SOURCE
ENERGY
SERVICES

MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE YEAR ENDED DECEMBER 31, 2017

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MANAGEMENT'S DISCUSSION AND ANALYSIS

The following is Management's Discussion and Analysis ("MD&A") dated March 14, 2018, of Source Energy Services Ltd.'s ("Source" or, the "Company"), operating and financial results as at and for the three months and year ended December 31, 2017 compared with the corresponding periods in the prior year. The MD&A is provided to assist readers in understanding the Company's financial performance and position during the periods presented and significant trends that may impact the future performance of Source.

This discussion should be read in conjunction with Source's audited consolidated financial statements for the year ended December 31, 2017 and 2016, together with the accompanying notes (the "Financial Statements"). The Financial Statements and other information relating to Source, including the Annual Information Form ("AIF") is available under the Company's SEDAR profile at www.sedar.com. The Financial Statements and comparative statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). Unless otherwise stated, all amounts are expressed in Canadian dollars.

Certain financial measures referred to in this MD&A are not prescribed by IFRS. See "Non-IFRS Measures" for information regarding the following non-IFRS measures used in this MD&A: "EBITDA", "Adjusted EBITDA", "Adjusted Gross Margin" and "Normalized Adjusted Gross Margin".

This MD&A contains "forward-looking statements" or "forward-looking information" within the meaning of applicable Canadian securities laws (collectively, "forward-looking statements") based on Source's current expectations and projections. For information on the material factors and assumptions underlying such forward-looking statements, refer to "Forward-Looking Statements" included at the end of this MD&A.

On April 13, 2017, Source completed a reorganization (the "Reorganization") pursuant to which the Company acquired, directly and indirectly, a majority of the limited partnership interests of Source Energy Services Canada LP ("Source Canada LP"), all of the limited partnership interests of Source Energy Services US LP ("Source US LP") and all of the shares of Source Energy Services Canada LP GP Ltd., Source Energy Services US II LP GP Ltd. and Berthold Transload Inc. ("Berthold"), such that those entities became subsidiaries of the Company. Unless otherwise stated or the context indicates otherwise, "Source" or the "Company" refers to Source Energy Services Ltd. And its subsidiaries collectively or, prior to the closing of the Reorganization, to Source Canada LP and Source US LP, together with their respective general partners and subsidiaries and Berthold on a combined basis. For more information please see "Corporate Structure" in Source's AIF, available under the Company's SEDAR profile at www.sedar.com.

About Source

Source is a fully integrated producer, supplier and distributer of high quality Northern White frac sand primarily to the Western Canadian Sedimentary Basin (the "WCSB"). Source provides its customers with a full end-to-end solution through its Wisconsin mines, processing facilities, unit train capable rail assets, strategically located terminal network and "last mile" logistics capabilities. Source's full-service approach allows customers to rely on its logistics capabilities to increase reliability of supply and to ensure the timely delivery of their growing frac sand requirements. In addition to its transload terminal network and in-basin storage capabilities, Source provides storage and logistics services for other bulk oil and gas well completion materials that are not produced by Source. Source's full service approach allows customers to rely on its logistics capabilities to increase reliability of supply and to ensure the timely delivery of their growing requirements for frac sand and other bulk completion materials.

2017 Highlights

Source underwent a transformational year in 2017 where it delivered a number of significant achievements including:

We've grown:

- Completed the acquisition of the Blair Facility in April 2017;
- Acquired the Preston Facility, as part of the larger Preferred Acquisition, in November and completed a public and private equity offering to finance the transaction;
- Expanded Source's production capacity and terminal capacity by 115% and 25% respectively,
- Grew our inferred mineral resources(1) by 61% or 57.3 million MT;
- Increased our fleet of specialized frac sand rail cars to 2,345;

We've prospered:

- Increased sand volumes by 128% and sales by 102% year-over-year;
- Reduced Net Loss by 79%, or $34.5 million, and improved Adjusted EBITDA(2) by $51.1 million, as compared to 2016;
- Improved Gross Margin per MT by $17.65, or 186%, and Adjusted Gross Margin(2) per MT by $14.27, or 75%, year-over-year;

We've become stronger:

- Completed our initial public offering ("IPO") in April 2017;
- Repaid $22.3 million of the Notes in April 2017;
- Expanded Credit Facilities from $35 million to $70 million;

We're prepared for continued growth:

- Commenced expansion of Wembley terminal;
- Commenced 500,000 MT per year expansion at the Weyerhaeuser processing facility;
- Continued improvement and expansion of the Blair and Preston processing facilities; and
- Doubled our workforce from 220 to over 440.

(1) Mineral resources are not mineral reserves and do not have demonstrated economic viability. There is no guarantee that all or any part of the mineral resource will be converted into a mineral reserve. The estimate of mineral resources may be materially affected by geology, environment, permitting, legal, title, taxation, socio-political, marketing or other relevant issues
(2) Adjusted EBITDA, Adjusted Gross Margin and Normalized Adjusted Gross Margin, including per MT, are not defined under IFRS, see "Non-IFRS Measures" below.

Results Overview

	Three Months Ended December 31		**Year Ended December 31**	
($000's, except MT and per unit amounts)	**2017**	**2016**	**2017**	**2016**
Sand Volumes (MT)[1]	**557,363**	281,472	**1,902,106**	832,435
Sand Revenue	**63,986**	35,840	**228,403**	112,962
Wellsite Solutions	**10,308**	8,922	**54,911**	21,261
Terminal Services	**894**	1,285	**6,184**	4,976
Sales	**75,188**	46,047	**289,498**	139,199
Cost of Sales	**57,572**	39,205	**225,927**	123,257
Cost of Sales – Depreciation and Depletion	**3,998**	1,612	**11,948**	8,039
Cost of Sales	**61,570**	40,817	**237,875**	131,296
Gross Margin	**13,618**	5,230	**51,623**	7,903
Operating and General and Administrative Expenses	**8,227**	6,750	**24,509**	23,866
Depreciation	**2,081**	2,351	**6,560**	6,373
Income (loss) from operations	**3,310**	(3,871)	**20,554**	(22,336)
Other expense(income):				
Loss (gain) on asset disposal	**(3)**	(1,788)	**(6)**	1,082
Loss (gain) on impairment	**-**	1,852	**-**	1,852
Finance expense	**5,575**	7,105	**28,342**	19,491
Loss/(gain) on derivative liability	**1,316**	910	**(1,581)**	910
Stock based compensation expense	**1,770**	-	**6,625**	-
Other income	**(144)**	(3,466)	**(1,266)**	(4,859)
Management Fees	**-**	153	**417**	1,043
Foreign exchange loss (gain)[2]	**(1,971)**	1,063	**(863)**	2,059
Total other expense (income)	**6,543**	5,829	**31,668**	21,578
Income (loss) before income taxes	**(3,233)**	(9,700)	**(11,114)**	(43,914)
Current income tax expense (recovery)	**(5,268)**	-	**-**	4
Deferred income tax expense (recovery)	**3,137**	(597)	**(2,179)**	(516)
Net Income (Loss)	**(1,102)**	(9,103)	**(8,935)**	(43,402)
Net Income (Loss) per share ($/share)	**(0.02)**	(0.38)	**(0.19)**	(1.82)
Diluted Net Income (Loss) per share ($/share)	**(0.02)**	(0.38)	**(0.19)**	(1.82)
Adjusted EBITDA [3]	**13,072**	(833)	**43,608**	(7,526)
Sand Revenue Sales/MT	**114.80**	127.33	**120.08**	135.70

	December 31, 2017	December 31, 2016
Total Assets	**467,957**	219,406
Total non-current financial liabilities	**112,361**	239,549

Notes:
(1) One metric tonne ("MT") is approximately equal to 1.102 short tons.
(2) The average Canadian to US dollar exchange rates for the three months and year ended December 31, 2017 were $0.7866 and $0.7704, respectively (2016 – $0.7496 and $0.7544, respectively).
(3) Adjusted EBITDA is not defined under IFRS, see "Non-IFRS Measures" below.

