significant assumptions regarding the forecasted revenue growth rates, forecasted EBITDA and the discount rate;
- estimated useful lives of drilling and other equipment and intangible assets;
- recognition of deferred tax assets based on estimates of the availability of future taxable profit against which carry-forward tax losses can be used;
- estimates and assumptions used in the valuation of inventory;
- estimate used in the valuation of accounts receivable;
- valuation of equity-settled and cash-settled share-based payments; and,
- key assumptions used in the estimate of leases including valuation of right of use assets and lease liabilities.

Significant judgement is required to assess when impairment indicators exist, and impairment testing is required. The assessment of impairment indicators is based on management's judgment of whether there are internal and external factors that would indicate that a cash generating unit ("CGU") and specifically the non-financial assets within the CGU, are impaired. The determination of a CGU is also based on management's judgment and is an assessment of the smallest group of assets that generate cash inflows independently of other assets.

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 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 year ended December 31, 2020 are government grants related to the CEWS and CERS programs of $5.4 million (2019 – $nil).

Financial Instruments

Credit Risk

The Corporation is exposed to normal credit risks of its customers that exist within the oil and natural gas exploration and development industry. The Corporation's credit risk associated with these customers can be directly impacted by a decline in economic conditions, which would impair the customers' ability to satisfy their obligations to the Corporation. During the year ended December 31, 2020, one customer comprised 9 percent of the total revenue (2019 - 7 percent of revenue). The customer's revenue is reported within the US operating segment.

As at December 31, 2020, the aging of trade and other receivables that were not impaired was as follows:

(Stated in thousands of dollars)		**2020**
Neither past due nor impaired	**$**	**25,950**
Past due 1-30 days		**13,069**
Past due 31-60 days		**3,596**
Past due 61-90 days		**349**
Past due over 90 days		**229**
	$	**43,193**

The Corporation's standard customer payment terms are 30 days after job completion or invoice issuance date, after which, the balance becomes past due. All accounts receivable balances that are past due for more than 90 days and were not impaired represented less than 1 percent or approximately $0.2 million of total receivables on the statement of financial position at December 31, 2020. Management believes that the unimpaired amounts that are past due are still collectible in full, based on historic payment behavior and extensive analysis of customer credit risk. Management has provided an allowance of $1.3 million for all amounts it considers uncollectable at December 31, 2020 (2019 - $0.8 million).

The Corporation has a credit management program to assist in managing this risk, which consists of conducting financial and other assessments to establish and monitor a customer's creditworthiness. The Corporation monitors and manages its credit risk on an ongoing basis.

Liquidity Risk

Liquidity risk is the risk that the Corporation will not be able to meet its financial obligations as they fall due. The Corporation has financial liabilities, thus, is exposed to liquidity risk. The Corporation's approach to managing liquidity risk is to ensure that it always has sufficient cash and credit facilities to meet its obligations when due. Management typically forecasts cash flows for a period of twelve months to identify financing requirements. These requirements are then addressed through a combination of demand credit facilities and access to capital markets. The Corporation believes that future cash flows generated by the operations and access to additional liquidity through capital and banking markets will be adequate to meet its financial obligations.

The following table reflects the Corporation's anticipated payment of contractual obligations related to continuing operations as at December 31, 2020:

(Stated in thousands of dollars)	2021	2022	2023	2024	2025 and after
Drilling and other equipment purchase commitments	11,461	-	-	-	-
Trade and other payables	37,562	-	-	-	-
Dividends payable	1,266	-	-	-	-
Lease payments	7,117	5,903	4,569	4,423	15,707
	57,406	5,903	4,569	4,423	15,707

Fair Values of Financial Instruments

The Corporation has designated its trade and other payables as other financial liabilities carried at amortized cost. Accounts receivable are designated as non-derivative financial instruments, 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.

Interest Rate Risk

Interest rate risk is created by fluctuations in the fair values of financial instruments due to changes in the market interest rates. The Corporation has variable interest long-term debt which exposes it to fluctuations in cash interest payment amounts.

A one percent change in interest rates would have increased or decreased the Corporation's profit by $75 thousand for the year ended December 31, 2020.

Foreign Exchange Risk

Foreign exchange risk is created by fluctuations in the fair values of financial instruments due to changes in foreign exchange rates. Due to operations of the Corporation's subsidiaries in the US and Russia, the Corporation has an exposure to foreign currency exchange rates. The carrying values of Canadian dollar, US dollar and Russian ruble ("RUB") denominated monetary assets and liabilities and earnings are subject to foreign exchange risk. For the year ended December 31, 2020, foreign exchange gains of $0.1 million (2019 – $0.5 million) resulted mainly from fluctuations in the CAD-USD exchange rates. The Corporation reviews options with respect to managing its foreign exchange risk periodically.

The following chart represents the Corporation's exposure to foreign currency risk:

As at December 31, 2020	**CAD**	**USD**	**RUB**
Cash and cash equivalents	**-**	**5,234,705**	**82,727,418**
Trade and other receivables	**-**	**-**	**83,911,812**
Trade and other payables	**-**	**(1,840,631)**	**(16,018,866)**
Intercompany receivables	**3,371,075**	**-**	**-**
Intercompany payables	**(969,679)**	**-**	**-**
Statement of financial position exposure	**2,401,396**	**3,394,074**	**150,620,364**

As at December 31, 2019	CAD	USD	RUB
Cash and cash equivalents	-	331,511	66,997,623
Trade and other receivables	-	3,900	178,608,038
Trade and other payables	-	(4,551,623)	(29,865,292)
Intercompany receivables	700,392	-	-
Intercompany payables	(13,207,293)	-	-
Statement of financial position exposure	(12,506,901)	(4,216,212)	215,740,369

The following significant exchange rates applied during the year ended December 31:

	Average Rate		December 31, Close Rate	
	2020	2019	**2020**	2019
USD	**1.3412**	1.3268	**1.2732**	1.2988
RUB	**53.8048**	48.7454	**57.7289**	47.3611

A strengthening of the Canadian dollar, US dollar, and Russian ruble against all other currencies as at December 31 would have affected the measurement of financial instruments denominated in a foreign currency and affected profit or loss by the amounts shown below. The analysis assumes that all other variables remain constant.

Gain (Loss)		**2020**		2019
CAD (10% strengthening)	**$**	**188,611**	$	(962,958)
USD (10% strengthening)		**432,133**		(547,602)
RUB (10% strengthening)		**260,910**		414,111

Business Risk Factors

The Corporation's operations are subject to certain factors that are beyond its control. A significant portion of the Corporation's operating costs are variable in nature and, as a result, the impact of a significant decline in demand for the Corporation's goods and services on its financial results is lessened. Management has identified herein certain key risks and uncertainties associated with PHX Energy's business that could impact financial results. More detailed disclosure of these risk factors and additional risk factors that could affect the Corporation are included in the Corporation's most recently filed AIF under the heading "*Risk Factors"*, which is available under the Corporation's profile at www.sedar.com. Such risks include, but are not limited to:

Impact of Pandemics - COVID-19

On March 11, 2020, the World Health Organization declared the outbreak of a strain of novel coronavirus disease, COVID-19, a global pandemic. The COVID-19 pandemic has negatively impacted the Canadian, US, and global economies; disrupted Canadian, US, and global supply chains; disrupted financial markets; contributed to a decrease in interest rates; resulted in ratings downgrades, credit deterioration and defaults in many industries; forced the closure of many businesses, led to loss of revenues, increased unemployment and bankruptcies; and necessitated the imposition of quarantines, physical distancing, business closures, travel restrictions, and sheltering-in-place requirements in Canada, the US, and other countries. If the pandemic is prolonged, including through subsequent waves, or if additional variants of COVID-19 emerge which are more transmissible or cause more severe disease, or if other diseases emerge with similar effects, the adverse impact on the economy could worsen. Moreover, it remains uncertain how the macroeconomic environment, and societal and business norms will be impacted following this COVID-19 pandemic. 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. Unexpected developments in financial markets, regulatory environments, or client behaviors particularly in the oil and natural gas industry may also have adverse impacts on the Corporation's results, business, financial condition or liquidity, for a substantial period of time.

Although at this time the Corporation's services are considered an essential service in both Canada and the US, there is no assurance that this classification will remain in place and there will not be any additional restrictions related to the Corporation's operations. The Corporation's business, financial condition, results of operations, cash flows, reputation, access to capital, cost of borrowing, access to liquidity, and/or business plans may, in particular, and without limitation, be adversely impacted as a result of the pandemic and/or decline in commodity prices as a result of:

- the shut-down of facilities or the delay or suspension of work due to workforce disruption or labour shortages caused by workers becoming infected with COVID-19, or government or health authority mandated restrictions on travel by workers or closure of facilities or worksites;
- clients, suppliers and third-party vendors experiencing similar workforce disruption or being ordered to cease operations;
- reduced cash flows resulting in less funds from operations being available to fund capital expenditure budgets;
- reduced commodity prices resulting in a reduction in the volumes of drilling activity in the countries in which the Corporation operates resulting from reduced commodity prices or other industry factors such as storage levels and production curtailments;
- the inability to deliver equipment to the Corporation’s facilities in different jurisdictions or to client worksites caused by border restrictions, road or port closures or other restrictions; and
- the ability to obtain additional capital including, but not limited to, debt and equity financing being adversely impacted as a result of unpredictable financial markets, commodity prices and/or a change in market fundamentals.

The COVID-19 pandemic has also created additional operational risks for the Corporation, including the need to provide enhanced safety measures for its employees and customers; comply with rapidly changing regulatory guidance; address the potential risks of attempted fraudulent activity and cybersecurity threat behaviour; and protect the integrity and functionality of the Corporation's systems, networks, and data as a percentage of employees work remotely. The Corporation is also exposed to human capital risks due to issues related to health and safety matters, and other environmental stressors as a result of measures implemented in response to the COVID-19 pandemic, as well as the potential for a significant proportion of the Corporation's employees, including key executives, to be unable to work effectively, because of illness, quarantines, sheltering-in-place arrangements, government actions or other restrictions in connection with the pandemic.

The extent to which the COVID-19 pandemic continues to impact the Corporation's results, business, financial condition or liquidity will depend on future developments in Canada, the US and globally, including the development and widespread availability of efficient and accurate testing options, and effective treatment options or vaccines. Despite the approval of certain vaccines by the regulatory bodies in Canada and the US, the ongoing evolution of the development and distribution of an effective vaccine also continues to raise uncertainty.

Commodity Price Volatility & Current Industry Environment

Market events and conditions, including global excess oil and natural gas supply, the ongoing COVID-19 pandemic, actions taken by the Organization of the Petroleum Exporting Countries, sanctions against Iran and Venezuela, slowing growth in China and emerging economies, weakened global relationships, conflict between the US and Iran, isolationist and punitive trade policies, US shale production, sovereign debt levels, world health emergencies and political upheavals in various countries including a growing anti-hydrocarbon sentiment, have caused significant volatility in commodity prices. These events and conditions have caused a significant reduction in the valuation of companies involved in the oil and natural gas industry and a decrease in confidence in the industry as a whole. These difficulties have been exacerbated in Canada by political and other actions resulting in uncertainty surrounding regulatory, tax, royalty changes and environmental regulation. As a result, there continues to be significant uncertainty and volatility in the oil and natural gas industry, particularly in Canada where oil and natural gas drilling and completion activity remains relatively low and midstream proponents are encountering difficulties obtaining or continuing to maintain necessary approvals on a timely basis to build pipelines, liquefied natural gas plants and other facilities to provide better access to markets. Low activity levels have resulted in continued price competition for the products and services provided by the Corporation, particularly in Canada. As a service provider to the energy sector, PHX Energy will continue to work with its customers during this challenging time and adjust its strategies and expenditures as required. The full duration and effect of the industry downturn and its impact on the Corporation's activity and results will depend on a variety of factors that are difficult to predict and cash flows may be materially adversely affected.

Capital Requirements

If the Corporation's revenues decline because of continued and sustained weakness in industry activity levels, it may be required to reduce its planned capital expenditures. In addition, continued sector, global and political volatility and resulting uncertain levels of near-term industry activity, exposes the Corporation to additional capital risk. There can be no assurance that debt or equity financing, or cash generated by operations will be available, or sufficient, to meet these capital expenditure requirements or for other corporate purposes, or if debt or equity financing is available, that it will be on terms acceptable to the Corporation. Additionally, the failure to obtain adequate financing on a timely basis could cause the Corporation to miss certain strategic opportunities and reduce or terminate certain of its operations. The current conditions in the oil and natural gas industry have negatively impacted the ability of, and the cost to, companies involved in the oil and natural gas industry to access additional financing. The inability of the Corporation to access sufficient and acceptable capital for its operations in a timely manner could have a material adverse effect on the Corporation's business, financial condition, results of operations and prospects.

Third Party Credit Risk

The Corporation is exposed to the credit risks of its customers that exist within the oil and natural gas exploration and development industry. As a result of the challenging oil and natural gas market conditions, particularly in Canada, and other market factors the Corporation may face heightened counterparty credit risk as a substantial portion of the Corporation's dealings are with entities involved in the oil and natural gas industry. The Corporation's credit risk associated with its customers can be directly impacted by a sustained decline in economic conditions, which would impair a customer's ability to satisfy their obligations to the Corporation and therefore could materially adversely effect the Corporation's business, financial condition, results of operations, receivable and prospects.

Environmental Risks

All phases of the oil and natural gas business present environmental risks and hazards and are subject to environmental regulation pursuant to a variety of federal, provincial, state and local laws and regulations. Compliance with such legislation can require significant expenditures and a breach may result in the imposition of fines and penalties, some of which may be material. Environmental legislation is evolving in a manner expected to result in stricter standards and enforcement, larger fines and liability, and potentially increased capital expenditures and operating costs. Implementation of strategies for reducing greenhouse gases could have a material impact on the nature of oil and natural gas operations, including those of the Corporation and the Corporation's customers. Given the evolving nature of the debate related to climate change and the control of greenhouse gases and the possible resulting requirements, it is not possible to predict either the nature of those requirements or the impact on the Corporation and its operations and financial condition.