Source had strong performance in 2017 as western Canadian completion activity improved significantly compared with 2016. Sand volumes increased by 128% while sand revenue for 2017 was 102% higher than in 2016, and total sales revenue was 108% higher than 2016. Wellsite solutions revenue increased by $33.7 million, or 158%, in 2017 compared to 2016 due to a 117% increase in trucking revenues and a 426% increase in revenues generated from the Sahara units. For 2017, Adjusted Gross Margins were $33.42 per MT, which was 75% higher, or $14.27 per MT, than Adjusted Gross Margins realized in 2016 due to improved pricing and production costs. For 2017, Adjusted EBITDA was $43.6 million, which was $51.1 million higher than the $7.5 million negative Adjusted EBITDA in 2016 and Net Loss in 2017 was reduced by $34.5 million compared to a $43.4 million Loss in 2016.

In the fourth quarter of 2017 Source's sand revenue increased by $28.1 million, or 79%, compared to the fourth quarter of 2016, due to a 98% (275,891 MT) increase in sand volumes partially offset by a 10% decrease ($12.53 per MT) in average price. The average sales price in the fourth quarter of 2017 was impacted by a 165,544 MT increase in coarse and finer grade sales at lower mine gate pricing which effectively lowered the average price by approximately $22.50 per MT. The increased mine gate sales were undertaken to minimize the impact of the year-end slowdown in oilfield activity in the WCSB in December 2017. In the fourth quarter of 2017, Source's sand revenue increased by $1.8 million, or 2.8%, compared to the third quarter of 2017, primarily due to a 9.2% increase in sand volumes (46,917 MT) partially offset by a 5.8% decrease ($7.12 per MT) in the average price. The decrease in the average price was due to the increase in mine gate sales in the fourth quarter of 2017.

In the fourth quarter of 2017 wellsite solutions revenue increased by $1.4 million, compared with the fourth quarter of 2016, due to a 320% increase in Sahara revenues, partially offset by a 25% decrease in trucking revenues due to a 15% decrease in sand sales occurring at the wellsite. Wellsite solutions revenue decreased by $7.1 million in the fourth quarter of 2017, compared with the third quarter of 2017, primarily due to a 51% decrease in trucking revenues due to a 38% decrease in sand sales occurring at the wellsite combined with a 18% decrease in Sahara revenues.

In the fourth quarter of 2017, Adjusted Gross Margin increased by $10.8 million, or $7.30 per MT, compared to the fourth quarter of 2016 due to improved pricing and production costs. However, Adjusted Gross Margin in the fourth quarter of 2017 decreased by $3.8 million, or $10.39 per MT (24.7%), from the third quarter of 2017 due to a combination of increased mine gate sales, as well as selling of inventory volumes acquired at fair market value as part of the Preferred Acquisition in November. All the assets acquired in the Preferred Acquisition in 2017, including inventory, were acquired at fair market value which negatively impacted gross margins as the fair value of inventory acquired at both the mine and terminal were greater than Source's internal costs to produce would have been. The impact of the sales of inventory acquired at fair value is estimated to have negatively impacted gross margins by approximately $2.80 per MT in the fourth quarter of 2017. As shown in the table below the Normalized Adjusted Gross Margin in the fourth quarter of 2017 reached $47.76 per MT. Adjusted EBITDA for the fourth quarter of 2017 has improved by $13.9 million to $13.1 million compared to the same period in 2016 and Net Loss in the fourth quarter of 2017 was reduced by $8.0 million compared to the same period in 2016.

	Three Months Ended December 31		Year Ended December 31	
($000's, except MT and per unit amounts)	**2017**	2016	**2017**	2016
Gross Margin	**13,618**	5,230	**51,623**	7,903
Cost of Sales – depreciation and depletion	**3,998**	1,612	**11,948**	8,039
Adjusted Gross Margin(1)	**17,616**	6,842	**63,571**	15,942
Gross Margin/MT	**$24.43**	$18.58	**$27.14**	$9.49
Adjusted Gross Margin/MT(1)	**$31.61**	$24.31	**$33.42**	$19.15
Sales Mix Impact of Mine Gate Sales/MT	**$13.35**	$0.60	**$3.05**	$0.70
Impact of Preferred Acquisition Inventory Acquired at Fair Value/MT	**$2.80**	-	**$0.80**	-
Normalized Adjusted Gross Margin/MT(1)	**$47.76**	$24.91	**$37.27**	$19.85
Percentage of Mine Gate Sand Volumes	**30%**	1%	**14%**	1%
Percentage of Terminal and Wellsite Sand Volumes	**70%**	99%	**86%**	99%

Notes:
(1) Adjusted Gross Margin and Normalized Adjusted Gross Margin are not defined under IFRS, see "Non-IFRS Measures" below.

Business Outlook

With continued strong economic results being realized by exploration and production ("E&P") companies operating in the liquids rich Montney, Duvernay and Deep Basin areas of the WCSB, Source expects well completion activities in 2018 to show significant improvement over 2017. Though the average amount of sand used in completing a well (the "sand intensity") in the WCSB lags the average sand intensity in US basins the Canadian average sand intensity is rising as US style completions are being adopted by Canadian E&P companies. If commodity prices remain at similar levels to first quarter 2018 pricing, and E&P companies continue with their previously announced capital plans, significant improvement in sand sales, and related services, are expected in 2018 compared to 2017. With the recent

weather-related slowdown in Canadian National Railway Company rail service across all industries and the tightness in the North American sand market, Source has seen renewed interest in direct sourcing sand from E&P companies.

Review of Operations

Sales

Most of Source's revenue is derived from mining, processing and providing complete frac sand logistics and supply chain solutions to customers in-basin or at the wellsite. Source also generates revenue from related services including wellsite solutions, which include the provision of storage and logistics services from the terminal to the wellsite, and terminal services, which involve transloading services. Frac sand sales occur at Source's terminals, at the customer's wellsite or at Source's processing facilities. These sales primarily occur under a variety of contracts with terms between one and three years. Typically, the contracts commit customers to a percentage of their Northern White frac sand requirements that range from 25% to 100% of their sand needs. Pricing under the contracts range from floating, market based pricing, or fixed pricing with cost-escalation adjustment mechanisms based on various factors. Frac sand sales can also occur on a spot basis. Transloading, wellsite storage and logistics coordination service sales are earned on a fee-for-service basis.

Total sales for the year ended December 31, 2017 increased by $150.3 million, or 108%, to $289.5 million, when compared to the $139.2 million generated in the year ended December 31, 2016. The increase was primarily driven by improvements in sand volumes, however, wellsite solutions sales and terminal services also contributed to the increase. For the fourth quarter of 2017, total sales increased $29.1 million, or 63%, to $75.2 million, when compared to $46.0 million in the fourth quarter of 2016. The increase was primarily driven by increased sand sales volumes. Total sales for the fourth quarter of 2017 were $6.0 million, or 7.4% lower when compared to the third quarter of 2017, primarily due to decreased wellsite solutions sales as delivered distances were reduced with a major customer who was working closer to a terminal location in the fourth quarter. Compared with 2016, the relative stability of oil and gas commodity prices that prevailed for most of 2017, along with a continued premium on western Canadian natural gas liquids prices in 2017, as compared to 2016, provided E&P companies the required confidence to increase their Montney and Duvernay completion programs in 2017.

Source's sand revenue for the year ended December 31, 2017 increased by $115.4 million, or 102%, compared to the year ended December 31, 2016, primarily due to a 128% increase in sand volumes (1,069,671 MT), partially offset by a 12% decrease, or $15.62 per MT, in average price. Sand volumes increased in the year ended December 31, 2017, compared to the year ended December 31, 2016, due to a significant increase in well completion activity and sand intensity levels, particularly by customers in the Montney, Duvernay and Deep Basin regions of the WCSB. The trend of increasing sand intensity levels in completion programs in western Canada was a key contributor to the increased sand volumes in 2017 compared with 2016. Though the average sand intensity in the WCSB lags the average sand intensity in US basins the Canadian average sand intensity is rising as US style completions are being adopted by Canadian E&P companies. In 2016, low commodity prices led to decreased sand volumes. Average sand pricing for the year ended December 31, 2017 was $120.08 per MT, which was 12% lower than the $135.70 per MT average sand price for the year ended December 31, 2016, due to increased sales of coarser and fine grade sand at lower mine gate prices, which reduced the effective price for the year by approximately $9.90 per MT, price concessions given in late 2016 that extended through to the end of the second quarter of 2017 and a change in mix of product sales by location. During 2017, the Canadian dollar strengthened 2.1% which reduced the effective price by approximately $2.50 per MT.

Source's sand revenue increased by $28.1 million, or 79%, in the fourth quarter of 2017, as compared to the fourth quarter of 2016, due to a 98% (275,891 MT) increase in sand volumes. This was partially offset by a 10% decrease ($12.53 per MT) in average price. Average sales price is impacted by the location where sales are made as well as the mesh size of the sand that is being sold. While Source's main business consists of the sale of mesh sizes most prevalent in the Source mines, which generate the best prices, sales of finer and coarse grade sands at the mine gate are generally made at lower prices. As a result, these sales can impact average sales price. The average sales price for the fourth quarter of 2017 was impacted by a 165,544 MT increase in coarse and finer grade sales at lower mine gate pricing which effectively lowered the average price in the quarter by approximately $22.50 per MT. Prices during the fourth quarter of 2017 were also negatively impacted by a 4.7% increase in the strength of the Canadian dollar compared with the fourth quarter of 2016, as approximately 88% of the fourth quarter of 2017 sand revenue was denominated in US dollars which effectively lowered the average price by approximately $5.50 per MT.

Source's sand revenue for the fourth quarter of 2017 increased by $1.8 million, or 2.8%, compared to the third quarter of 2017, primarily due to a 9.2% increase in sand volumes (46,917 MT). This was partially offset by a 5.8% decrease ($7.12 per MT) in average price. Increased sand volumes were primarily due to increased mine gate sales which were undertaken to minimize the impact of the year-end slowdown in oilfield activity that disproportionately affected the WCSB in December making more of Source's rail car fleet available for lower value finer and coarse grade sand sales into the US market. The positive impact of increased sand volumes was partially offset by the negative price impact of the 116,500 MT increase in mine gate sales volumes which lowered the effective price by approximately $22.50 per MT in the fourth quarter of 2017.

Wellsite solutions revenue is comprised of revenue from the “last mile” logistics, from the terminal to the wellsite, and wellsite service offerings including Sahara units. These services benefit customers as it helps them manage their overall trucking costs and sand supply reliability, which in turn helps them succeed with their completion programs. Wellsite solutions revenue increased by $33.7 million, or 158%, in the year ended December 31, 2017 as compared to the year ended December 31, 2016, due to a 117% increase in trucking revenues from an 81% increase in sand volumes sold at the wellsite and a 426% increase in revenues generated from the Sahara units. Wellsite solutions revenue increased by $1.4 million in the fourth quarter of 2017, compared with the fourth quarter of 2016, due to a 320% increase in Sahara revenues, partially offset by a 25% decrease in trucking revenues due to a 15% decrease in sand volumes sold at the wellsite. Sand volumes sold at the wellsite made up 33% of total sand volume in the fourth quarter of 2017 compared with 78% of total sand volume in the fourth quarter of 2016. Wellsite solutions revenue decreased by $7.1 million in the fourth quarter of 2017, compared with the third quarter of 2017, primarily due to a 51% decrease in trucking revenues due to a 38% decrease in sand volumes sold at the wellsite combined with an 18% decrease in Sahara revenues. Trucking revenues decreased in the fourth quarter of 2017, compared to the third quarter of 2017, due to a reduction in the distance hauled based on wellsite locations. Sand volumes sold at the wellsite made up 59% of total sand sale volume in the third quarter of 2017, compared to 33% in the fourth quarter.

Source also provides terminal services for certain well-completion products that aren’t produced by Source. These products primarily consist of hydrochloric acid and resin coated proppants. The revenue generated from these terminal services increased by $1.2 million, or 24%, in the year ended December 31, 2017 compared to year ended December 31, 2016, primarily due to an 86% increase in hydrochloric acid transloading revenue while revenue from transloading services for resin coated proppant was relatively unchanged. Terminal services revenue generally follow completion activity trends in the WCSB. In the fourth quarter of 2017, compared with the fourth quarter of 2016, terminal services revenue decreased slightly by $0.4 million, or 30%, as a 54% decrease in revenue from transloading services for resin coated proppant was largely offset by a 50% increase in hydrochloric acid transloading revenue. In the fourth quarter of 2017, compared with the third quarter of 2017, terminal services revenue decreased by $0.7 million, or 42%, due to a 57% decrease in revenue from transloading services for resin coated proppant combined with a 11% decrease in hydrochloric acid transloading revenue.

Cost of Sales

	Three Months Ended December 31		**Year Ended December 31**	
($000’s, except MT and per unit amounts)	**2017**	2016	**2017**	2016
Direct Materials	**30,435**	21,365	**121,258**	74,138
People Costs	**8,762**	4,533	**27,845**	12,451
Equipment Costs	**5,642**	1,978	**16,394**	6,720
Transportation Costs	**10,430**	9,916	**53,275**	24,695
Facility Costs	**2,302**	1,413	**7,155**	5,253
Cost of Sales	**57,571**	39,205	**225,927**	123,257

The principal expenses involved in the production of frac sand are excavation, labour, utilities, transportation and maintenance costs. At some facilities Source contracts with third parties to remove the overburden, excavate the unprocessed frac sand and for delivery of that material to its washing facilities. Source pays a fixed price per MT of material excavated and delivered to the washing facilities. Until this material is washed and dried it will not necessarily meet American Petroleum Institute specifications for use as a proppant and will not be a saleable product. Therefore, Source incurs excavation costs for some materials which are handled but from which it does not ultimately generate sales (rejected materials). Source also incurs costs related to sand that is washed and stockpiled as work in progress inventory. This material needs to be dried before being saleable as finished product. The ratio of rejected materials to the total amounts excavated has been, and is expected to continue to be, in line with Source’s expectations, based on the core sampling Source has undertaken at the Sumner Facility, Blair Facility and the Preston Facility.

Labour costs at Source’s processing facilities represent the most significant cost of converting raw materials to finished product. Source incurs utility costs in connection with the operation of its processing facilities, primarily natural gas and electricity. Source has entered into a physical fixed price natural gas contract for a portion of its natural gas needs. The balance of Source’s utility purchases are based on local market prices. Source has contracted a third party to transport the washed sand from the Sumner Facility to the Weyerhaeuser Facility, and to transport waste material back to the Sumner Facility. Source’s processing facilities require periodic scheduled maintenance to ensure efficient operations. Direct and indirect labour costs, utilities, transportation and maintenance costs associated with sand processing are capitalized as a component of inventory and are included in cost of sales when that inventory is ultimately sold.

To distribute sand from its processing facilities to its terminals or to its customers’ wellsites, Source purchases freight from Canadian National Railway Company and then, if applicable, incurs third party trucking costs to move the sand to its customers’ wellsites. In addition to freight costs Source also incurs the following shipping charges: fuel surcharges

by the transportation companies, leasing costs related to its railcars, and labour and other terminal operating costs. Costs related to rail are capitalized as a component of inventory and are included in the cost of sales when that inventory is sold. Costs directly related to moving sand or other transloaded products at Source's terminals are charged to cost of goods sold, while overhead costs of operating the terminals are recorded as operating costs of the business.