Climate Change and Carbon Pricing Risk

Climate change policy is evolving at regional, national and international levels, and political and economic events may significantly affect the scope and timing of climate change measures that are ultimately put in place to slow the rate of climate change or mitigate its effects. The direct or indirect costs of compliance with greenhouse gas-related regulations may have an adverse effect on the Corporation's and its customer's business, financial condition, results of operations and prospects. Concerns about climate change have resulted in a number of environmental activists and members of the public opposing the continued exploitation and development of hydrocarbons which has influenced investors' willingness to invest in the oil and natural gas industry. Historically, political and legal opposition to the hydrocarbons industry focused on public opinion and the regulatory process. More recently, however, there has been a movement to more directly hold governments and participants in the oil and natural gas industry responsible for climate change through climate litigation. Given the evolving nature of climate change policy and the control of greenhouse gases and resulting requirements, it is expected that current and future climate change regulations will have the effect of increasing the Corporation's operating expenses as well as third party credit risk, and, in the long-term, potentially reducing the demand for oil and natural gas production, resulting in declining operations by the Corporation's customers and in turn potentially resulting in a decrease in the demand for the Corporation's services, as well as its profitability, and a reduction in the value of its assets or requiring asset impairments for financial statement purposes.

The majority of countries across the globe have agreed to reduce their carbon emissions in accordance with the Paris Agreement. In Canada, the federal government implemented legislation aimed at incentivizing the use of alternative fuels and in turn reducing carbon emissions. The federal system applies in provinces and territories that request it to be implemented or are without their own system that meets federal standards. The federal regime was subject to a number of court challenges by Alberta, Saskatchewan and Ontario. The final decision from the Supreme Court of Canada is expected to be delivered sometime in 2021. Any taxes placed on carbon emissions may have the effect of decreasing the demand for oil and natural gas products which could have a material impact on the Corporation's customers and thereby adversely effect the Corporation's profitability and financial condition. Further, the imposition of carbon taxes puts the Corporation at a disadvantage with its counterparts who operate in jurisdictions where there are less costly carbon regulations

Alternatives to and Changing Demand for Petroleum & Petroleum Based Products

Fuel conservation measures, alternative fuel requirements, increasing consumer demand for alternatives to oil and natural gas and technological advances in fuel economy and renewable energy generation systems could reduce the demand for oil, natural gas and liquid hydrocarbons. Recently, certain jurisdictions have implemented policies or incentives to decrease the use of hydrocarbons and encourage the use of renewable fuel alternatives, which may lessen the demand for petroleum and petroleum based products and put downward pressure on commodity prices. Advancements in energy efficient products have a similar effect on the demand for oil and natural gas products. The Corporation cannot predict the impact of changing demand for oil and natural gas products, and any major changes may have a material adverse effect the Corporation's customers and therefore in turn have a material adverse effect on the Corporation's business, financial condition, results of operations and cash flow.

Reliance on a Skilled Workforce and Key Personnel

The success of the Corporation will be dependent upon the recruitment and retention of a skilled workforce and key personnel. Losing the services of such persons could have a material adverse effect on the business and operations of the Corporation. The Corporation does not have any key personnel insurance in effect. The contributions of the existing management team and other key personnel to the immediate and near-term operations of the Corporation are likely to be of central importance. Competition for qualified personnel in certain sectors of the oil and natural gas services industry is intense and there can be no assurance that the Corporation will be able to continue to attract and retain all personnel necessary for the development and operation of its business.

Availability and Cost of Equipment and Development of New Technology

The industry in which the Corporation operates is categorized by rapid and significant technological advancements and introductions of new products and services utilizing new technologies. The ability of the Corporation to compete and expand its business is dependent upon it having access to certain industry-leading equipment and specialized components at a reasonable cost, as well as upon its ability to develop or acquire new competitive technology. There can be no assurance that the Corporation will be able to respond to the competitive pressures of those companies with greater financial and technical resources and implement new technologies on a timely basis, at an acceptable cost, or at all. The Corporation purchases equipment and materials from various suppliers in the oil and natural gas drilling service industry. There can be no assurance that these sources for equipment and materials will be maintained or available at acceptable cost. If such equipment is not available, and is not available from any other source, the Corporation's ability to compete may be impaired. If the Corporation is unable to continue to offer advanced and industry leading technologies to its customers, or is unsuccessful in implementing certain technologies, its business and results of operations could also be adversely affected.

Competition

The Corporation's major competitors are principally large multinational companies with significantly greater resources available for marketing and R&D programs. The Corporation also competes with a number of other small and medium sized companies. Like the Corporation, these companies have certain competitive advantages, such as low overhead costs and specialized regional strengths. The Corporation's ability to generate revenue depends on its ability to successfully compete, continue to obtain contracts and to perform services within projected times and costs.

Oil and Natural Gas Industry Risk

There are risks associated with the provision of drilling services to the oil and natural gas industry. The Corporation may become liable for risks against which it may choose not to insure due to high premium costs, or which may exceed the limits of policy coverage or may not have the option of insuring. Interruptions and delays caused by adverse weather conditions, equipment failures or other events can significantly adversely affect revenue. While the Corporation maintains liability insurance, the insurance is subject to exceptions and coverage limits. There can be no assurance that insurance will continue to be available to the Corporation on commercially reasonable terms, that the possible types of liabilities that may be incurred by the Corporation will be covered by its insurance, or that the dollar amount of such liabilities will not exceed policy limits. Even a partially uninsured claim, if successful and of sufficient magnitude, could have a material adverse effect on business, results of operations and prospects.

Seasonality

In general, the level of activity of the Canadian and certain parts of the US and international oilfield service industry is influenced by seasonable weather patterns. Wet weather and the spring thaw may make the ground unstable, which prevents, delays or makes operations more difficult. Consequently, municipalities and provincial or state transportation departments may enforce road bans that restrict the movement of rigs and other heavy equipment, thereby reducing activity levels. Additionally, certain oil and natural gas producing areas, located where the ground consists of swampy terrain known as muskeg, are inaccessible except during winter months.

Geopolitical Risks

In the last several years, the United States and certain European and Middle Eastern countries have experienced significant political events that have cast uncertainty on global financial and economic markets. During its tenure, the former American

Administration took action to reduce regulation, which affected relative competitiveness of other jurisdictions as part of its environmental and "Buy American" initiatives, which included withdrawing the US from the Trans-Pacific Partnership, passing sweeping tax reforms, and signing the Canada–United States–Mexico Agreement ("USMCA"), which officially replaced the North American Free Trade Agreement ("NAFTA") on April 3, 2020. There are still residual impacts from this Administration's policies and these may impact the Corporation's business.

The newly-inaugurated Biden administration in the US has indicated that it will roll-back certain policies of the former administration, and has taken action to cancel TC Energy Corporation's Keystone X.L. pipeline permit. While it is unclear which other legislation or policies of the former Trump administration will be rolled-back and if such roll-backs will be a priority of the new administration in light of the ongoing COVID-19 pandemic, any future actions taken by the new US administration may impact the oil and gas industry, the Canadian and US economies and results, valuation and operations of the Corporation. The Corporation has operations in both the US and Canada and therefore potential impact on the Corporation's business is not currently determinable at this time.

In addition to the changing political landscape in the United States, the impacts of the United Kingdom's exit from the European Union are slowing emerging and some impacts may not become apparent for some time. Some European countries have also experienced the rise of anti-establishment political parties and public protests held against open-door immigration policies, trade and globalization. Conflict and political uncertainty also continues to progress in the Middle East. To the extent that certain political actions taken in North America, Europe and elsewhere in the world result in a marked decrease in free trade, access to personnel and freedom of movement, it could have an adverse effect on the Corporation's ability to market its products internationally, increase costs for goods and services required for the Corporation's operations, reduce access to skilled labour and negatively impact the Corporation's business, operations, financial conditions and the market value of the Corporation's common shares.

A change in federal, provincial or municipal governments in Canada may have an impact on the directions taken by such governments on matters that may impact the oil and natural gas industry including the balance between economic development and environmental policy. The UCP government in Alberta is supportive of the Trans Mountain Pipeline expansion project and while a minority government in British Columbia remains opposed to the project the federal government remains supportive of the project. Continued uncertainty and delays have led to decreased investor confidence, increased capital costs and operational delays for producers and service providers operating in the industry.

The federal Government was re-elected in 2019, but in a minority position. The ability of the minority federal government to pass legislation will be subject to whether it is able to come to agreement with, and garner the support of, the other elected parties, most of whom are opposed to the development of the oil and natural gas industry. The minority federal government will also be required to rely on the support of the other elected parties to remain in power, which provides less stability and may lead to an earlier subsequent federal election. Political instability, at both the federal and provincial level, continues to create regulatory uncertainty, the effects of which become apparent on an ongoing basis, particularly with respect to carbon pricing regimes, curtailment of crude oil production and transportation and export capacity, and may affect the business of participants in the oil and natural gas industry.

Foreign Operations

The Corporation will conduct a certain portion of its business in the US and Albania. Any change in government policies could have a significant impact on business. Risks of foreign operations include, but are not necessarily limited to foreign currency exchange rate fluctuations, changes of laws affecting foreign ownership, government participation, taxation, royalties, duties, inflation, repatriation of earnings, social unrest or civil war, corruption, acts of terrorism, extortion or armed conflict and uncertain political and economic conditions resulting in unfavourable government actions such as sanctions and unfavourable legislation or regulation. There are no assurances that the economic and political conditions in the countries in which the Corporation operates will continue as they are at the present time. While the impact of these factors cannot be accurately predicted, if any of the risks materialize, they could have a material adverse effect on the Corporation's business, financial condition, results of operations and cash flows.

Changing Investor Sentiment

A number of factors, including the effects of the use of hydrocarbons on climate change, the impact of oil and natural gas operations on the environment, environmental damage relating to spills of petroleum products during production and transportation, Indigenous rights and gender balance, have affected certain investors' sentiments towards investing in the oil and natural gas industry and certain corporations generally. Any reduction in the investor base interested or willing to invest in the oil and natural gas industry and more specifically, the Corporation, may result in limiting the Corporation's access to capital, increasing the cost of capital, and decreasing the price and liquidity of the Corporation's securities even if the Corporation's operating results, underlying asset values or prospects have not changed. Additionally, these factors, as well as other related factors, may cause a decrease in the value of the Corporation's assets which may result in an impairment charge.

Dividends

The amount of future cash dividends paid by the Corporation, if any, will be subject to the discretion of the Board and may vary depending on a variety of factors and conditions existing from time to time, including, among other things, fluctuations in commodity prices, capital expenditure requirements, debt service requirements, operating costs, foreign exchange rates and the satisfaction of the liquidity and solvency tests imposed by applicable corporate law for the declaration and payment of dividends. Depending on these and various other factors, many of which will be beyond the control of the Corporation, the dividend policy of the Corporation may change from time to time and, as a result, future cash dividends could be reduced or suspended entirely.

The market value of the Corporation's common shares may deteriorate if cash dividends are reduced or suspended. Furthermore, the future treatment of dividends for tax purposes will be subject to the nature and composition of dividends paid by the Corporation and potential legislative and regulatory changes. Dividends may be reduced during periods of lower funds from operations, which result from lower commodity prices and reduced customer services demands and any decision by the Corporation to finance capital expenditures using funds from operations.

To the extent that external sources of capital become limited or unavailable, the ability of the Corporation to make its necessary capital investments in its business will be impaired. To the extent that the Corporation is required to use funds from operations to finance capital expenditures or invest in or further expand its asset base, the cash available for dividends may be reduced.

Market Price

The trading price of the securities of issuers in the oil and natural gas industry is subject to substantial volatility often based on factors related and unrelated to the financial performance or prospects of the issuers involved. Factors unrelated to the Corporation's performance could include macroeconomic developments nationally, within North America or globally, domestic and global commodity prices, and/or current perceptions of the oil and natural gas market. Similarly, the market price of the common shares of the Corporation could be subject to significant fluctuations in response to variations in the Corporation's operating results, financial condition, liquidity and other internal factors. Accordingly, the price at which the common shares of the Corporation will trade cannot be accurately predicted.

Reputational Risk

The Corporation's business, financial condition, operations or prospects may be negatively impacted as a result of any negative public opinion toward the Corporation or as a result of any negative sentiment toward or in respect of Corporation's reputation with stakeholders, special interest groups, political leadership, the media or other entities. Public opinion may be influenced by certain media and special interest groups' negative portrayal of the industry in which the Corporation operates as well as their opposition to certain oil and natural gas projects. Potential impacts of negative public opinion or reputational issues may include, with respect to both the Corporation and its customers which would indirectly affect the Corporation, the following: delays or interruptions in operations, legal or regulatory actions or challenges, blockades, increased regulatory oversight, reduced support for, delays in, challenges to, or the revocation of regulatory approvals, permits and/or licences and increased costs and/or cost overruns. Any environmental damage, loss of life, injury or damage to property caused by the Corporation's operations could damage the reputation of the Corporation. The Corporation's reputation could be affected by actions and activities of other corporations operating in the oil and natural gas industry, over which the Corporation has no control. Opposition from special interest groups opposed to oil and natural gas development and the possibility of climate related litigation against hydrocarbons companies may indirectly harm the Corporation's reputation.

Reputational risk cannot be managed in isolation from other forms of risk. Credit, market, operational, insurance, regulatory and legal risks, among others, must all be managed effectively to safeguard the Corporation's reputation. Damage to the Corporation's reputation could result in in negative investor sentiment towards the Corporation, which may result in limiting the Corporation's access to capital, increasing the cost of capital, and decreasing the price and liquidity of the Corporation's securities.

Management of Growth

The Corporation may be subject to growth related risks at certain periods of time including capacity constraints and pressure on its internal systems and controls. The ability of the Corporation to manage growth effectively when it occurs will require it to continue to implement and improve its operational and financial systems and to expand, train and manage its employee base. If the Corporation is unable to deal with this growth, it may have a material adverse effect on the Corporation's business, financial condition, results of operations and prospects.

Information Technology Systems, Cyber-Security and Social Media

The Corporation is increasingly dependent upon the availability, capacity, reliability and security of its information technology infrastructure and its ability to expand and continually update this infrastructure to conduct daily operations. The Corporation depends on various information technology systems to process and record financial data, manage financial resources, administer contracts with customers and communicate with employees and third-party partners.

Further, the Corporation is subject to a variety of information technology and system risks as a part of its operations including potential breakdown, invasion, virus, cyber-attack, cyber-fraud, security breach, and destruction or interruption of the Corporation’s information technology systems by third parties or insiders. Unauthorized access to these systems by employees or third parties could lead to corruption or exposure of confidential, fiduciary or proprietary information, interruption to communications or operations or disruption to business activities or the Corporation's competitive position. In addition, cyber phishing attempts, in which a malicious party attempts to obtain sensitive information such as usernames, passwords, and credit card details (and money) by disguising as a trustworthy entity in an electronic communication, have become more widespread and sophisticated in recent years. Cyber-attack activity has increased with the ongoing COVID-19 pandemic targeting vulnerabilities in remote access platforms as many companies, including the Corporation, continue to operate with work from home arrangements. The Corporation applies technical and process controls in line with industry-accepted standards to protect its information, assets and systems. However, these controls may not adequately prevent cyber-security breaches. Disruption of critical information technology services, or breaches of information security, could have a negative effect on the Corporation's performance and earnings, as well as its reputation, and any damages sustained may not be adequately covered by the Corporation's current insurance coverage, or at all. The significance of any such event is difficult to quantify, but may in certain circumstances be material and could have a material adverse effect on the Corporation’s business, financial condition and results of operations.

Additionally, social media is increasingly used as a vehicle to carry out cyber phishing attacks. Information posted on social media sites, for business or personal purposes, may be used by attackers to gain entry into the Corporation's systems and obtain confidential information. While the Corporation takes steps to alleviate such risks, despite its efforts, as social media continues to grow in influence and access to social media platforms becomes increasingly prevalent, there are significant risks that the Corporation may not be able to properly regulate social media use and preserve adequate records of business activities and client communications conducted through the use of social media platforms.

Breach of Confidentiality

While discussing potential business relationships or other transactions with third parties, the Corporation may disclose confidential information relating to its business, operations or affairs. Although confidentiality agreements are generally signed by third parties prior to the disclosure of any confidential information, a breach could put the Corporation at competitive risk and may cause significant damage to its business. The harm to the Corporation's business from a breach of confidentiality cannot presently be quantified, but may be material and may not be compensable in damages. There is no assurance that, in the event of a breach of confidentiality, the Corporation will be able to obtain equitable remedies, such as injunctive relief, from a court of competent jurisdiction in a timely manner, if at all, in order to prevent or mitigate any damage to its business that such a breach of confidentiality may cause.

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 the Corporation. Additional information relating to the Corporation's Corporate Governance can be found in the Corporation's AIF and in its 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.

The Certifying Officers have evaluated, or caused to be evaluated under their supervision, the effectiveness of the Corporation's DC&P. Based on that evaluation, the Certifying Officers have concluded that the Corporation's DC&P were effective as at December 31, 2020.

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).

The Certifying Officers have evaluated, or caused to be evaluated under their supervision, the effectiveness of the Corporation's ICFR and have concluded that the Corporation's ICFR were effective as at December 31, 2020.

There were no changes in the Corporation's ICFR that occurred during the period beginning on October 1, 2020 and ended on December 31, 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

	As at February 24, 2021
Common shares outstanding	50,294,832
Dilutive securities:	
Options	3,215,467
Corporation shares – diluted	53,510,299

Selected Annual Financial Information

The following selected annual financial information was obtained from the audited consolidated financial statements prepared in accordance with IFRS, with the exception of net debt.

(Stated in thousands of dollars except per share amounts)

Years ended December 31,	**2020**	2019	2018
Revenue	**233,734**	349,715	303,192
Earnings (loss) from continuing operations	**(6,878)**	867	(18,577)
Earnings (loss) per share from continuing operations – basic	**(0.13)**	0.02	(0.33)
Earnings (loss) per share from continuing operations – diluted	**(0.13)**	0.02	(0.33)
Net loss per share – basic and diluted	**(0.15)**	(0.04)	(0.33)
Net Debt (1)(2)	**(25,746)**	14,710	21,526
Total assets	**216,541**	277,253	263,628

n.m. – non 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 December 31, 2020, the Corporation had no bank loans outstanding and was in a cash positive position.

In 2018 and 2019, revenue from continuing operations was increasing and this trend continued through the first quarter of 2020. However, towards the end of March 2020 with the outbreak of COVID-19 pandemic, commodity prices started to fall to unprecedented levels and remained suppressed with gradual recovery near the end of 2020. As a result, industry activity severely contracted resulting in significant declines in operating days. Revenue declined 33 percent from 2019 to 2020 and consequently, the Corporation's profitability suffered as net earnings from continuing operations diminished to a loss in 2020. The primary driver of the loss in 2020 was due to impairment charges on goodwill and drilling and other equipment, which were partially offset by government grant assistance received through the CEWS and CERS programs. With decreased earnings and global uncertainties, the goal was to exit the 2020-year in a stable financial position. Through various cost restructuring initiatives and close monitoring of expenses, cash flows were preserved leading to a strong balance sheet with no bank loans and a net cash position of $25.7 million. As at December 31, 2020, PHX Energy's total assets decreased to $216.9 million primarily due to lower trade receivables and depreciation on drilling and other equipment.

Summary of Quarterly Results – Continuing Operations

(Stated in thousands of dollars except per share amounts)

	Dec-20	**Sept-20**	**Jun-20**	**Mar-20**	Dec-19	Sept-19	Jun-19	Mar-19
Revenue	**54,805**	**37,044**	**42,985**	**98,901**	90,060	89,640	79,923	90,093
Earnings (loss)	**2,028**	**(1,544)**	**(5,204)**	**(2,158)**	(839)	2,724	(1,078)	62
Earnings (loss) per share – basic	**0.04**	**(0.03)**	**(0.10)**	**(0.04)**	(0.02)	0.05	(0.02)	0.00
Earnings (loss) per share – diluted	**0.04**	**(0.03)**	**(0.10)**	**(0.04)**	(0.02)	0.05	(0.02)	0.00
Adjusted EBITDA(1)	**8,502**	**6,869**	**4,577**	**19,269**	12,693	15,106	11,495	11,845
Funds from operations(1)	**7,118**	**5,421**	**2,149**	**20,508**	11,814	14,920	10,323	10,980

(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.

Outlook

Despite the unprecedented events and challenges in 2020, we have many accomplishments to be proud of. These did not happen without difficult decisions and sacrifices, diligently adhering to our strategy and the dedication of our personnel. Despite the economic and industry downturn, notable accomplishments during 2020 include:

- Successfully implementing procedures and protocols to ensure a safe work environment for all employees and stakeholders
- Achieving a strong level of Adjusted EBITDA
- Eliminating all bank debts and maintained a strong cash position
- Further reducing our shares outstanding by leveraging our NCIB
- Growing our US market share to the highest level in our history
- Drafting our first annual ESG report, and
- Drilling numerous record-breaking wells utilizing our premium fleet of technology.

In 2021 we will continue to build upon these successes, staying focused on preserving our financial strength, protecting our position as a top technology provider, delivering operational excellence to drill wells faster and more efficiently and further enhancing returns to our shareholders.

In the fourth quarter, North American industry activity began to rebound slightly, and this has continued into the first quarter of 2021. We are cautiously optimistic that this activity level will be sustained. We believe our North American operations are well positioned to grow with the higher rig counts and maintain the strong market share we have established. We continue to dedicate capital expenditures towards our premium technologies that are in high demand and, along with the expertise of our personnel, are driving the many performance records we have achieved. Recently, we were part of a team that drilled the longest horizontal lateral section in Texas, and it is achievements such as this that continue to strengthen our reputation.

In the US, it is likely there will be new federal regulations that impact the oil and natural gas industry; however, we believe that our strong client mix will help minimize the impact of these on our operations. In Canada, although the pricing environment is very competitive we believe operators understand how our proven performance and technologies positively impact the economics of their operations.

Late in the fourth quarter we announced the proposed sale of our Russia division, which is expected to close early in the second quarter of this year. With the decline of the global economy and commodity prices, our operations in Albania were suspended in late 2019 and we expect these operations to start back up in the second half of 2021. PHX Energy has a unique package of expertise and technology that can be exported to other markets in the world and we remain open to opportunities that align with our business model.

We are proud of the strong financial position we have built and believe we are one of a few publicly traded energy service companies who are in a position to enhance rewards to shareholders. We have been leveraging our NCIB for a number of years and in 2021 purchased and cancelled the remaining 460,888 shares under our current NCIB. Additionally, in December our Board approved the re-instatement of a quarterly dividend of $0.025 per share and the first dividend was paid January 15, 2021.

As 2021 progresses we will continue to build our operational and financial strength, leveraging our unique market position. Additionally, we are committed to working with our clients and other service providers in our industry to showcase our commitment to a sustainable future.

Michael Buker, President
February 24, 2021

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 December 31,		Years ended December 31,	
	2020	2019	**2020**	2019
Earnings (loss) from continuing operations:	**2,028**	(839)	**(6,878)**	867
Add:				
Depreciation and amortization drilling and other equipment	**6,453**	9,171	**27,975**	37,827
Depreciation and amortization right-of-use asset	**838**	889	**3,555**	3,503
Provision for income taxes	**(1,610)**	1,883	**(1,476)**	3,621
Finance expense	**105**	333	**748**	1,423
Finance expense lease liability	**562**	612	**2,361**	2,508
Impairment loss	**-**	500	**10,730**	500
Equity-settled share-based payments	**28**	53	**242**	612
Unrealized foreign exchange (gain) loss	**95**	91	**33**	278
Severance	**3**	-	**1,927**	-
Adjusted EBITDA as reported	**8,502**	12,693	**39,217**	51,139

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 December 31,		Years ended December 31,	
	2020	2019	**2020**	2019
Cash flows from operating activities	**9,552**	9,741	**67,945**	51,972
Add (deduct):				
Changes in non-cash working capital	**(2,528)**	1,486	**(32,685)**	(5,202)
Interest paid	**50**	136	**366**	804
Income taxes paid (received)	**44**	451	**(430)**	462
Funds from operations	**7,118**	11,814	**35,196**	48,037

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 December 31,		Years ended December 31,	
	2020	2019	**2020**	2019
Funds from operations [(1)]	**7,118**	11,814	**35,197**	48,037
Deduct:				
Maintenance capital expenditures	**(2,606)**	(3,630)	**(8,015)**	(11,336)
Cash payment on leases	**(1,347)**	(1,447)	**(5,409)**	(5,690)
Free cash flow	**3,165**	6,737	**21,773**	31,011

[(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. See "Funds from Operations" above for the reconciliation of funds from operations to the nearest IFRS term, cash flows from operating activities.

Debt to Covenant EBITDA Ratio

Debt is represented by loans and borrowings. Covenant EBITDA, for purposes of the calculation of this covenant ratio, is represented by net earnings for a rolling four quarter period, adjusted for finance expense and finance expense lease liability, provision for income taxes, depreciation and amortization, equity-settled share-based payments, impairment losses on goodwill and intangible assets, onerous contracts, and IFRS 16 Leases 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. Working capital excludes assets held for sale and liabilities associated with assets held for sale. 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 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.

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INDEPENDENT AUDITORS' REPORT

To the Shareholders of PHX Energy Services Corp.

Opinion

We have audited the consolidated financial statements of PHX Energy Services Corp. (the "Company"), which comprise:

- the consolidated statements of financial position as at December 31, 2020 and December 31, 2019
- the consolidated statements of comprehensive loss for the years then ended
- the consolidated statements of changes in equity for the years then ended
- the consolidated statements of cash flows for the years then ended
- and notes to the consolidated financial statements, including a summary of significant accounting policies

(Hereinafter referred to as the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the consolidated financial position of the Company as at December 31, 2020 and December 31, 2019, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards ("IFRS").

Basis for Opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the ***"Auditors' Responsibilities for the Audit of the Financial Statements"*** section of our auditors' report.

We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in Canada and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matter

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements for the year ended December 31, 2020. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

We have determined the matters described below to be the key audit matters to be communicated in our auditors' report.

Assessment of the recoverable amount of the Canadian and US cash generating units ("CGU" or "CGUs")

Description of the matter

We draw attention to note 2c), note 2d), note 3h)ii, note 6b) and note 7 to the financial statements. Where the carrying amount of an asset or CGU exceeds its recoverable amount, the non-financial assets within the CGU are considered impaired and its carrying amount is reduced to its recoverable amount. The Company has recorded an impairment loss of $8.9 million and nil related to the Canadian CGU and US CGU, respectively.

The estimated recoverable amount of the CGU involves certain significant assumptions including the:

- Forecasted revenue growth rates
- Forecasted earnings before interest, taxes, depreciation and amortization ("EBITDA")
- Discount rate.

Why the matter is a key audit matter

We identified the assessment of the recoverable amount of the Canadian and US CGUs as a key audit matter. Significant auditor judgment was required to evaluate the results of our audit procedures regarding the Company's significant assumptions.

How the matter was addressed in the audit

The primary procedures we performed to address this key audit matter included the following:

We compared the Canadian and US CGUs Q1 2020 actual revenue and EBITDA to the amount budgeted for Q1 2020 and the Canadian and US CGUs 2019 actual revenue and EBITDA to the amount budgeted for 2019 to assess the Company's ability to accurately forecast.

We evaluated the appropriateness of the Canadian and US CGUs forecasted revenue and EBITDA used in the estimate of the recoverable amount by:

- Comparing the forecasted 2021 revenue and EBITDA to the 2021 cash flow forecast to assess consistency with other significant assumptions used by the Company in other estimates used in the financial statements
- Comparing the Canadian and US CGUs forecasted revenue and EBITDA to historical results. We took into account changes in conditions and events affecting the Canadian and US CGUs to assess the adjustments or lack of adjustments made by the Company in arriving at forecasted revenue and EBITDA
- Comparing certain underlying assumptions in the forecasted revenue and EBITDA to certain market data.

We involved valuation professionals with specialized skills and knowledge, who assisted in:

- Evaluating the appropriateness of the Canadian and US CGU's discount rate by comparing the discount rate to market and other external data
- Assessing the reasonableness of the Company's estimate of the recoverable amount of the Canadian and US CGUs by comparing the Company's estimate to market metrics and other external data.

Other Information

Management is responsible for the other information. Other information comprises:

- the information included in Management's Discussion and Analysis filed with the relevant Canadian Securities Commissions.
- the information, other than the financial statements and the auditor's report thereon, included in a document likely to be entitled "2020 Annual Report".