Occasionally, Source will purchase sand from third party producers. This may occur when there are third party transportation disruptions, when Source has other production constraints or when Source identifies strategic opportunities in the marketplace. When Source purchases third party sand, these costs are included in inventory until the sand is sold and then such costs are recognized in cost of goods sold.

Cost of sales increased by $102.7 million, or 83%, to $225.9 million for the year ended December 31, 2017, as compared to the year ended December 31, 2016, while sales volumes increased by 128%. The increase in cost of sales is due to increased production costs associated with higher sales volumes and the increased use of third party trucking firms to support the "last mile" solution for Source's customers, partially offset by the positive impact of a 2.1% strengthening of the Canadian dollar on US dollar denominated components of cost of sales. Significant components of cost of sales were mainly US dollar denominated costs including sand processing, rail freight, and rail car leases and are therefore subject to exchange rate fluctuations. The Blair Facility became fully operational in the second quarter of 2017, and combined with the Preston Facility acquired in the fourth quarter of 2017, significantly reduced the need to purchase third party sand in the second half of 2017. Sand production costs per unit declined by 20% in 2017, compared to 2016, as production rose and the fixed cost elements of production were spread over more units combined with the positive impact of a stronger Canadian dollar. Fourth quarter 2017 cost of sales was $57.6 million, which was $18.4 million higher than fourth quarter of 2016, for the same reasons that year over year costs were higher combined with the unfavorable impact associated with inventory volumes acquired at fair market value as part of the Preferred Acquisition in November 2017. As part of the Preferred Acquisition all assets acquired, including inventory, were acquired at fair market value which negatively impacted cost of sales as the fair value of inventory acquired at both the mine and terminal were greater than Source's internal costs to produce would have been. The fair value of inventory acquired is estimated to have negatively impacted cost of sales by $1.6 million, or approximately $2.80 per MT, in the fourth quarter of 2017. The remaining inventory is expected to be fully processed and sold by the end of the first quarter of 2018 with an expected negative impact in the first quarter of 2018 of approximately $1.9 million. Source incurred $4.3 million of incremental costs to acquire third party sand to meet contractual commitments during the year ended December 31, 2017, of which none was incurred in the fourth quarter of 2017. Yields from the Sumner Facility, the Blair Facility and Preston Facility were consistent with expectations found in the three related technical reports each dated December 31, 2017. These technical reports are available on SEDAR under Source's profile. In the fourth quarter of 2017, the average Canadian/US dollar exchange rate strengthened by 4.7% as compared to the fourth quarter of 2016, which led to decreases in the Canadian dollar equivalent cost of sales.

Costs associated with sand processing equipment and overburden stripping costs are capitalized as the cost is incurred and depreciated on a unit of production basis. Costs associated with mineral resources are recognized at cost, which approximates the estimated fair value on the date of acquisition, and are depleted on a unit of production basis. Cost of sales depreciation and depletion increased by $3.9 million for the year ended December 31, 2017 over the prior year, primarily due to depreciation on 2016 capital additions, which were mainly due to fourth quarter of 2016 capital additions, the impact of the second quarter 2017 Blair Facility acquisition and subsequent operation combined with some depletion on mineral resources following the Preston Facility acquisition in November 2017.

Gross Margin

	Three Months Ended December 31		Year Ended December 31	
($000's, except MT and per unit amounts)	**2017**	2016	**2017**	2016
Gross Margin	**13,618**	5,230	**51,623**	7,903
Cost of Sales — depreciation and depletion	**3,998**	1,612	**11,948**	8,039
Adjusted Gross Margin(1)	**17,616**	6,842	**63,571**	15,942
Gross Margin %	**18.1%**	11.4%	**17.8%**	5.7%
Gross Margin/MT	**$24.43**	$18.58	**$27.14**	$9.49
Adjusted Gross Margin %(1)	**23.4%**	14.9%	**22.0%**	11.5%
Adjusted Gross Margin/MT(1)	**$31.61**	$24.31	**$33.42**	$19.15

Notes:
(1) Adjusted Gross Margin is not defined under IFRS, see "Non-IFRS Measures" below.

Adjusted Gross Margin increased by $47.6 million or $14.27 per MT in the year ended December 31, 2017 compared to $15.9 million in the year ended December 31, 2016. Adjusted Gross Margin percentage also improved significantly year over year due to higher sales volumes and improved sand production costs per unit as discussed above. Adjusted

Gross Margin for the fourth quarter of 2017, compared to the fourth quarter of 2016, increased $10.8 million or $7.30 per MT for the same reasons as above. However, Adjusted Gross Margin in the fourth quarter of 2017 decreased from the third quarter of 2017 by $3.8 million, or $10.39 per MT (24.7%), due primarily to the sales mix impact of selling an incremental 116,500 MT of lower margin mine gate sales combined with the sale of higher cost associated with inventory volumes acquired at fair market value as part of the Preferred Acquisition in November 2017. As part of the Preferred Acquisition in November 2017 all assets acquired, including inventory, were acquired at fair market value. As the fair market value exceeded Source's internal cost to produce inventory, the sale of this purchased inventory negatively impacted gross margins. The fair value of inventory acquired is estimated to have negatively impacted gross margins by $2.80 per MT in the fourth quarter of 2017.

Gross Margin of $51.6 million or 17.8% for the year ended December 31, 2017 increased by $43.7 million from the year ended December 31, 2016, for the same reasons the Adjusted Gross Margin improved. Gross margins were also impacted by an increase in cost of sales – depreciation and depletion.

Operating and General and Administrative Expense

	Three Months Ended December 31		**Year Ended December 31**	
($000's, except MT and per unit amounts)	**2017**	2016	**2017**	2016
People	**3,491**	2,082	**11,913**	8,446
Equipment	**265**	1,142	**1,454**	5,229
Facility	**1,848**	947	**3,973**	3,064
Selling and Administrative	**2,623**	2,579	**7,169**	7,127
Operating and General and Administrative Expense	**8,227**	6,750	**24,509**	23,866

Source incurs general and administrative expenses related to its corporate operations, including operating its corporate offices. Significant general and administrative costs for Source include salaries for the corporate staff, facility costs for the corporate offices, professional and advisory fees and information systems related costs. Operating expenses related to overhead costs of operating the terminals are recorded as operating costs of the business.

Operating and general and administrative expenses for the year ended December 31, 2017 were $24.5 million, an increase of $0.6 million from the year ended 2016. Costs associated with people increased $3.5 million year over year due to the replacement of some positions where staff had left during the downturn in 2016 and the positions were not filled at that time, as well as the inclusion of a bonus accrual estimate. Equipment costs of $1.5 million in the year ended 2017 were $3.8 million lower than the year ended December 31, 2016, due to not having excess rail car costs in 2017. Excess rail car leases expired at the end of 2016 and were removed from the rail fleet. These rail cars were replaced in 2017 with newer, more functional cars, at lower lease rates, and are now being fully utilized and recorded in cost of goods sold. The rail car fleet included 2,345 cars at December 31, 2017. Facility costs of $4.0 million were $0.9 million higher than the year ended December 31, 2016 due to the increase in size and scope of operations. Selling and administrative costs of $7.2 million were virtually unchanged from the year ended December 31, 2016 due to increased costs in 2017 associated with the increase in size and scope of the operations being offset by a large bad debt expense in 2016. In the fourth quarter of 2017, compared to the fourth quarter of 2016, operating and general and administrative costs were $1.5 million higher due to increased people costs and facility costs, as described above, partially offset by decreased equipment costs, due to the excess rail costs expiring at the end of 2016.