Our opinion on the financial statements does not cover the other information and we do not and will not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

We obtained the Management's Discussion and Analysis filed with the relevant Canadian Securities Commissions as at the date of this auditors' report. If, based on the work we have performed on this other information, we conclude that there is a material misstatement of this other information, we are required to report that fact in the auditors' report.

We have nothing to report in this regard.

The information, other than the financial statements and the auditors' report thereon, included in a document likely to be entitled "2020 Annual Report" is expected to be made available to us after the date of this auditors' report. If, based on the work we will perform on this other information, we conclude that there is a material misstatement of this other information, we are required to report that fact to those charged with governance.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with IFRS, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit.

We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion.

The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.
- Provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the group Company to express an opinion on the financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.
- Determine, from the matters communicated with those charged with governance, those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditors' report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our auditors' report because the adverse consequences of doing so

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would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner on the audit resulting in this auditors’ report is Lee Bardwell.

KPMG LLP

Chartered Professional Accountants

Calgary, Canada
February 24, 2021

Consolidated Statements of Financial Position

		December 31, 2020		December 31, 2019
ASSETS				
Current assets:				
Cash and cash equivalents	$	25,745,911	$	10,582,296
Trade and other receivables (Note 18a)		43,193,310		93,641,885
Inventories (Note 5)		26,665,902		30,826,700
Prepaid expenses		1,926,336		2,569,046
Current tax assets		219,400		-
Assets held for sale (Note 4)		4,405,516		-
Total current assets		102,156,375		137,619,927
Non-current assets:				
Drilling and other long-term assets (Note 6)		68,933,236		78,416,229
Right-of-use asset (Note 20)		28,956,908		32,825,964
Intangible assets (Note 8)		16,204,673		18,901,559
Deferred tax assets (Note 10)		289,542		613,355
Goodwill (Note 7)		-		8,876,351
Total non-current assets		114,384,359		139,633,458
Total assets	$	216,540,734	$	277,253,385
LIABILITIES AND SHAREHOLDERS' EQUITY				
Current liabilities:				
Operating facility (Note 9)	$	-	$	11,395,835
Lease liability		3,398,559		2,765,633
Trade and other payables		37,562,481		54,892,277
Dividends payable (Note 11d)		1,265,648		-
Liabilities directly associated with assets held for sale (Note 4)		943,063		-
Current tax liability		-		172,766
Total current liabilities		43,169,751		69,226,511
Non-current liabilities:				
Loans and Borrowings (Note 9)		-		13,896,400
Lease liability		35,698,084		39,753,860
Deferred tax liability (Note 10)		5,640,261		5,432,527
Total non-current liabilities		41,338,345		59,082,787
Equity:				
Share capital (Note 11a)		247,543,263		251,815,183
Contributed surplus		10,131,786		10,854,650
Retained earnings		(136,939,398)		(127,902,593)
Accumulated other comprehensive income		21,707,101		14,176,847
Accumulated other comprehensive loss related to assets held for sale		(10,410,114)		-
Total equity		132,032,638		148,944,087
Total liabilities and equity	$	216,540,734	$	277,253,385

See accompanying notes to consolidated financial statements.

Consolidated Statements of Comprehensive Loss

Years ended December 31,		2020		2019
Revenue (Note 16)	**$**	**233,734,479**	$	349,715,063
Direct costs (Note 13)		**201,697,504**		296,832,136
Gross profit		**32,036,975**		52,882,927
Expenses:				
Selling, general and administrative expenses (Note 13)		**26,855,472**		43,391,073
Research and development expenses (Note 13)		**1,943,713**		3,868,779
Finance expense		**747,779**		1,422,791
Finance expense lease liability (Note 20)		**2,361,066**		2,507,652
Impairment loss (Note 6 and Note 7)		**10,729,587**		500,000
Other income (Note 14)		**(2,246,134)**		(3,295,076)
		40,391,483		48,395,219
Earnings (loss) from continuing operations before income taxes		**(8,354,508)**		4,487,708
Provision for (recovery of) income taxes (Note 15)				
Current		**(1,049,256)**		555,590
Deferred		**(426,909)**		3,065,056
		(1,476,165)		3,620,646
Earnings (loss) from continuing operations		**(6,878,343)**		867,062
Discontinued operations				
Net loss from discontinued operations, net of taxes (Note 4)		**(892,814)**		(3,080,182)
Net loss		**(7,771,157)**		(2,213,120)
Other comprehensive loss				
Foreign currency translation		**(2,879,860)**		(3,229,667)
Total comprehensive loss for the period	**$**	**(10,651,017)**	$	(5,442,787)
Earnings (loss) per share – basic and diluted (Note 11c)				
Continuing operations	**$**	**(0.13)**	$	0.02
Discontinued operations	**$**	**(0.02)**	$	(0.06)
Net loss	**$**	**(0.15)**	$	(0.04)

See accompanying notes to consolidated financial statements.

Consolidated Statements of Changes in Equity

Year Ended December 31, 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 (Note 11a)	**50,000**		**77,500**		**-**		**-**		**-**		**77,500**
Common shares repurchased (Note 11a)	**(2,670,500)**		**(3,796,095)**		**-**		**-**		**-**		**(3,796,095)**
Share-based payments	**-**		**-**		**241,853**		**-**		**-**		**241,853**
Surrender value share exercise (Note 11a)	**-**		**(1,518,042)**		**-**		**-**		**-**		**(1,518,042)**
Fair value of options exercised	**-**		**964,717**		**(964,717)**		**-**		**-**		**-**
Net loss	**-**		**-**		**-**		**-**		**(7,771,157)**		**(7,771,157)**
Foreign currency translation, net of tax	**-**		**-**		**-**		**(2,879,860)**		**-**		**(2,879,860)**
Dividends	**-**		**-**		**-**		**-**		**(1,265,648)**		**(1,265,648)**
Balance, December 31, 2020	**50,625,920**	**$**	**247,543,263**	**$**	**10,131,786**	**$**	**11,296,987**	**$**	**(136,939,398)**	**$**	**132,032,638**

Year Ended December 31, 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 (Note 11a)	45,000		87,750		-		-		-		87,750
Common shares repurchased (Note 11a)	(4,762,300)		(14,071,163)		-		-		-		(14,071,163)
Share-based payments	-		-		611,681		-		-		611,681
Surrender value share exercise (Note 11a)	-		(350,808)		-		-		-		(350,808)
Fair value of options exercised	-		389,013		(389,013)		-		-		-
Net loss	-		-		-		-		(2,213,120)		(2,213,120)
Foreign currency translation, net of tax	-		-		-		(3,229,667)		-		(3,229,667)
Balance, December 31, 2019	53,246,420	$	251,815,183	$	10,854,650	$	14,176,847	$	(127,902,593)	$	148,944,087

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

Years ended December 31,	2020	2019
Cash flows from operating activities:		
Earnings (loss) from continuing operations	**$ (6,878,343)**	$ 867,062
Adjustments for:		
Depreciation and amortization (Note 13)	**27,974,556**	37,826,857
Depreciation and amortization right-of-use asset (Note 13)	**3,555,336**	3,502,783
Provision for (recovery of) income taxes (Note 15)	**(1,476,165)**	3,620,646
Impairment loss (Note 6 and Note 7)	**10,729,587**	500,000
Unrealized foreign exchange loss	**33,030**	277,787
Gain on disposition of drilling equipment (Note 14)	**(3,694,467)**	(3,163,254)
Equity-settled share-based payments (Note 12a)	**241,853**	611,681
Finance expense	**747,779**	1,422,791
Provision for bad debts (Note 14)	**1,529,660**	387,728
Provision for inventory obsolescence (Note 5 and Note 13)	**2,433,139**	2,182,919
Interest paid	**(366,417)**	(804,406)
Income taxes received (paid)	**430,418**	(462,465)
Change in non-cash working capital (Note 17)	**32,685,407**	5,201,979
Continuing operations	**67,945,373**	51,972,108
Discontinued operations	**(33,957)**	(1,798,764)
Net cash from operating activities	**67,911,416**	50,173,344
Cash flows from investing activities:		
Proceeds on disposition of drilling equipment	**7,229,645**	13,860,158
Acquisition of drilling and other equipment (Note 6c)	**(25,680,361)**	(34,007,163)
Acquisition of intangible assets (Note 8)	**-**	(66,180)
Change in non-cash working capital (Note 17)	**(648,472)**	(6,837,332)
Continuing operations	**(19,099,188)**	(27,050,517)
Discontinued operations	**(940)**	896,649
Net cash used in investing activities	**(19,100,128)**	(26,153,868)
Cash flows from financing activities:		
Repurchase of common shares under the NCIB (Note 11a)	**(3,796,095)**	(14,071,163)
Payments of lease liability	**(3,048,361)**	(3,182,316)
Surrender value cash payment	**(1,518,042)**	-
Repayment of operating facility	**(11,395,835)**	(1,952,727)
Proceeds from (Repayment of) loans and borrowings	**(13,960,400)**	2,075,400
Proceeds from issuance of share capital (Note 11a)	**77,500**	87,750
Continuing operations	**(33,641,233)**	(17,043,056)
Discontinued operations	**(6,440)**	(37,542)
Net cash used in financing activities	**(33,647,673)**	(17,080,598)
Net increase in cash and cash equivalents	**15,163,615**	6,938,878
Cash and cash equivalents, beginning of year	**10,582,296**	3,643,418
Cash and cash equivalents, end of year	**$ 25,745,911**	$ 10,582,296

See accompanying notes to consolidated financial statements.

Notes to the Consolidated Financial Statements

For the years ended December 31, 2020 and 2019

In Canadian dollars

1. Reporting Entity

PHX Energy Services Corp. (PHX Energy or the "Corporation") 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 service oil and natural gas exploration and development companies in Canada, United States, and Albania. The Corporation also develops and manufactures technologies that are made available for internal operational use.

The consolidated financial statements include the accounts of the Corporation and its wholly owned subsidiaries. The Corporation has presented its operations in Russia as a discontinued operation (see Note 4).

2. Basis of Preparation

a) Basis of Measurement

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

b) Functional and Presentation Currency

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

c) Use of Estimates

The preparation of the consolidated financial statements in conformity with International Financial Reporting Standards ("IFRS") requires management to make 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.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

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 consolidated financial statements have been difficult and are subject to a higher degree of measurement uncertainty during this volatile period.

Assumptions and estimation uncertainties that have a significant risk of material adjustment in the context of these financial statements include the following:

- estimated recoverable amount including certain significant assumptions regarding the forecasted revenue growth rates, forecasted earnings before interest, taxes, depreciation and amortization ("EBITDA") and the discount rate;
- estimated useful lives of drilling and other equipment and intangible assets;
- recognition of deferred tax assets based on estimates of the availability of future taxable profit against which carry-forward tax losses can be used;
- estimates and assumptions used in the valuation of inventory;
- estimate used in the valuation of accounts receivable;
- valuation of equity-settled and cash-settled share-based payments; and,

- key assumptions used in the estimate of leases including valuation of right of use assets and lease liabilities.

d) Critical Judgments

Significant judgement is required to assess when impairment indicators exist, and impairment testing is required. The assessment of impairment indicators is based on management's judgment of whether there are internal and external factors that would indicate that a cash generating unit ("CGU") and specifically the non-financial assets within the CGU, are impaired. The determination of a CGU is also based on management's judgment and is an assessment of the smallest group of assets that generate cash inflows independently of other assets.

3. Significant Accounting Policies

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements.

a) Basis of Consolidation

i. Business Combinations

Business acquisitions are accounted for using the acquisition method when the acquired set of activities and assets meets the definition of a business and control is transferred. In determining whether a particular set of activities and assets is a business, the Corporation assesses whether the set of assets and activities acquired includes, at a minimum, an input and substantive process and whether the acquired set has the ability to produce outputs.

The Corporation has an option to apply a "concentration test" that permits a simplified assessment of whether an acquired set of activities and assets is not a business. The optional concentration test is met if substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets.

The consideration transferred in the acquisition is measured at fair value and excludes amounts related to the settlement of pre-existing relationships. In a business combination achieved in stages, the acquirer re-measures its previously held equity interest in the acquiree at its acquisition-date fair value and recognizes the resulting gain or loss, if any, in profit or loss.

Any contingent consideration payable is measured at fair value at the acquisition date. If the contingent consideration is classified as equity, then it is not re-measured and settlement is accounted for within equity. Otherwise, subsequent changes in the fair value of the contingent consideration are recognized in profit or loss.

ii. Subsidiaries

Subsidiaries are entities controlled by the Corporation. The Corporation controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

iii. Loss of Control

When the Corporation loses control over a subsidiary it derecognizes the assets and liabilities of the subsidiary, and any other related components of equity. Any resulting gain or loss is recognized in profit or loss. Any interest retained in the former subsidiary is measured at fair value when control is lost.

iv. Transactions Eliminated on Consolidation

Intra-group balances and transactions, and any unrealized income and expenses arising from intra-group transactions, are eliminated. Unrealized gains arising from transactions with equity-accounted investees are eliminated against the investment to the extent of the Corporation's interest in the investee. Unrealized losses are eliminated in the same way as unrealized gains, but only to the extent that there is no evidence of impairment.

v. Foreign Currency Transactions

Transactions in foreign currencies are translated to the respective functional currencies of the Corporation's entities at exchange rates at the dates of the transactions. The methods used to account for assets and liabilities relating to foreign currency transactions entered into by the Corporation's entities, and to measure the foreign exchange risk arising on such transactions, depend upon whether the asset or liability in question is classified as a monetary or non-monetary item.

Receivables, liabilities and other monetary assets denominated in foreign currencies at the reporting date are translated at the functional currency spot exchange rate at the statement of financial position date. Exchange differences that arise between the rate at the transaction date and the one in effect at the payment date or the rate at the statement of financial position date are recognized in the statement of comprehensive income (loss) as other income or expense.

Drilling and other equipment, inventories and other non-monetary items purchased in foreign currencies and that are measured on the basis of historical cost are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value is determined.

vi. Foreign Operations

When entities, which prepare their financial statements in a functional currency other than Canadian dollars, are recognized in the consolidated financial statements, the income and expenses are translated at the monthly average exchange rates. The assets and liabilities of foreign operations are translated to Canadian dollars at the rate of exchange prevailing at the statement of financial position date.

Foreign currency differences are recognized in other comprehensive income (loss) in the accumulated other comprehensive income account. The exchange differences arising on the translation to the Corporation's presentation currency are recognized directly in the cumulative translation reserve as a separate component of equity. When a foreign operation is disposed of in its entirety or partially such that control, significant influence or joint control is lost, the cumulative amount in the translation reserve related to that foreign operation is reclassified to profit or loss as part of the gain or loss on disposal.

When the settlement of a monetary item receivable from or payable to a foreign operation is neither planned nor likely in the foreseeable future, foreign exchange gains and losses arising from such a monetary item are considered to form part of a net investment in a foreign operation and are recognized in other comprehensive income (loss), and are presented within equity in accumulated other comprehensive income.

b) Financial Instruments

i. Non-Derivative Financial Assets

The Corporation initially recognizes trade and other receivables on the date that they originate. All other financial assets (including assets designated at fair value through profit or loss) are recognized initially on the trade date at which the Corporation becomes a party to the contractual provisions of the instrument.

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when the Corporation has a legal right to offset the amounts and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

Financial assets at fair value through profit and loss ("FVTPL")

These assets are subsequently measured at fair value. Net gains and losses, including any interest or dividend income, are recognized in profit or loss

Financial assets at amortized cost

These assets are subsequently measured at amortized cost using the effective interest method. The amortized cost is reduced by impairment losses. Interest income, foreign exchange gains and losses and impairment are recognized in profit or loss. Any gain or loss on derecognition is recognized in profit or loss.

Cash and cash equivalents

The Corporation's short-term deposits with original maturities of three months or less are considered to be cash equivalents and are recorded at cost, which approximates fair value.

Non-derivative financial assets

The carrying amount of the Corporation's financial assets includes cash and cash equivalents and trade and other receivables. A lifetime expected credit loss ("ECL") is recognized on financial assets when there is objective evidence of a significant increase in credit risk as a result of one or more events that occurred after the initial recognition of the asset.

Financial assets at amortized cost consist of cash and cash equivalents and trade and other receivables. Trade and other receivables are recorded at its original invoice value less any amounts estimated to be uncollectible plus any directly attributable transaction costs.

Non-derivative financial liabilities

Financial liabilities are recognized initially on the trade date at which the Corporation becomes a party to the contractual provisions of the instrument. Such financial liabilities are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition these financial liabilities are measured at amortized cost using the effective interest rate method. Transaction costs related to the issuance of any long-term debt are netted against the carrying value of the associated long-term debt and amortized as part of financing costs over the life of the debt using the effective interest rate method. The Corporation derecognizes a financial liability when its contractual obligations are discharged, cancelled or expire.

The Corporation has the following non-derivative financial liabilities: trade and other payables, and dividends payable.

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Corporation has a legal right to offset the amounts and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

c) Share Capital

Common shares

Common shares are classified as equity. Incremental costs directly attributable to the issue of ordinary shares and share options are recognized as a deduction from equity, net of any tax effects.

Repurchase and reissue of common shares (treasury shares)

When shares recognized as equity are repurchased, the amount of the consideration paid, which includes directly attributable costs, net of any tax effects, is recognized as a deduction from equity. Repurchased shares are classified as treasury shares and are presented in the treasury share reserve. When treasury shares are sold or reissued subsequently, the amount received is recognized as an increase in equity and the resulting surplus or deficit on the transaction is presented within contributed surplus.

d) Drilling and Other Equipment

i. Recognition and Measurement

Items of drilling and other equipment are measured at cost less accumulated depreciation and accumulated impairment losses.

Cost is comprised of the acquisition price, costs directly attributable to the acquisition and preparation costs of the asset until the time when it is ready to be put into operation. Where material, borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset (one that takes a substantial period of time to be ready for use) are included in capitalized cost. Borrowing costs have not been material to the cost of assets for any period presented. The cost of self-constructed assets includes the cost of materials and any other costs directly attributable to bringing the assets to a working condition for their intended use. No borrowing costs were capitalized in 2020 and 2019.

Drilling and other equipment also includes parts and raw materials awaiting assembly. These assets are recorded at cost and no depreciation is taken until the asset is completed and available for intended use.

When parts of an item of drilling and other equipment have different useful lives, they are accounted for as separate items (major components) of drilling and other equipment.

Gains and losses on disposal of an item of drilling and other equipment are determined by comparing the proceeds from disposal with the carrying amount of drilling and other equipment, and are recognized net within other income in the Corporation’s profit or loss.

ii. Subsequent Costs

The cost of replacing a part of an item of drilling and other equipment is recognized in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Corporation, and its cost can be measured reliably. The carrying amount of the replaced part is derecognized. The costs of the day-to-day servicing of drilling and other equipment (repair and maintenance) are recognized in the Corporation’s profit or loss as incurred.

iii. Depreciation

Depreciation expense is recognized in profit or loss on a straight-line basis over the estimated useful lives of drilling and other equipment and is calculated using the depreciable amount, which is the cost of an asset, or other amount substituted for cost, less its residual value.

Significant components of individual assets are assessed, and if a component has a useful life that is different from the remainder of that asset, then that component is depreciated separately.

The estimated useful lives for the current period are as follows:

Directional drilling equipment	2 to 8 years straight-line
Office and computer equipment	3 to 5 years straight-line
Machinery and equipment	5 years straight-line
Vehicles	5 years straight-line
Building	20 years straight-line

Depreciation methods, useful lives and residual values are reviewed at each financial year end and adjusted if appropriate.

e) Intangible Assets and Goodwill

i. Goodwill

Goodwill arising on the acquisition of subsidiaries is measured at cost less accumulated impairment losses.

ii. Research and Development Costs

Expenditure on research activities undertaken with the prospect of gaining new scientific or technical knowledge and understanding is recognized in profit or loss as incurred.

Development activities involve a plan or design for the production of new or substantially improved product and process. Development expenditure is capitalized only if development costs can be measured reliably, the product or process is technically and commercially feasible, future economic benefits are probable, and the Corporation intends to and has sufficient resources to complete development and to use or sell the asset. The expenditure capitalized includes the cost of materials, direct labour, overhead costs that are directly attributable to preparing the asset for its intended use, and borrowing costs. Other development expenditures are recognized in profit or loss as incurred.

Capitalized development expenditure is measured at cost less accumulated amortization and accumulated impairment losses.

iii. Other Intangible Assets

Other intangible assets that are acquired by the Corporation and have finite useful lives are measured at cost less accumulated amortization and any accumulated impairment losses.

iv. Subsequent Expenditures

Subsequent expenditures are capitalized only when they increase the future economic benefits embodied in the specific asset to which they relate. All other expenditures, including expenditures on internally generated goodwill, are recognized in profit or loss as incurred.

v. Amortization

Amortization is calculated to write-off the costs of intangible assets less their estimated residual values using the straight-line method over their estimated useful lives, and is recognized in profit or loss. Goodwill is not amortized.

The estimated useful lives are as follows:

Licenses	10 to 15 years
Development Costs	3 years

Amortization methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

f) Assets Held for Sale

Non-current assets, or disposal groups comprising assets and liabilities, are classified as held for sale if it is highly probable that they will be recovered primarily through sale rather than through continuing use.

Such assets, or disposal groups, are generally measured at the lower of their carrying amount and fair value less costs to sell. Any impairment loss on a disposal group is allocated first to goodwill, and then to the remaining assets and liabilities on a pro rata basis, except that no loss is allocated to inventories, financial assets, and deferred tax assets, which continue to be measured in accordance with the Corporation's other accounting policies. Impairment losses on initial classification as held for sale and subsequent gains and losses on remeasurement are recognized in profit or loss.

Once classified as held for sale, intangible assets and property, plant, and equipment are no longer depreciated .

g) Inventories

Inventories are measured at the lower of cost and net realizable value. The cost of inventories is based on the first-in first-out method, and includes expenditures incurred in acquiring the inventories, production or conversion costs and other costs incurred in bringing them to their existing location and condition.

Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

h) Impairment

i. Financial Assets (Including Receivables)

A financial asset not carried at fair value through profit or loss is assessed at each reporting date to determine whether there is objective evidence that it is impaired. A financial asset is impaired if objective evidence indicates that a loss event has occurred after the initial recognition of the asset, and that the loss event had a negative effect on the estimated future cash flows of that asset that can be estimated reliably.

The Corporation considers evidence of impairment for receivables at a specific asset level. When determining whether the credit risk of a financial asset has increased significantly since initial recognition and when estimating ECL, the Corporation considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes both quantitative and qualitative information and analysis based on the Corporation's historical experience, informed credit assessment, and forward-looking information. The Corporation has elected to measure loss allowances for trade and other receivables at an amount equal to the ECL over the expected life of a financial instrument.

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. Losses are recognized in profit or loss and are reflected in an allowance account against receivables. Interest on the impaired asset continues to be recognized through the unwinding of the discount. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through profit or loss.

ii. Non-Financial Assets

The carrying amounts of the Corporation's non-financial assets, other than inventories and deferred tax assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. For goodwill and intangible assets that have indefinite useful lives or that are not yet available for use, the recoverable amount is estimated each year at the same time.

The recoverable amount of an asset or cash-generating unit ("CGU") is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets. For the purposes of goodwill impairment testing, goodwill acquired in a business combination is allocated to the group of CGUs that is expected to benefit from the synergies of the combination. This allocation is subject to an operating segment ceiling test and reflects the lowest level at which that goodwill is monitored for internal reporting purposes.

The Corporation's corporate assets do not generate separate cash inflows. If there is an indication that a corporate asset may be impaired, then the recoverable amount is determined for the CGU to which the corporate asset belongs.

Where the carrying amount of an asset or CGU exceeds its recoverable amount, the non-financial assets within the CGU are considered impaired and its carrying amount is reduced to its recoverable amount. Impairment losses recognized in respect of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the units, and then to reduce the carrying amounts of the other assets in the unit (group of units) on a pro rata basis.

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognized in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

iii. Employee Benefits

Short-term employee benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided.

A liability is recognized for the amount expected to be paid under short-term cash bonus plans if the Corporation has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee, and the obligation can be estimated reliably.

Share-based payment transactions

The grant date fair value of share-based payment awards granted to employees is recognized as an employee expense, with a corresponding increase in equity, over the period that the employees unconditionally become entitled to the awards (vesting period). The amount recognized as an expense is adjusted to reflect the number of awards for which the related service and non-market vesting conditions are expected to be met, such that the amount ultimately recognized as an expense is based on the number of awards that do meet the related service and non-market performance conditions at the vesting date.

The fair value of the amount payable to employees in respect of Retention Awards, which are settled in cash, is recognized as an expense with a corresponding increase in liabilities, over the period that the employees unconditionally become entitled to payment. The liability is re-measured at each reporting date and at settlement date. Any changes in the fair value of the liability are recognized as personnel expense in profit or loss.

i) Provisions

A provision is recognized if, as a result of a past event, the Corporation has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. The unwinding of the discount is recognized as finance cost.

j) Revenue

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

The Corporation primarily generates drilling services revenue whereby the client is charged a flat day rate for each day the rig requires directional drilling services. The day rate includes personnel assistance as well as use of equipment. The Corporation recognizes revenue daily based on the daily drilling rate. The Corporation's performance obligation is the bundling of its services relating to directional drilling activities, which distinctly benefit the client each day of active drilling. The Corporation recognizes this benefit to revenue daily, over a period of time, as services have been provided. An invoice is sent to the client upon completion of the well, also revenues are accrued based on daily services provided at period end. Clients are expected to pay the Corporation 30 days after the invoice has been received.

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

k) Government Grants

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 year ended December 31, 2020, government grants relating to the Canadian Emergency Wage Subsidy and Canadian Emergency Rent Subsidy programs of $5 million and $0.4 million, respectively, were included in the consolidated statement of comprehensive loss. For the year ended December 31, 2019, there were no government grants recognized in the consolidated statement of comprehensive loss.

l) Statement of Compliance

The consolidated financial statements have been prepared in accordance with IFRS. Details of the Corporation's accounting policies, including changes during the year, are included in Note 3.

The consolidated financial statements were authorized for issue by the Board of Directors (the "Board") on February 24, 2021.

m) Leases

i. Definition of a Lease

The Corporation determines whether an arrangement or an agreement contains a lease in accordance to IFRS 16 *Leases*. Under IFRS 16, a contract is, or contains, a lease if the contract conveys a right to control the use of an identified asset for a period of time in exchange for consideration.

At inception of a contract, the Corporation assesses whether a contract is, or contains, a lease. To assess whether a contract conveys the right to control the use of an identified asset, the Corporation assesses whether:

- The contract involves the use of an identified asset, which may be specifically or implicitly stated, and the identified asset should be physically distinct or represents substantially all of the capacity of the asset. If the supplier has the substantive right to substitute the asset throughout the term of the contract, then the asset is not identified;
- The Corporation has the right to obtain substantially all of the economic benefits from use of the asset throughout the contract; and
- The Corporation has the right to direct the use of the identified asset throughout the contract. The Corporation has this right to direct how and for what purpose the asset is used. In addition, the Corporation has the right to operate the asset without the lessor or supplier having the right to change those operation instructions, or the Corporation designed the asset in a way that predetermines how and for what purpose it will be used.

At inception or on reassessment of a contract that contains a lease component, the Corporation allocates the consideration in the contract to each lease and non-lease component on the basis of their relative stand-alone prices. However, for leases of properties in which it is a lessee, the Corporation has elected not to separate non-lease components and will instead account for the lease and non-lease components as a single lease component.

ii. As a Lessee

The Corporation recognizes right-of-use assets and lease liabilities at the lease commencement date. The right-of-use assets are initially measured at cost, which comprises the initial amount of the lease liabilities adjusted for any lease payments made at or before the commencement date, plus any initial direct costs incurred less any lease incentives received.

The right-of-use assets are depreciated using the straight-line method from the commencement date to the end of the lease term, unless the lease transfers ownership of the underlying asset to the Corporation by the end of the lease term or the cost of the right-of-use asset reflects that the Corporation will exercise a purchase option. In that case the right-of-use asset will be depreciated over the useful life of the underlying asset, which is determined on the same basis as those of drilling and other equipment.

The lease liabilities are initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the Corporation's incremental borrowing rate. The Corporation determines its incremental borrowing rate by obtaining interest rates from external financing sources and adjusting to reflect the terms of the lease and type of the asset leased.