Depreciation

Depreciation primarily consists of depreciation on property plant and equipment and depreciation of capitalized stripping costs. In addition, mineral resources acquired as part of the Preston Facility acquisition are depleted using a unit of production method and recorded on a per ton basis in cost of goods sold. Depreciation of the processing equipment used to process frac sand to a final saleable product and depreciation of capitalized stripping costs are included in cost of goods sold. Depreciation of other equipment used in the business is recorded as a separate line item in the statement of operations and comprehensive income.

Depreciation expense of $2.1 million in the fourth quarter of 2017 and $6.6 million for the year ended December 31, 2017 were comparable to the same periods in 2016.

Finance Expense

Finance expense is primarily composed of interest expense on: (a) the Notes; (b) the $70 million asset backed loan facilities ("Credit Facilities"), which include (i) a revolving credit facility with availability thereunder subject to the limit of the lesser of: (A) $70 million and (B) the borrowing base, to be used to finance day-to-day operations of Source and its subsidiaries and for general working capital requirements, including financing receivables, inventory and capital expenditures that have been approved by the lenders, and (ii) a US$5 million standby letter of credit facility to be used to issue one or more standby letters of credit; (c) the preferred shares obligation; (d) the amount due to related parties;

and (e) the shareholder loans. These items are all further described in the notes to the Financial Statements and items (c), (d) and (e) were settled in conjunction with the completion of the IPO.

Finance expenses decreased by $1.5 million to $5.6 million in the fourth quarter of 2017 as compared to $7.1 million in the same period in 2016 due primarily to lower interest expense due to repayment of the preferred share obligation, the shareholder loans, the related party loans and $22.3 million of the Notes during the second quarter of 2017. Finance expense for the year ended December 31, 2017 increased by $8.9 million due to $2.1 million in legal and professional fees for the IPO, Reorganization and secondary offering, combined with the recognition of additional accretion of $3.2 million on the partial Note repayment in the second quarter of 2017.

Other Expense and Income

Source recorded $6.6 million in stock based compensation for the year ended December 31, 2017 and $1.8 million in stock based compensation in the fourth quarter of 2017 as a result of granting deferred stock units (“DSUs”), restricted stock units (“RSUs”) and performance stock units (“PSUs”), combined with accrued expense related to the stock options granted in the second quarter of 2017. All share based payments were granted in relation to the IPO in the second quarter of 2017 and were done based on the IPO equity price of $10.50. The initial grant of stock options done at the time of the IPO was the first grant, and one-third of the options vested immediately, with the remaining two-thirds vesting in 2018 and 2019 respectively, resulting in a larger expense being recognized in the second quarter of 2017. Future grants of Options will vest, and grants of RSUs and PSUs vest, in equal thirds over a three year period, with the first vesting date being one year after the initial grant. DSUs vest and are expensed over the earlier of three years or when a director leaves. They are payable only when a director leaves the company.

Other income of $0.1 million was recorded in the fourth quarter of 2017, compared to other income of $3.5 million in the fourth quarter of 2016. In December 2016 Source settled a deferred revenue contract with a customer and recognized a $3.3 million gain on the settlement. For the year ended December 31, 2017 other income decreased $3.6 million to $1.3 million, compared with $4.9 million for the year ended December 31, 2016.

Source realized a foreign exchange gain of $2.0 million in the fourth quarter of 2017, which was $3.0 million higher than the $1.0 million loss recognized in the fourth quarter of 2016. The 2017 gain, was primarily generated from a $2.0 million gain resulting from a change in the Canadian dollar to US dollar foreign exchange rate from the date that the US$80 million Preferred Acquisition was approved and the closing date as a result of US dollar foreign exchange forward contracts entered into on date of Board approval. For the year ended December 31, 2017, Source had a foreign exchange gain of $0.9 million, which was $3.0 million higher than the prior year primarily for the same reasons as in the fourth quarter of 2017.

Adjusted EBITDA for the fourth quarter of 2017 increased by $13.9 million to $13.1 million as compared to the same period in the prior year, as the increase in sand sales volumes increased sales and helped reduce production costs on a per unit basis. Wellsite solutions revenue improvements also helped fourth quarter performance. For the year ended December 31, 2017, Adjusted EBITDA was $43.6 million, an increase of $51.1 million over the year ended December 31, 2016 primarily due to increased sand sales as mentioned above.

Source recorded a tax recovery in the fourth quarter of 2017 of $2.1 million, compared to a recovery $0.6 million in the fourth quarter of 2016. The Reorganization changed Source’s corporate structure from a series of partnerships to a corporate structure, which caused a more traditional tax provision to be recorded starting in April of 2017. Year-to-date tax recovery of $2.2 million has been recorded in 2017. The US tax reform that occurred late in 2017 resulted in Source recording a $5.3 million current tax recovery and corresponding deferred tax expense of $3.1 million in the fourth quarter and delaying Source from paying cash taxes until 2018.

Summary of Quarterly Results

($000’s, except MT and per unit amounts)	2016				2017			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Sand Sales MT	*260,117*	*133,636*	*157,210*	*281,472*	*420,011*	*414,286*	*510,446*	*557,363*
Sand Revenue	40,947	17,066	19,109	35,840	51,630	50,555	62,232	63,986
Wellsite Solutions	858	6,982	4,499	8,922	10,535	16,629	17,439	10,308
Terminal Services	1,530	1,049	1,112	1,285	2,267	1,475	1,547	894
Sales	43,335	25,097	24,720	46,047	64,432	68,659	81,218	75,188
Cost of Sales	34,249	25,755	24,048	39,205	53,155	55,420	59,779	57,572
Cost of Sales Depreciation	2,360	1,989	2,078	1,612	2,558	2,810	2,582	3,998
Cost of Sales	36,609	27,744	26,126	40,817	55,713	58,230	62,361	61,570
Gross Margin	6,726	(2,647)	(1,406)	5,230	8,719	10,429	18,857	13,618
Operating and General and Admin Expenses	4,766	7,906	4,444	6,750	3,884	5,718	6,680	8,227
Depreciation	1,299	1,523	1,200	2,351	1,267	1,540	1,671	2,081
Income (loss) from operations	661	(12,076)	(7,050)	(3,871)	3,568	3,171	10,506	3,310