Lease payments included in the measurement of the lease liabilities comprise the following:

- Fixed payments, including in-substance fixed payments;
- Amounts expected to be payable under a residual value guarantee if applicable; and,
- The exercise price under a purchase option that the Corporation is reasonably certain to exercise, lease payments in an optional renewal period if the Corporation is reasonably certain to exercise and penalties for early termination of a lease unless the Corporation is reasonably certain not to terminate early.

The lease liabilities are measured at amortized cost using the effective interest method. It is re-measured when there is a change in future lease payments arising from a change in discount rate or change in estimate and assumptions related to the leased asset. When a lease liability is re-measured a corresponding adjustment is made to the carrying amount of the right-of-use asset or is recorded in profit or loss if the carrying amount of the right-of-use asset has been reduced to zero.

The Corporation has elected to apply recognition exemptions to right-of-use assets and lease liabilities for some leases of low-value assets (e.g. office equipment), as well as for short-term leases or leases with terms less than twelve months or entered into on a month-to-month basis. The Corporation recognizes the lease payments associated with these leases as an expense on a straight-line basis over the lease term.

iii. As a Lessor

The Corporation accounts for its interest in the head lease and the sub-lease separately. The Corporation assesses the lease classification of a sub-lease with reference to the right-of-use assets arising from the head lease, not with reference to the underlying asset. If a head lease is a short-term lease then it is classifies the sub-lease an operating lease and lease payments received are recognized as operating income on a straight-line basis over the lease term.

n) Finance Income and Expense

Finance income comprises of interest income on funds invested. Interest income is recognized as it accrues in the Corporation's profit or loss, using the effective interest method.

Finance expense comprises interest expense on borrowings. Borrowing costs that are not directly attributable to the acquisition, construction or production of a qualifying asset are recognized in the Corporation's profit or loss using the effective interest method.

o) Income Tax

Income tax expense comprises current and deferred tax. Current tax and deferred tax are recognized in profit or loss except to the extent that it relates to a business combination or items recognized directly in equity or in other comprehensive income.

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized for the following temporary differences: the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss, and differences relating to investments in subsidiaries and jointly controlled entities to the extent that it is probable that they will not reverse in the foreseeable future. In addition, deferred tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

A deferred tax asset is recognized for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

The criteria for recognizing deferred tax assets arising from unused tax losses is the same as the criteria arising from temporary differences between the carrying amounts of asset and liabilities for tax purposes. However, the Corporation under the circumstances of having unused tax losses due to a history of recent losses recognizes deferred tax assets to the extent there is convincing other evidence that sufficient taxable income will be available against the unused losses.

Tax exposures

In determining the amount of current and deferred tax, the Corporation takes into account the impact of uncertain tax positions and whether additional taxes and interest may be due. This assessment relies on estimates and assumptions and may involve a series of judgements about future events. New information may become available that causes the Corporation to change its judgement regarding the adequacy of existing tax liabilities; such changes to tax liabilities will impact tax expense in the period that such a determination is made.

p) Earnings per Share

The Corporation presents basic and diluted earnings per share data for its ordinary shares. Basic per share amounts are calculated by dividing the earnings or loss attributable to ordinary shareholders of the Corporation by the weighted-average number of ordinary shares outstanding during the period, adjusted for own shares held. Diluted per share amounts are calculated by adjusting the earnings or loss attributable to ordinary shareholders and the weighted-average number of common shares outstanding, adjusted for own shares held, for the effects of all dilutive potential ordinary shares, which comprise share options granted to employees.

q) Segment Reporting

An operating segment is a component of the Corporation that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the

Corporation's other components. All operating segments' operating results are reviewed regularly by the Corporation's Chief Executive Officer ("CEO") to make decisions about resources to be allocated to the segment and assess its performance, and for which discrete financial information is available.

Segment results that are reported to the CEO include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated items comprise mainly of corporate assets (primarily the Corporation's headquarters), head office expenses, and income tax assets and liabilities.

Segment capital expenditure is the total cost incurred during the period to acquire drilling and other equipment, and intangible assets other than goodwill.

4. Assets Held for Sale

During the fourth quarter of 2020 management committed to a plan to sell the Russian division, operating under the entity Phoenix TSR LLC ("Phoenix TSR"). Accordingly, Phoenix TSR is represented as a disposal group held for sale. Efforts to sell the disposal group have started and a sale is expected by April 2021.

As at December 31, 2020, the disposal group was stated at fair value less costs to sell and comprised the following assets and liabilities:

Trade and other receivables	**$ 1,494,184**
Inventories	**819,699**
Prepaid expenses	**139,130**
Drilling and other equipment	**1,952,503**
Assets held for sale	**$ 4,405,516**

Trade and other payables	**$ 943,063**
Liabilities directly associated with assets held for sale	**$ 943,063**

The held for sale assets and liabilities of Phoenix TSR met the criteria for discontinued operations in the fourth quarter of 2020, as such the comparative consolidated statements of comprehensive loss for the year ended December 31, 2019 have been re-presented to show the discontinued operations separate from the continuing operations of the Corporation.

The results of the held for sale Phoenix TSR operations are as follows:

		2020		2019
Revenue	$	**12,667,511**	$	12,341,698
Expenses		**13,491,127**		15,278,284
Loss from discontinued operations		**(823,616)**		(2,936,586)
Income tax expense from discontinued operations		**69,198**		143,596
Net loss from discontinued operations, net of taxes	$	**(892,814)**	$	(3,080,182)

5. Inventories

Inventories are mainly comprised of drilling and other equipment repair parts. In 2020, consumed repair parts, which are included in direct costs, amounted to $21.4 million (2019 - $32.3 million). For the year ended December 31, 2020, the Corporation recognized a provision for obsolete inventory of $2.4 million (2019 - $2.2 million).

6. Drilling and Other Long-Term Assets

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 year ended December 31, 2020, EDR equipment with a carrying amount of $1.4 million was derecognized.

b) Impairment Analysis

The Corporation is required to assess whether there are any external and internal indicators that exist at the end of each reporting period. As at March 31, 2020, the Corporation determined indicators of impairment existed in the Canadian, US, and International CGUs 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 7 Goodwill for details on the Canadian CGU impairment test. The estimated recoverable amounts for the 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 with significant assumptions including forecasted revenue growth rates, forecasted EBITDA and the discount rate. The discount rate was estimated using the weighted-average cost of capital formula and adjusted for risks specific to the CGU. As at December 31, 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 significant assumptions were used in the discounted cash flow projection:

- Forecasted EBITDA" is expected to decrease 46 percent in 2020 relative to 2019 results. Forecasted revenues in 2020 are expected to decline 44 percent relative to 2019 revenues, expenses are forecasted to decrease in line with forecasted EBITDA. Forecasted average revenue growth rates for the five years subsequent to 2020 is 18 percent.
- 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 and therefore no impairment loss was recorded. Management identified that an increase of 5 percent to the discount rate or a reduction of 6 percent to the average forecasted revenue growth rates 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 significant assumptions were used in the discounted cash flow projection:

- Subsequent to the 2020-year, estimated forecasted revenue growth rates are expected to increase annually on average by 10 percent in the five-year business plan.
- 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 and therefore no impairment loss was recorded. Management identified that an increase of 12 percent to the discount rate or a reduction of 18 percent to the average forecasted revenue growth rates 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 significant assumptions for the 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 year ended December 31, 2020, the Corporation acquired assets with a cost of $25.7 million (2019 - $34 million).

Assets with a carrying amount of $3.5 million (2019 - $10.7 million) were disposed of as a result of tools lost down hole and scrapped assets, resulting in a net gain on disposition of $3.7 million (2019 - $3.2 million), which is included in other income in the consolidated statement of comprehensive loss.

(Stated in thousands of dollars)

	Directional Drilling Equipment	EDR Equipment	Machinery and Equipment	Office and Computer Equipment	Development Costs	Vehicles	Total
Cost							
At January 1, 2020	**274,154**	**8,124**	**19,852**	**17,090**	**3,791**	**1,259**	**324,270**
Additions	**24,436**	**-**	**753**	**203**	**-**	**288**	**25,680**
Disposals	**(11,595)**	**-**	**(214)**	**-**	**(8)**	**(736)**	**(12,553)**
Reclassification to assets held for sale	**(13,206)**	**-**	**(1,368)**	**(105)**	**-**	**-**	**(14,679)**
Impairment	**-**	**(1,410)**	**-**	**-**	**-**	**-**	**(1,410)**
Effect of movement in exchange rate	**(4,329)**	**(101)**	**(678)**	**(153)**	**-**	**(15)**	**(5,276)**
At December 31, 2020	**269,460**	**6,613**	**18,345**	**17,035**	**3,783**	**796**	**316,032**
Accumulated Depreciation							
At January 1, 2020	**203,600**	**6,613**	**16,479**	**14,589**	**3,785**	**788**	**245,854**
Depreciation	**23,246**	**-**	**1,293**	**622**	**4**	**174**	**25,339**
Disposals	**(8,246)**	**-**	**(189)**	**-**	**(6)**	**(580)**	**(9,021)**
Reclassification to assets held for sale	**(11,498)**	**-**	**(1,141)**	**(87)**	**-**	**-**	**(12,726)**
Effect of movement in exchange rate	**(1,666)**	**-**	**(533)**	**(142)**	**-**	**(6)**	**(2,347)**
At December 31, 2020	**205,436**	**6,613**	**15,909**	**14,982**	**3,783**	**376**	**247,099**
Carrying amount at December 31, 2020	**64,024**	**-**	**2,436**	**2,053**	**-**	**420**	**68,933**

(Stated in thousands of dollars)

	Directional Drilling Equipment	EDR Equipment	Machinery and Equipment	Office and Computer Equipment	Development Costs	Vehicles	Building	Land	Total
Cost									
At January 1, 2019	280,853	8,688	18,991	16,764	3,791	1,325	3,413	178	334,003
Additions	32,282	12	1,430	648	-	154	-	-	34,526
Disposals	(30,265)	(83)	(289)	(1)	-	(147)	(3,279)	(171)	(34,235)
Impairment	-	(500)	-	-	-	-	-	-	(500)
Effect of movement in exchange rate	(8,716)	7	(280)	(321)	-	(73)	(134)	(7)	(9,524)
At December 31, 2019	274,154	8,124	19,852	17,090	3,791	1,259	-	-	324,270
Accumulated Depreciation									
At January 1, 2019	200,064	5,389	14,946	13,725	3,741	787	1,186	-	239,838
Depreciation	31,832	1,273	1,949	1,154	44	194	74	-	36,520
Disposals	(21,757)	(76)	(197)	-	-	(145)	(1,212)	-	(23,387)
Effect of movement in exchange rate	(6,539)	27	(219)	(290)	-	(48)	(48)	-	(7,117)
At December 31, 2019	203,600	6,613	16,479	14,589	3,785	788	-	-	245,854
Carrying amount at December 31, 2019	70,554	1,511	3,373	2,501	6	471	-	-	78,416

d) Capital Commitments

As at December 31, 2020, the Corporation has entered into commitments to purchase drilling and other equipment for $11.5 million (2019 - $19.5 million); delivery is expected to occur within the first half of 2021.

7. 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. In the first quarter of 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 estimated 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 with significant assumptions including forecasted revenue growth rates, forecasted earnings before interest, taxes, depreciation and amortization ("EBITDA") and the discount rate. The discount rate was estimated using the weighted-average cost of capital formula and adjusted for risks specific to the CGU. The following significant assumptions were used in the discounted cash flow projection:

- Forecasted EBITDA in 2020 is in line with 2019 results. Forecasted revenues in 2020 are expected to decline 36 percent relative to 2019 revenues, expenses are forecasted to decrease in line with forecasted EBITDA. Forecasted average revenue growth rates for the five years subsequent to 2020 is 20 percent.
- 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 significant 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 and the Company recorded an impairment loss of $8.9 million.

8. Intangible Assets

(Stated in thousands of dollars)

	Technology	License	Development Costs	Systems/ Software	Total
Cost					
At January 1, 2020	**1,826**	**25,876**	**2,643**	**1,965**	**32,310**
Additions	**-**	**-**	**-**	**-**	**-**
Effect of movement in exchange rate	**-**	**(59)**	**-**	**(3)**	**(62)**
At December 31, 2020	**1,826**	**25,817**	**2,643**	**1,962**	**32,248**
Accumulated Amortization					
At January 1, 2020	**1,826**	**7,903**	**1,727**	**1,952**	**13,408**
Amortization	**-**	**1,709**	**916**	**10**	**2,635**
Effect of movement in exchange rate	**-**	**-**	**-**	**-**	**-**
At December 31, 2020	**1,826**	**9,612**	**2,643**	**1,962**	**16,043**
Carrying amount at December 31, 2020	**-**	**16,205**	**-**	**-**	**16,205**

(Stated in thousands of dollars)

	Technology	License	Development Costs	Systems/ Software	Total
Cost					
At January 1, 2019	1,826	26,025	2,577	1,972	32,400
Additions	-	-	66	-	66
Effect of movement in exchange rate	-	(149)	-	(7)	(156)
At December 31, 2019	1,826	25,876	2,643	1,965	32,310
Accumulated Amortization					
At January 1, 2019	1,826	6,182	859	1,231	10,098
Amortization	-	1,737	868	721	3,326
Effect of movement in exchange rate	-	(16)	-	-	(16)
At December 31, 2019	1,826	7,903	1,727	1,952	13,408
Carrying amount at December 31, 2019	-	17,973	916	13	18,902

During the year ended December 31, 2020, the Corporation did not acquire any intangible assets (2019 - $0.1 million).

9. Loans and Borrowings

(Stated in thousands of dollars)

	Currency	Amount of Facility	Date of Maturity	**Currency**	**Carrying Amount at December 31, 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 December 31, 2020 the Corporation was in compliance with all its financial covenants as follows:

Ratio	Covenant	**As at December 31, 2020**
Debt to covenant EBITDA	<3.0x	**n.m.**
Interest coverage ratio	>3.0x	**37.6**

n.m. – not meaningful

The syndicated loan has a maturity date of December 11, 2022 and borrowing amounts of CAD $50 million in the syndicated facility and USD $15 million in the US operating facility.

As at December 31, 2020 the Corporation has CAD $65 million and USD $15 million available to be drawn from its credit facilities with a borrowing base limited to $76 million.