($000's, except MT and per unit amounts)	2016				2017			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Other expense (income):								
Loss (gain) on asset disposal	-	1,460	1,410	(1,788)	-	(3)	-	(3)
Loss (gain) on impairment	-	-	-	1,852	-	-	-	-
Finance expense	3,500	4,902	3,984	7,105	9,479	9,409	3,879	5,575
Loss (gain) on derivative liability	-	-	-	910	(4,133)	(31)	1,267	1,316
Stock based compensation expense	-	-	-	-	-	3,870	984	1,770
Other income	(1,028)	(55)	(310)	(3,466)	(532)	(432)	(158)	(144)
Management Fees	178	636	76	153	417	-	-	-
Foreign exchange loss/(gain)	309	569	118	1,063	681	(157)	583	(1,971)
Total other expense (income)	2,959	7,512	5,278	5,829	5,912	12,656	6,555	6,543
Income (loss) before income taxes	(2,298)	(19,588)	(12,328)	(9,700)	(2,344)	(9,485)	3,951	(3,233)
Income taxes expense (recovery)	–	4	81	(597)	(339)	(649)	942	(2,131)
Net Income (loss)	(2,298)	(19,592)	(12,409)	(9,103)	(2,005)	(8,836)	3,009	(1,102)
Net Income (loss) Per Share ($/Share)	(0.10)	(0.79)	(0.52)	(0.38)	(0.08)	(0.24)	0.08	(0.02)
Diluted Net Income (loss) Per Share ($/Share)	(0.10)	(0.79)	(0.52)	(0.38)	(0.08)	(0.24)	0.06	(0.02)
Net Income (loss)	(2,298)	(19,592)	(12,409)	(9,103)	(2,005)	(8,836)	3,009	(1,102)
Interest	3,193	4,325	3,840	4,844	6,609	3,394	2,987	3,631
Income taxes	–	4	81	(597)	(339)	(649)	942	(2,131)
Depreciation	1,299	1,523	1,200	2,351	1,267	1,540	1,671	2,081
Cost of Sales Depreciation	2,360	1,989	2,078	1,612	2,558	2,810	2,582	3,998
EBITDA(1)	4,554	(11,751)	(5,210)	(893)	8,090	(1,741)	11,191	6,477
Add:								
Loss (gain) on asset disposal	-	1,460	1,410	(1,788)	-	(3)	-	(3)
Loss (gain) on impairment	-	-	-	1,852	-	-	-	-
Finance expense	307	577	144	2,261	2,870	6,015	892	1,944
Loss (gain) on derivative liability	-	-	-	910	(4,133)	(31)	1,267	1,316
Share based compensation expense	-	-	-	-	-	3,870	984	1,770
Management Fees	178	636	76	153	417	-	-	-
Transaction and professional fees	264	-	662	-	-	849	-	-
Preferred Acquisition inventory acquired at fair value	-	-	-	-	-	-	-	1,568
Gain on settlement of deferred revenue	-	-	-	(3,328)	-	-	-	-
Adjusted EBITDA(1)	5,303	(9,078)	(2,918)	(833)	7,244	8,959	14,334	13,072
Sand Revenue Sales/MT	157	128	122	127	123	122	122	115
Gross Margin	6,726	(2,647)	(1,406)	5,230	8,719	10,429	18,857	13,618
Cost of Sales Depreciation	2,360	1,989	2,078	1,612	2,558	2,810	2,582	3,998
Adjusted Gross Margin(1)	9,086	(658)	672	6,842	11,277	13,239	21,439	17,616
Gross Margin/MT	25.86	(19.81)	(8.94)	18.58	20.76	25.17	36.94	24.43
Adjusted Gross Margin/MT(1)	34.93	(4.92)	4.27	24.31	26.85	31.96	42.00	31.61

Notes:

(1) EBITDA, Adjusted EBITDA and Adjusted Gross Margin are not defined under IFRS see "Non-IFRS Measures" below.

In 2017, as oil and gas commodity prices continued to stabilize and began to rise, larger, better financed E&P companies increased activity levels, resulting in Source achieving a 9% increase in sand volumes from the third quarter of 2017 and a 128% increase in sand volumes for the year ended December 31, 2017 compared to 2016. As North American sand demand increased in 2017, industry-wide utilization increased relative to supply. Sales for the year ended December 31, 2017 were $289.5 million, an increase of $150.3 million over the same period in 2016. For the year ended December 31, 2017, a 128% increase in sand volumes in 2017 contributed to a 117% increase in trucking revenue and a 426% increase in Sahara revenues, resulting in a $33.7 million increase in wellsite solutions revenue. The higher sand volumes for the year ended December 31, 2017 helped decrease the cost of the delivered product, which, when combined with the end of price concessions and a stronger Canadian dollar, resulted in improved Adjusted Gross Margin for 2017.

The Notes offering was completed in the fourth quarter of 2016. The proceeds from the Notes offering were used to repay the previous credit facilities and prepay a note with a customer, which increased finance expense in the fourth quarter of 2016, as the previous credit facilities' deferred financing costs were expensed. Source also recognized a gain of $3.3 million on the settlement of the prepaid note at that time.

Source's business is seasonal in nature with the majority of activity being in the first, third and fourth quarters of the year. The least activity is in the second quarter, due to spring break-up. Spring break-up occurs for a period of approximately eight weeks between March and June as the frost comes out of the roads in western Canada and hauling weight restrictions are put in place. The severity of the winter snowfalls and the amount of moisture received during this period impact the length of spring break-up. As a result, Source's operating results may vary on a quarterly basis. In addition, some exploration and production areas in northern Canada are accessible only in the winter months when the ground is frozen.

As a general industry practice, frac sand washing facilities in Wisconsin are not operated during the winter months. However, Source's sand washing facility at the Sumner Facility is fully enclosed and heated, making it capable of operating year-round. Winter operations at the Sumner Facility are an important facet of Source's business, as the WCSB is seasonally busiest in the winter months. Regardless of its ability to wash sand in the winter, Source excavates and washes more sand than current delivery requirements during the warmer months when Source's processing facilities are more efficient. The excess sand is placed in stockpiles that feed drying operations throughout the year. Source's Blair Facility and Preston Facility washing plants are not enclosed and therefore are not operated during the winter months, but the dry plants are operated year-round.

Select Annual Information	Year Ended December 31		
($000's, except MT and per unit amounts)	**2017**	2016	2015
Sales	**289,498**	139,199	153,135
Net Income (Loss)	**(8,935)**	(43,402)	(9,766)
Net Income (Loss) per share ($/share)	**(0.19)**	(1.82)	(0.41)
Diluted Net Income (Loss) per share ($/share)	**(0.19)**	(1.82)	(0.41)

	December 31, 2017	December 31, 2016	December 31, 2015
Total Assets	**467,957**	219,406	231,112
Total non-current financial liabilities	**112,361**	239,549	196,677

Liquidity and Capital Resources

Source operates in a working capital and capital expenditure intensive industry where capital is required to fund working capital growth and continued development of the transload terminal network and processing facilities. To date, cash flows provided by operating activities, amounts available under the Notes, the Credit Facilities and equity offerings have been the primary sources of liquidity that allow Source to meet its financial requirements to grow and operate its business operations in the short and long term. Source funded its 2017 capital requirements through a combination of cash flows provided by operating activities and funds received from equity issuance and available credit facilities. In 2018, Source intends to finance working capital and its capital expenditures through a combination of cash flows provided by operating activities and amounts available under the existing Credit Facilities, plus additional debt and equity issuances as required. The availability of any additional future funding will depend on, among other things, operating performance and the current state of the equity and debt capital markets.

Capital Expenditures	Three Months Ended December 31		Year Ended December 31	
($000's, except MT and per unit amounts)	**2017**	2016	**2017**	2016
Terminal Expansion	**12,773**	-	**17,439**	487
Wellsite Solutions	**1,933**	-	**4,877**	131
Production Expansion	**6,382**	318	**15,990**	2,598
Overburden Removal	**1,153**	1,182	**7,567**	2,766
Other	**2,305**	-	**4,642**	423
Capital Expenditures	**24,546**	1,500	**50,515**	6,405
Blair Facility	**-**	-	**59,914**	-
Preferred Acquisition	**110,149**	-	**110,149**	-

Source's capital expenditures fall into three main categories: overburden removal, capital expenditures at existing facilities to make improvements and maintain operations, and growth capital expenditures for new capacity to grow production or distribution. Capital expenditures for the fourth quarter of 2017 were $24.5 million, an increase of $23.0 million from the fourth quarter of 2016. The increased capital expenditures were primarily driven by terminal expansion associated with the new Fox Creek terminal and the expansion of the existing Wembley terminal, increased overburden removal costs associated with increased production in the quarter, wellsite solutions expenditures associated with new Sahara units and production expansion associated with purchasing additional land with the potential for future mining activities, and new processing equipment at its mines. Capital expenditures for the year ended December 31, 2017 were $50.5 million, an increase of $44.1 million compared with the year ended December 31, 2016. The increased capital expenditures in 2017 were primarily driven by the same reasons as in the fourth quarter of 2017 plus increased Blair Facility expenditures associated with purchasing additional land with potential for future mining activities. Source

funded its 2017 growth capital expenditures using proceeds raised from the IPO, while the overburden and maintenance capital expenditures were funded through a combination of cash flows provided by operating activities and amounts drawn on its Credit Facilities. Source's capital investment program has not changed since the IPO other than in respect of the short-term deferral of the planned terminal in Taylor, British Columbia and the related capital expenditures as the Preferred Acquisition has closed. Source does not have any specific capital commitments it must fulfill in 2018. Source's use of proceeds has not changed from the previously disclosed use of proceeds in both the IPO and the Preferred Acquisition. Approximately $6 million of 2017 planned production expansion capital expenditures at the Blair Facility are being carried forward into the 2018 capital expenditure plans.