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

10. Deferred Tax Assets and Liabilities

a) Unrecognized Deferred Tax Assets and Liabilities

(Stated in thousands of dollars)

	2020		2019	
	Gross Amount	**Tax Effect**	Gross Amount	Tax Effect
Non-capital income tax losses	**$ 48,644**	**$ 10,368**	$ 53,600	$ 12,010
Investment tax credit / foreign tax credit	**-**	**4,011**	-	4,108
Drilling and other equipment	**8,717**	**2,005**	10,256	2,359
Intangibles	**2,110**	**485**	4,669	1,074
Partnership loss	**374**	**86**	6,353	1,461
IFRS 16 – lease liability	**-**	**-**	-	-
Other	**6,455**	**1,485**	10,367	2,384
	$ 66,300	**$ 18,440**	$ 82,245	$ 23,396

The Corporation has unrecognized deferred tax assets relating to the Canadian and international jurisdictions. Deferred tax assets have not been recognized in respect of the losses as they may not be used to offset taxable profits elsewhere in the Corporation, and they have arisen in subsidiaries that have no established indicators demonstrating that it is probable that future taxable profits will be available to utilize those loss carry-forwards. These non-capital losses will expire between 2022 and 2040. The investment tax credits and foreign tax credits will expire between 2026 and 2038.

As at December 31, 2020, the Corporation has unrecognized deferred tax assets in respect of deductible temporary differences in the Canadian jurisdiction. Deferred tax assets have not been recognized in respect of deductible temporary differences due to the recent history of taxable losses in Canada.

b) Recognized Deferred Tax Assets and Liabilities

Deferred tax assets and liabilities are attributable to the following:

(Stated in thousands of dollars)

Years ended December 31,		2020		2019
Deferred income tax assets:				
Non-capital income tax losses	**$**	**3,681**	$	3,983
Lease liability		**9,167**		8,440
Other (including foreign and other tax credits)		**1,798**		1,515
	$	**14,646**	$	13,938
Deferred income tax liabilities:				
Drilling and other equipment	**$**	**(12,120)**	$	(11,059)
Right-of-use asset		**(6,791)**		(7,698)
Intangibles		**(177)**		-
Undistributed profits		**(909)**		-
		(19,997)		(18,757)
Net deferred income tax liability	**$**	**(5,351)**	$	(4,819)

Non-capital income tax losses expire between 2022 and 2040. Deferred tax assets are recognized only to the extent it is considered probable that those assets will be recoverable. The determination involves an assessment of when those deferred tax assets are likely to reverse and a judgment of whether there will be sufficient taxable profits available to utilize the tax assets when they do reverse. Assumptions regarding future profitability have been made and used as the basis for recognizing the deferred tax asset. Deferred tax movements are included in net loss.

(Stated in thousands of dollars)

	Drilling and Other Equipment	Right-of-Use Asset	Intangibles	Undistributed Profits	Non-Capital Income Tax Losses	Lease Liabilities	Other	Total
At January 1, 2020	(11,059)	(7,698)	-	-	3,983	8,440	1,515	(4,819)
Recognized in profit	(1,388)	679	(177)	(909)	935	977	310	427
Recognized in equity	-	-	-	-	-	-	-	-
Recognized in OCI	327	228	-	-	(1,237)	(250)	(45)	(977)
Other	-	-	-	-	-	-	18	18
At December 31, 2020	(12,120)	(6,791)	(177)	(909)	3,681	9,167	1,798	(5,351)

(Stated in thousands of dollars)

	Drilling and Other Equipment	Right-of-Use Asset	Non-Capital Income Tax Losses	Lease Liabilities	Other	Total
At January 1, 2019	(8,251)	-	4,709	-	576	(2,966)
Recognized in profit	(3,284)	(4,704)	(454)	4,764	613	(3,065)
Recognized in equity	-	(2,994)	-	3,676	-	682
Recognized in OCI	476	-	(272)	-	(33)	171
Other	-	-	-	-	359	359
At December 31, 2019	(11,059)	(7,698)	3,983	8,440	1,515	(4,819)

11. Share Capital

a) Authorized and Issued Shares

The Corporation is authorized to issue an unlimited number of common 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	**(2,670,500)**		**(3,796,095)**
Surrender value of options exercised	**-**		**(608,724)**
Issued shares pursuant to share option plan	**50,000**		**132,899**
Balance as at December 31, 2020	**50,625,920**	**$**	**247,543,263**

b) Weighted-Average Number of Shares

	2020	2019
Issued common shares at January 1,	**53,246,420**	57,963,720
Effect of shares pursuant to Normal Course Issuer Bid	**(676,384)**	(1,769,379)
Effect of share options exercised	**10,311**	35,014
Weighted-average number of common shares at December 31,	**52,580,347**	56,229,355

c) Basic and Diluted Loss per Share

2020		**Loss (numerator)**	**Shares (denominator)**		**Per Share Amount**
Continuing operations:					
Basic and diluted loss per share:	**$**	**(6,878,343)**	**52,580,347**	**$**	**(0.13)**
Discontinued operations:					
Basic and diluted loss per share		**(892,814)**	**52,580,347**		**(0.02)**
Net loss per share – basic and diluted	**$**	**(7,771,157)**	**52,580,347**	**$**	**(0.15)**

2019		Loss (numerator)	Shares (denominator)		Per Share Amount
Continuing operations:					
Basic earnings per share:	$	867,062	56,229,355	$	0.02
Diluted earnings per share:		867,062	57,115,387		0.02
Discontinued operations:					
Basic and diluted loss per share:		(3,080,182)	56,229,355		(0.06)
Net loss per share – basic and diluted	$	(2,213,120)	56,229,355	$	(0.04)

The continuing and discontinued operations, individually and when combined, were in loss positions for the year ended December 31, 2020 and therefore all options were considered anti-dilutive and excluded for the calculation of diluted earnings per share. The number of excluded options was 3,345,267 (2019 – 4,783,601) of which 1,475,267 options (2019 – 2,371,101) had exercise prices below the Corporation share price as at December 31, 2020.

d) Dividends

In December 2020, the Board approved the reinstatement of a quarterly dividend program. On December 31, 2020, the Corporation declared a dividend of $0.025 per share or $1.3 million, payable on January 15, 2021.

e) Normal Course Issuer Bid ("NCIB")

During the third quarter of 2020, the 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, subsequent to August 14, 2020, 2,670,500 common shares were purchased by the Corporation and cancelled as at December 31, 2020. Subsequent to December 31, 2020, the Corporation purchased and cancelled 460,888 shares and completed the current NCIB program.

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 all purchased and cancelled by the Corporation in 2019.

12. Share-Based Payments

a) Share Option Program (Equity-Settled)

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

Summary of option grants in 2020

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

During the year ended December 31, 2020, a total of 50,000 options (2019 – 45,000 options) were exercised at exercise price of $1.55, a total of 820,834 options were forfeited (2019 – 312,500 options), 150,000 options were cancelled (2019 – nil), and 667,500 options expired (2019 – 400,000). The 820,834 options forfeited were surrendered to the Corporation and payment was made to the option holders equal to the excess of the five-day weighted average share price at date of surrender less 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. As at December 31, 2020, the Corporation had a total of 3,345,267 (2019 – 4,783,601) options outstanding which expire over a period of 1 year to 5 years.

The fair value of options that were exercised for the year ended December 31, 2020 in the amount of $1 million has been added to share capital.

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 2020, the Corporation recognized a total compensation expense of $241,853 (2019 - $611,681) for share options granted between 2017 and 2020.

A summary of the status of the plan as at December 31, 2020, is presented below:

	2020 Options	**2020** Weighted-Average Exercise Price	2019 Options	2019 Weighted-Average Exercise Price
Outstanding, beginning of year	**4,783,601**	**$ 3.35**	5,291,101	$ 3.89
Granted	**250,000**	**2.15**	250,000	2,81
Exercised	**(50,000)**	**1.55**	(45,000)	1.95
Forfeited / cancelled	**(970,834)**	**1.87**	(312,500)	1.55
Expired	**(667,500)**	**6.88**	(400,000)	11.76
Outstanding, end of year	**3,345,267**	**$ 3.01**	4,783,601	$ 3.35
Options exercisable, end of year	**3,095,262**	**$ 3.06**	4,283,593	$ 3.49

The range of exercise prices for options outstanding at December 31, 2020 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	**110,000**	**0.17 yrs**	**$ 1.55**	**110,000**	**$ 1.55**
1.71	**175,000**	**1.62 yrs**	**1.71**	**175,000**	**1.71**
1.79	**575,000**	**1.62 yrs**	**1.79**	**575,000**	**1.79**
1.95	**165,267**	**0.78 yrs**	**1.95**	**165,267**	**1.95**
2.00	**200,000**	**2.19 yrs**	**2.00**	**200,000**	**2.00**
2.09	**100,000**	**4.18 yrs**	**2.09**	**33,332**	**2.09**
2.19	**150,000**	**4.18 yrs**	**2.19**	**49,998**	**2.19**
2.81	**200,000**	**3.18 yrs**	**2.81**	**133,332**	**2.81**
2.83	**50,000**	**3,18 yrs**	**2.83**	**33,333**	**2.83**
3.41	**25,000**	**0.89 yrs**	**3.41**	**25,000**	**3.41**
4.06	**1,180,000**	**1.17 yrs**	**4.06**	**1,180,000**	**4.06**
4.15	**415,000**	**1.17 yrs**	**4.15**	**415,000**	**4.15**
	3,345,267	**1.65 yrs**	**$ 3.01**	**3,095,262**	**$ 3.06**

b) 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. During the year ended December 31, 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). As at December 31, 2020, 1,500,000 PAs were outstanding (2019 – 1,316,668).

The Corporation recorded a total of $1.9 million in compensation expense relating to these plans for year ended December 31, 2020 (2019 - $6.9 million). The expense is included in selling, general and administrative expense and has a corresponding liability included in trade and other payables. There were 3,487,297 RAs and PAs outstanding as at December 31, 2020 (2019 – 3,555,634).

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

	2020	2019
RAs and PAs outstanding, beginning of year	**3,555,634**	3,443,456
Granted	**1,695,655**	1,645,221
Settled	**(1,661,482)**	(1,479,039)
Forfeited / cancelled	**(102,510)**	(54,004)
RAs and PAs outstanding, end of year	**3,487,297**	3,555,634

13. Expenses by Nature

(Stated in thousands of dollars)

Years ended December 31,	2020	2019
Salaries and employee benefits	**85,233**	134,230
Share-based payments	**2,131**	7,431
Personnel expenses	**87,364**	141,661
Equipment expenses	**52,458**	72,651
Depreciation and amortization drilling and other equipment	**27,975**	37,827
Consumed repair parts	**21,352**	31,742
Contract labour	**13,145**	16,358
Field and freight expenses	**8,528**	13,356
Insurance and business and sales taxes	**8,568**	11,835
Facility and office expenses	**5,499**	5,095
Travel and entertainment	**2,108**	4,217
Depreciation and amortization right-of-use asset	**3,555**	3,503
Other	**1,344**	2,406
Provisions for inventory	**2,433**	2,183
Legal and audit fees	**1,572**	1,258
Government grants	**(5,404)**	-
	230,497	344,092

The total amount of expenses represents the aggregate of direct costs, selling, general and administrative expenses, and research and development expenses in the statements of comprehensive loss.

14. Other Income

Years ended December 31,		2020		2019
Net gain on disposition of drilling equipment (Note 6)	**$**	**3,694,467**	$	3,163,254
Foreign exchange gain		**81,327**		519,550
Provision for bad debts		**(1,529,660)**		(387,728)
	$	**2,246,134**	$	3,295,076

15. Income Taxes

Years ended December 31,		**2020**		2019
Current tax expense (recovery):				
Current period	**$**	**(313,806)**	$	642,902
Adjustment for prior periods		**(735,450)**		(87,312)
		(1,049,256)		555,590
Deferred tax recovery:				
Origination and reversal of temporary differences		**182,139**		2,836,056
Adjustment for prior periods		**(609,048)**		229,000
		(426,909)		3,065,056
Total income tax expense	**$**	**(1,476,165)**	$	3,620,646

Reconciliation of effective tax rate

Years ended December 31,			**2020**			2019
Earnings (loss) from continuing operations	**$**	**(6,878,343)**		$	867,062	
Total income tax provision (recovery)		**(1,476,165)**			3,620,646	
Income (loss) before income taxes		**(8,354,508)**			4,487,708	
Income tax using the Corporation's domestic tax rate		**(2,004,664)**	**24.0%**		1,189,243	26.5%
Non-taxable portion of gains on disposal of assets		**(214,029)**	**2.6%**		(246,522)	(5.5%)
Change in unrecognized deductible temporary differences		**(2,181,311)**	**26.1%**		669,067	14.9%
Effect of tax rates in foreign jurisdictions		**(1,031,871)**	**12.4%**		(1,010,768)	(22.5%)
Non-deductible share-based payments and other expenses		**215,873**	**(2.6%)**		357,660	8.0%
Effect of change in Alberta tax rate		**(17,150)**	**0.2%**		2,452,280	54.6%
Non-deductible impairment on goodwill		**2,041,561**	**(24.4%)**		-	n.m.
Tax distribution and dividend		**2,624,987**	**(31.4%)**		-	n.m
Other		**(909,561)**	**(10.9%)**		209,686	4.7%
	$	**(1,476,165)**	**17.7%**	$	3,620,646	80.7%

n.m. – not meaningful

16. Operating Segments

The Corporation provides directional and horizontal oil and natural gas well drilling services. 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	
Years ended December 31,	**2020**	2019	**2020**	2019	**2020**	2019	**2020**	2019
Total revenue	**48,676**	71,923	**185,058**	270,028	**-**	7,764	**233,734**	349,715
Reportable segment profit (loss) before income taxes [1]	**3,916**	(5,917)	**7,393**	20,899	**(1,513)**	2,757	**9,796**	17,739

[1] Includes adjustments to intercompany transactions.