Source's capital management policy is to maintain a strong capital base that optimizes Source's ability to grow, maintain investor and creditor confidence and to provide a platform to create value for its stakeholders. Source considers its capital structure to include Source's equity, the Notes and bank debt and manages its capital structure through various means including monthly management meetings and quarterly board meetings including regular reviews of financial information, such as budgets and forecasts. Source monitors its capital based on its then current working capital, available bank line, projected cash flows provided by operating activities and anticipated capital expenditures. Source management prepares annual capital expenditure and operating budgets, which are approved by the Board, and are regularly reviewed and updated as necessary.

In order to maintain or adjust the capital structure, Source may issue equity securities, seek debt financing and adjust its capital spending to manage its current and projected capital structure. Source's ability to raise additional debt or equity financing is impacted by external conditions, including regional and global economic conditions. Source continually monitors economic and general business conditions.

Source's share capital is not subject to external restrictions but the amount of the Credit Facilities is determined with reference to current inventory and accounts receivable.

Source's capital management policy has not changed during the year ended December 31, 2017 or for the year ended December 31, 2016.

Source intends to meet its future capital requirements primarily through cash flows provided by operating activities, the Credit Facilities and by raising equity in the public markets in Canada. Source expects these sources will be sufficient to meet its capital needs. However, Source's ability to fund future operating expenses and capital expenditures, to make scheduled payments of interest on the Notes and the Credit Facilities and to satisfy any of Source's other present or future debt obligations will depend on Source's future operating performance which will be affected by general economic, financial and other factors, including the risks described under the heading "Risk Factors" in the AIF.

On December 8, 2016, the Note Issuers issued the Notes, which bear interest at 10.5% per annum and mature on December 15, 2021. The Notes are secured by a fixed and floating charge over all the assets of the business except accounts receivable and inventory, on which the Notes carry a second charge. Each holder of Notes was entitled to a relevant right of 4% of the equity value of the Note Issuers upon an initial public offering and various liquidation or change of control events. There are prepayment options, where the Note Issuers may redeem 35% of the aggregate principal amounts of the Notes with the net proceeds of an equity offering at a redemption price of 110.5% of the principal amount. The Note Issuers may also redeem all or part of the Notes at any time prior to December 15, 2018 for 100% of the principal plus accrued and unpaid interest and the applicable premium as defined in the corresponding trust indenture. After December 15, 2018, the principle amount of the Notes may be redeemed in whole or in part at the applicable percentage (2018 - 107.875%, 2019 - 103.9375%, 2020 - 100%), plus accrued and unpaid interest. Such relevant rights and prepayment option have been classified as a derivative liability and are measured at fair value through profit or loss. On May 29, 2017, Source elected to settle the relevant rights through the issuance of 1,005,831 Common Shares to the holders of the Notes with net proceeds from the IPO. In connection with the closing of the IPO, Source also exercised its right to repay a portion of the Notes, and on June 5, 2017 it repaid $22.3 million of the principal amount of the Notes along with accrued interest and a make-whole premium of 10.5%. At December 31, 2017, the principal outstanding on the Notes was $107.7 million.

At December 31, 2017, the fair value of the Notes prepayment option and embedded derivative in the customer contract that includes foreign exchange rate collars (see "Fair Value of Financial Instruments" below) was $2.1 million ($0.1 million - December 31, 2016). Changes in fair values of derivative liabilities are recorded through the Consolidated Statements of Operations and Comprehensive Income (Loss). Source has recorded a fair value loss on the Notes' prepayment option plus exchange rate collars embedded derivative of $1.3 million for the fourth quarter of 2017 (fourth quarter of 2016 - $0.9 million). For the year ended 2017 a $1.6 million gain on derivative liability has been recognized, as a $4.2 million gain was recognized on the fair value of the settlement of relevant rights in the first quarter of 2017.

The Company's $70 million Credit Facilities are secured by a floating first lien charge on the accounts receivable and inventory of Source under a general security agreement and a second lien charge on all other assets of the business. The amount available under the general operating facility is subject to a borrowing base formula applied to accounts receivable and inventories. Effective February 13, 2018 the maturity was extended to December 8, 2019. As of

December 31, 2017, $33.8 million was drawn under the Credit Facilities and an additional $7.9 million was committed to supporting letters of credit under the facilities with $13.0 million available. The borrowing base is updated by the bank weekly. Source is subject to externally imposed capital requirements for the Credit Facilities, requiring Source Canada LP to maintain a springing fixed charge ratio of 1.25:1 to be measured when Source's excess availability is less than 20% of the lesser of the borrowing base and the operating facility. As of December 31, 2017, the excess availability was less than 20%. Source's fixed charge ratio as defined in the Credit Facilities was 3.3 at December 31, 2017. Source Canada LP was in compliance with all covenants of the Credit Facilities as of December 31, 2017.

Foreign Currency Risk

Source is exposed to currency price risk on sales denominated in US dollars to the extent that the receipt of payment of the US denominated accounts receivable are subject to fluctuations in the related foreign exchange rate. In addition, foreign currency risk exists on cost of manufacturing inventory for sale to the extent that the payment of those costs are foreign denominated accounts payable and are subject to fluctuations in the foreign exchange rate. Included in accounts receivable and accounts payable and accrued liabilities at December 31, 2017 are $34.1 million (December 31, 2016 - $1.7 million) and $18.9 million (December 31, 2016 - $8.4 million) denominated in foreign currency respectively. The net effect of each 1% change in foreign exchange would have an impact on net income of $0.4 million for the year ended December 31, 2017 (December 31, 2016 - $0.2 million). As at December 31, 2017, the Company had no forward exchange rate contracts in place.

Cash and Net Working Capital

As of December 31, 2017, Source had $nil cash on hand and had senior long-term debt outstanding of $129.3 million, as compared to $124.4 million as of December 31, 2016. For the fourth quarter of 2017, Source had cash flows provided by operating activities of $25.5 million compared to cash flows used in operating activities of $12.7 million for the same period in 2016, due to the impact of a $7.9 million decrease in total current assets less total current liabilities (the "Net Working Capital") combined with a $8.0 million decrease in net loss for the quarter. Source had cash flows provided by operating activities of $6.5 million for the year ended December 31, 2017 compared to cash flows used in operating activities of $9.5 million in 2016, as the impact of a $34.5 million decrease in net loss for the year ended December 31, 2017 was partially offset by an $31.8 million increase in Net Working Capital. Capital expenditures for the year ended December 31, 2017 were $50.5 million compared to $6.4 million in the same period in 2016, excluding the purchases of the Blair Facility for $59.9 million and the Preferred Acquisition for $110.1 million. Capital expenditures in both periods were funded through a combination of cash flows provided in operating activities and funds received from the equity issuances and amounts available under the Credit Facilities.

Net Working Capital as of December 31, 2017 was $35.1 million, as compared to $6.2 million as of December 31, 2016. The increase was primarily due to higher accounts receivable balances as Source had significantly higher sales in the year ended December 31, 2017 compared to year ended December 31, 2016, combined with higher inventory levels due to the size and scale of Source operations growing substantially over 2017. This impact was partially offset by an increase in accounts payable as of December 31, 2017 for the same reasons as above.

Deferred Revenue

Source has entered into storage subscription agreements with some customers to provide them with guaranteed proppant storage at its facilities. Under the terms of such agreements, customers pay a non-refundable subscription fee entitling them to a discount of $2.50 per MT from Source's normal sand distribution fees. The subscription fees have been deferred and are recognized as revenue as proppant is transloaded by the subscribers. In the fourth quarter of 2017 Source recognized subscription fees of $0.1 million. Year-to-date, Source has recognized $1.3 million from storage agreements.