(Stated in thousands of dollars)

	Canada		United States		International		Total	
As at December 31,	**2020**	2019	**2020**	2019	**2020**	2019	**2020**	2019
Drilling and other equipment	**15,628**	19,814	**52,677**	53,713	**628**	4,889	**68,933**	78,416
Goodwill	**-**	8,876	**-**	-	**-**	-	**-**	8,876

Reconciliation of reportable segment loss and other material items

(Stated in thousands of dollars)

Years ended December 31,	**2020**	2019
Reportable segment income before income taxes	**$ 9,796**	$ **17,739**
Corporate:		
Selling, general and administrative expenses	**4,614**	**8,246**
Research and development expenses	**1,944**	**3,869**
Finance expense	**748**	**1,423**
Finance expense lease liability	**2,361**	**2,508**
Impairment loss	**10,730**	**500**
Other income	**(2,246)**	**(3,295)**
Earnings (loss) before income taxes	**$ (8,355)**	$ **4,488**

17. Changes in Non-Cash Working Capital

(Stated in thousands of dollars)

Years ended December 31,		**2020**		2019
Trade and other receivables	**$**	**46,408**	$	9,103
Inventories		**2,632**		(3,303)
Prepaid expenses		**427**		10
Investment and foreign tax credits		**18**		356
Trade and other payables		**(15,780)**		(3,549)
Impact of foreign exchange rate changes in working capital		**(1,668)**		(4,252)
	$	**32,037**	$	(1,635)

18. Financial Instruments

a) Credit Risk

The Corporation is exposed to normal credit risks of its customers that exist within the oil and natural gas exploration and development industry. The Corporation's credit risk associated with these customers can be directly impacted by a decline in economic conditions, which would impair the customers' ability to satisfy their obligations to the Corporation. During the year ended December 31, 2020, one customer comprised 9 percent of the total revenue (2019 - 7 percent of revenue). The customer's revenue is reported within the US operating segment.

As at December 31, 2020, the aging of trade and other receivables that were not impaired was as follows:

(Stated in thousands of dollars)

		2020
Neither past due nor impaired	**$**	**25,950**
Past due 1-30 days		**13,069**
Past due 31-60 days		**3,596**
Past due 61-90 days		**349**
Past due over 90 days		**229**
	$	**43,193**

The Corporation's standard customer payment terms are 30 days after job completion or invoice issuance date, after which, the balance becomes past due. The Corporation will assess for impairment once the receivable becomes past due. All accounts receivable balances that are past due for more than 90 days and were not impaired represented less than 1 percent or approximately $229 thousand of total receivables on the statement of financial position at December 31, 2020. Management believes that the unimpaired amounts that are past due are still collectible in full, based on historic payment behavior and extensive analysis of customer credit risk. Management has provided an allowance of $1.3 million for all amounts it considers uncollectable at December 31, 2020 (2019 - $0.8 million).

The Corporation has a credit management program to assist in managing this risk, which consists of conducting financial and other assessments to establish and monitor a customer's creditworthiness. The Corporation monitors and manages its credit risk on an ongoing basis.

b) Liquidity Risk

Liquidity risk is the risk that the Corporation will not be able to meet its financial obligations as they fall due. The Corporation has financial liabilities, thus, is exposed to liquidity risk. The Corporation's approach to managing liquidity risk is to ensure that it always has sufficient cash and credit facilities to meet its obligations when due. Management typically forecasts cash flows for a period of twelve months to identify financing requirements. These requirements are then addressed through a combination of demand credit facilities and access to capital markets. The Corporation believes that future cash flows generated by the operations and access to additional liquidity through capital and banking markets will be adequate to meet its financial obligations.

The following table reflects the Corporation's anticipated payment of contractual obligations related to continuing operations as at December 31, 2020:

(Stated in thousands of dollars)

	2021	2022	2023	2024	2025 and after
Drilling and other equipment purchase commitments	11,461	-	-	-	-
Trade and other payables	37,562	-	-	-	-
Dividends payable	1,266	-	-	-	-
Lease payments	7,117	5,903	4,569	4,423	15,707
	57,406	5,903	4,569	4,423	15,707

c) Fair Values of Financial Instruments

The Corporation has designated its trade and other payables and dividends payable as other financial liabilities carried at amortized cost. Accounts receivable are designated as non-derivative financial assets 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.

d) Interest Rate Risk

Interest rate risk is created by fluctuations in the fair values of financial instruments due to changes in the market interest rates. The Corporation has variable interest long-term debt which exposes it to fluctuations in cash interest payment amounts.

A one percent change in interest rates would have increased or decreased the Corporation's profit by $74,630 for the year ended December 31, 2020.

e) Foreign Exchange Risk

Foreign exchange risk is created by fluctuations in the fair values of financial instruments due to changes in foreign exchange rates. Due to operations of the Corporation's subsidiaries in the US and Russia, the Corporation has an exposure to foreign currency exchange rates. The carrying values of Canadian dollar, US dollar and Russian ruble ("RUB") denominated monetary assets and liabilities and earnings are subject to foreign exchange risk. For the year ended December 31, 2020, foreign exchange gains of $0.1 million (2019 – $0.5 million) resulted mainly from fluctuations in the CAD-USD exchange rates. The Corporation reviews options with respect to managing its foreign exchange risk periodically.

The following chart represents the Corporation's exposure to foreign currency risk:

As at December 31, 2020	**CAD**	**USD**	**RUB**
Cash and cash equivalents	**-**	**5,234,705**	**82,727,418**
Trade and other receivables	**-**	**-**	**83,911,812**
Trade and other payables	**-**	**(1,840,631)**	**(16,018,866)**
Intercompany receivables	**3,371,075**	**-**	**-**
Intercompany payables	**(969,679)**	**-**	**-**
Statement of financial position exposure	**2,401,396**	**3,394,074**	**150,620,364**

As at December 31, 2019	CAD	USD	RUB
Cash and cash equivalents	-	331,511	66,997,623
Trade and other receivables	-	3,900	178,608,038
Trade and other payables	-	(4,551,623)	(29,865,292)
Intercompany receivables	700,392	-	-
Intercompany payables	(13,207,293)	-	-
Statement of financial position exposure	(12,506,901)	(4,216,212)	215,740,369

The following significant exchange rates applied during the year ended December 31:

	Average Rate		December 31, Close Rate	
	2020	2019	**2020**	2019
USD	**1.3412**	1.3268	**1.2732**	1.2988
RUB	**53.8048**	48.7454	**57.7289**	47.3611

A strengthening of the Canadian dollar, US dollar, and Russian ruble against all other currencies as at December 31 would have affected the measurement of financial instruments denominated in a foreign currency and affected profit or loss by the amounts shown below. The analysis assumes that all other variables remain constant.

Gain (Loss)		**2020**		2019
CAD (10% strengthening)	**$**	**188,611**	$	(962,958)
USD (10% strengthening)		**432,133**		(547,602)
RUB (10% strengthening)		**260,910**		414,111

19. Capital Management

The Corporation's primary objective of capital management is to maintain a strong capital base, in conjunction with conservative long-term debt levels so as to maintain investor, creditor and market confidence, and to sustain future development of the business. The Corporation seeks to maintain a balance between higher returns that might be possible with higher levels of borrowings and the advantages and security created by a strong equity position.

The Corporation's management considers the capital structure to consist of long-term debt, including any current portion of long-term debt, and shareholders' equity. As at December 31, 2020, the Corporation did not have any loans and borrowings outstanding (2019 – $25.3 million) and $132 million (2019 – $148.9 million) in shareholders' equity. The Corporation's resulting long-term debt to equity ratio was nil as at December 31, 2020 (2019 – 0.17).

The Corporation prepares annual and quarterly operating and capital expenditure budgets, and forecasts to assist with the management of its capital. The Corporation intends to maintain a flexible capital structure and it may alter its dividend levels, raise new equity or issue new debt in response to a change in economic conditions.

The Corporation is subject to capital requirements relating to debt covenants on debt facilities held. As at December 31, 2020, the Corporation was in compliance with all debt covenants.

There were no changes to the Corporation's approach to capital management during the year ended December 31, 2020.

20. Leases

a) Leases as lessee

The Corporation leases shop facilities, offices, and vehicles. The shop and office leases typically run for a period between 5 to 15 years, with an option to renew the lease after that date. Vehicle leases typically run for a period between 3 to 6 years with an option to purchase the vehicle. Office leases that are sub-leased by the Corporation are applied against the right-of-use asset. The office lease and sublease expires in the year 2023.

The Corporation elected not to recognize right-of-use assets and lease liabilities for leases that were short-term, expired in 2020, or were low-value items like office equipment. Information about leases for which the Corporation is the lessee is presented below.

i. Right-of-Use Assets

Right-of-use assets relate to leased properties that do not meet the definition of investment property.

(Stated in thousands of dollars)

	Shop and Office Buildings	Vehicles	Total
2020			
Balance at January 1	$ 31,839	$ 987	$ 32,826
Depreciation charge for the year	(3,179)	(376)	(3,555)
Reclassification to assets held for sale	(6)	-	(6)
Additions to right-of-use assets	-	347	347
Derecognition of right-of-use assets (1)	(482)	(72)	(554)
Effect of movement in exchange rate	(88)	(13)	(101)
Balance at December 31	28,084	873	28,957

(1) Derecognition of right-of-use assets during 2020 is a result of early termination of vehicle leases and office lease modifications.

(Stated in thousands of dollars)

		Shop and Office Buildings		Vehicles		Total
2019						
Balance at January 1	$	35,150	$	1,094	$	36,244
Depreciation charge for the year		(3,090)		(413)		(3,503)
Reclassification to assets held for sale		(36)		-		(36)
Additions to right-of-use assets		200		365		565
Derecognition of right-of-use assets [(1)]		(90)		(16)		(106)
Effect of movement in exchange rate		(295)		(43)		(338)
Balance at December 31		31,839		987		32,826

[(1)] Derecognition of right-of-use assets during 2019 is as a result of entering in to finance sub-leases of offices, and early termination of a vehicle lease.

ii. Amounts Recognized in Consolidated Statements of Comprehensive Loss

(Stated in thousands of dollars)

Years ended December 31,		**2020**		2019
Interest on lease liabilities	**$**	**2,361**	$	2,508
Income from sub-leasing right-of-use assets presented in "finance expense lease liability"		**(13)**		(17)
Expenses relating to short-term leases		**316**		841
Expenses relating to leases of low-value assets, excluding short-term leases of low value		**123**		136
	$	**2,787**	$	3,468

iii. Amounts Recognized in Consolidated Statements of Cash Flows

(Stated in thousands of dollars)

Years ended December 31,		**2020**		2019
Total cash outflow for IFRS 16 leases	**$**	**(5,409)**	$	(5,690)

iv. Extension Options

Shop and office leases contain extension options exercisable by the Corporation during the term of the lease. Where practicable, the Corporation seeks to include extension options in new leases to provide operational flexibility. The extension options held are exercisable only by the Corporation and not by the lessors.

The Corporation has estimated that the potential future lease payments, should it elect to exercise the extension option would result in an increase in lease liability of $0.1 million.

b) Leases as Lessor

During 2020 the Corporation has sub-leased offices that are presented as part of a right-of-use asset. During the 2020 year the Corporation recognized interest income on lease receivables of $13 thousand (2019 – $17 thousand).

The following table sets out a maturity analysis of lease payments, showing the undiscounted lease payments to be received after the reporting date.

2021	$	**127**
2022		**134**
2023		**11**
2024		**-**
2025		**-**

21. Related Parties

a) Transactions with Key Management Personnel

Key management personnel compensation

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Corporation as a whole. The Corporation determined that key management personnel consists of members of the Board, the Chief Executive Officer, President, Senior Vice Presidents and Vice Presidents reporting directly to the Chief Executive Officer.

In addition to their salaries, the Corporation also provides its executive officers with annual incentives which consist of bonuses and commissions that the Compensation Committee considers comparable to benefits provided to executives of other publicly traded oil and natural gas service companies.

Executive officers also participate in the Corporation's share option program and retention award plan.

The Corporation, either directly or indirectly through its subsidiaries, has entered into executive employment agreements with certain executive officers that provide for termination payments. These agreements continue indefinitely until terminated in accordance with the terms thereof and the base salary payable thereunder is subject to annual review.

Key management personnel compensation comprised:

Years ended December 31,		2020		2019
Base salaries, benefits, and directors' remuneration	$	**2,868,966**	$	2,340,480
Short-term bonuses and commissions		**2,489,342**		4,635,797
Share-based compensation		**3,323,900**		3,229,164
	$	**8,682,208**	$	10,205,441

Key management personnel and director transactions

As at December 31, 2020, Directors and Executive Officers of the Corporation control 12 percent of the common shares of the Corporation.

Directors are entitled to receive an annual retainer as well as a fee for each meeting of the Board or Committee of the Board attended. The Chairman of the Board and the Lead Director receive an additional annual retainer, as do the Chairs of the Audit Committee, Compensation Committee, and Nomination and Corporate Governance Committee. Directors are also entitled to participate in the retention award plan (see Note 12) and can elect to receive certain percentages of these fees as RAs under the retention award plan. As at December 31, 2020, the directors held 845,073 of RAs outstanding (2019 – 784,888).

From time-to-time, Directors of the Corporation, or their related entities, may purchase goods or services from the Corporation. These purchases are on the same terms and conditions as those entered into by other Corporation employees or customers. For the year ended December 31, 2020, there were no purchases of goods, equipment, or services from or to a related party (2019 – $24 thousand).

22. Significant Subsidiaries

		Ownership Interest	
	Country of Incorporation	**2020**	2019
Phoenix Technology Services Inc.	Canada	**100%**	100%
Phoenix Technology Services LP	Canada	**100%**	100%
Phoenix Technology Services USA Inc.	USA	**100%**	100%
Phoenix Technology Services Luxembourg Sarl.	Luxembourg	**100%**	100%
Phoenix Technology Services International Ltd. (1)	Cyprus	**100%**	100%

(1) Entity holds a branch in Albania.

Corporate Information

Board of Directors

John Hooks

Randolph ("Randy") M. Charron

Myron Tétreault

Judith Athaide

Lawrence Hibbard

Roger Thomas

Terry Freeman

Officers

John Hooks
CEO

Michael Buker
President

Cameron Ritchie
Sr. Vice President Finance and CFO
Corporate Secretary

Craig Brown
Sr. Vice President Engineering and Technology

Jeffery Shafer
Sr. Vice President Sales and Marketing

Daniel Blanchard
Vice President Executive Sales

Legal Counsel

Burnet, Duckworth & Palmer LLP
Calgary, Alberta

Auditors

KPMG LLP
Calgary, Alberta

Bankers

HSBC Bank Canada
Calgary, Alberta

Transfer Agent

Computershare Trust Company of Canada
Calgary, Alberta