In 2015, one customer failed to meet the minimum sand purchase requirement outlined in their sale agreement and, as a result, Source deferred $0.9 million of revenue relating to this penalty which was recognized in the first quarter of 2016.

Contractual Obligations

Source has various lease commitments regarding equipment, railcars, physical natural gas contract and office space. The leases expire between January 2018 and December 2025. The financial liabilities on Source's Consolidated Statement of Financial Position consist of the Notes, Credit Facilities and capital loan and finance leases. Source's planned cash outflows relating to lease commitments and financial liabilities are outlined in the table below:

($000's, except MT and per unit amounts)	Total	2018	2019	2020	2021	2022	2022 and thereafter
Finance leases	1,683	957	399	181	35	111	-
Lease commitments	72,988	20,987	15,722	11,354	9,723	8,760	6,442
Credit Facilities[1]	33,765	-	33,765	-	-	-	-
The Notes	152,454	11,310	11,310	11,310	118,524	-	-

Notes:
(1) Interest payments on such balances have been excluded from the above table as the amount and timing of any interest payments will fluctuate depending on balances outstanding and applicable interest rates. Effective February 13, 2018, Source extended the maturity date to December 8, 2019.

Source is a party to contracts with numerous customers. Source's customers consist primarily of E&P companies and pressure pumping companies operating in the WCSB. Source has structured contracts with customers outlining volume commitments and in some cases fixed pricing, the terms of which vary from one to three years. This mitigates the impact of any non-payment or non-performance by, or significant reduction in purchases by, any of these contracted customers. A significant number of Source's customers are serviced on a spot basis where volume thresholds are not set and orders are serviced on an as-available basis at prevailing market prices.

In the ordinary course of conducting business, Source occasionally becomes involved in legal proceedings relating to contracts, environmental issues, or other matters. While any proceeding or litigation has an element of uncertainty, management of Source believes that the outcome of any pending or threatened actions will not have a material adverse effect on the business or on the financial condition of Source.

Off-Balance Sheet Arrangements

Source does not have any off-balance sheet arrangements at this time.

Outstanding Shares

The weighted average number of Common Shares outstanding for the three months and year ended December 31, 2017 was 57,033,291 and 44,454,714, respectively (three months and year ended December 31, 2016 – 23,845,618, being the equivalent number of Common Shares based on the number of issued and outstanding limited partnership units at that time).

	Three months ended December 31		Year ended December 31	
	2017	2016	2017	2016
Common Shares outstanding, beginning of period	**50,316,715**	**23,845,618**	**23,845,618**	**23,845,618**
Issued upon closing of IPO	-	-	12,009,133	-
Issued upon repayment of shareholder loans	-	-	3,755,554	-
Issued on repayment of preferred share obligation	-	-	2,584,258	-
Issued pursuant to November 7, 2017 equity offering	6,716,576	-	1,662,164	-
Issued on settlement of Relevant Transaction Rights	-	-	597,987	-
Weighted average Common Shares, end of period	**57,033,291**	**23,845,618**	**44,454,714**	**23,845,618**

As at March 14, 2018, Source had issued and outstanding (i) 62,851,866 Common Shares; (ii) 1,300,154 Class B shares, each redeemable for a Common Share on a one-to-one ratio at the option of the holder; and (iii) 2,580,843 stock options. See "Corporate Structure" in the AIF.

Transactions between Related Parties

In the second quarter of 2017, the Reorganization and the IPO were completed and in connection with which the shareholder loans and the amount due to related parties were settled as described above.

During the year ended December 31, 2017, Source contracted with a company that is partially owned by a close member of the CEO's family. This company provided various project management services in locations where Source did not have adequate construction management or construction execution resources. This company also performed various civil and mechanic construction tasks and provided construction materials. This company billed Source $2.9 million for the year ended December 31, 2017 of which $1.3 million was included in accounts payable at December 31, 2017.

Proposed Transactions

Source does not have any proposed transactions at this time other than those occurring in the ordinary course of business.

Controls and Procedures

The Company is required to comply with National Instrument 52-109 - *Certification of Disclosure in Issuers' Annual and Interim Filings*. The certificate for annual filings requires the Chief Executive Officer and the Chief Financial Officer to certify the design of Source's disclosure controls and procedures ("DC&P") and internal control over financial reporting ("ICFR") as at December 31, 2017. There were no material weaknesses in the design of the DC&P and the ICFR at December 31, 2017, and no changes in ICFR during the financial year ended on December 31, 2017 that have materially affected, or are reasonably likely to materially affect Source's ICFR. The control framework used to design the Company's ICFR is the framework in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. While the Company's certifying officers believe that the Company's DC&P and ICFR provide a reasonable level of assurance with regard to their effectiveness, a control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system will be met and it should not be expected that the control system will prevent all errors or fraud.

Business Risks

Source's operations are subject to operating risks that are often beyond its control and could adversely affect production levels and costs

Source's mining, processing and production facilities, its logistics operations and any future properties it develops or may acquire in the future are and will be subject to risks normally encountered in the frac sand industry. These risks include:

- changes in the price and availability of transportation;
- inability to obtain necessary production equipment or replacement parts;
- inclement or hazardous weather conditions, including flooding, and the physical impacts of climate change;
- unanticipated ground, grade or water conditions;
- inability to acquire or maintain necessary permits or mining or water rights;
- late delivery of supplies;
- changes in the price and availability of natural gas or electricity that Source uses as fuel sources for its frac sand plants and equipment;
- technical difficulties or failures;
- cave-ins or similar pit wall failures;
- environmental hazards, such as unauthorized spills, releases and discharges of wastes, tank ruptures and emissions of unpermitted levels of pollutants;
- industrial accidents;
- changes in laws and regulations (or the interpretation thereof) related to the mining and oil and natural gas industries, silica dust exposure or the environment;
- inability of Source's customers or distribution partners to take delivery;
- reduction in the amount of water available for processing;
- fires, explosions or other accidents; and
- facility shutdowns in response to environmental regulatory actions.

The occurrence of any of these events could have a material adverse effect on Source's business, financial position, results of operations and cash flows.

Source's business may be adversely affected by changing economic conditions beyond its control, including decreases in oil and natural gas development

Source's revenue is closely tied to conditions in the oil and natural gas industry in which its customers operate, and more broadly to general economic conditions. Source's product and services are used primarily in oil and gas exploration and production in Western Canada and the United States. Consequently, economic downturns and particularly weakness in the oil and natural gas market may lead to a significant decrease in demand for Source's products and services or depress utilization rates and the prices for the products and services Source sells. During periods of expansion in Source's respective end markets, Source generally has benefited from increased demand for its products and services. However, during recessionary periods in Source's end markets, Source may be adversely affected by reduced demand for its products and services. Weakness in Source's end markets, such as a decline in oil and natural gas exploration and production, may in the future lead to a decrease in the demand for Source's products and services or the price Source can charge for its products and services, which could adversely affect Source's operating results by decreasing revenues and profit margins. Deterioration in the oil and natural gas industry could have a material adverse effect on Source's business, financial position, results of operations and cash flows in the future.

Source's business and financial performance depend on the level of activity in the oil and natural gas industry

Substantially all of Source's revenues are derived from the sale of proppant to companies in the oil and natural gas industry. As a result, Source's operations are dependent on the levels of activity in oil and natural gas exploration, development and production. More specifically, the demand for the proppants Source produces is closely related to the number of oil and natural gas wells completed in geological formations that Source serves and where sand-based proppants are used in hydraulic fracturing activities. These activity levels are affected by both short and long-term trends in oil and natural gas prices, among other factors. In recent years, oil and natural gas prices and, therefore, the level of exploration, development and production activity, have experienced a sustained decline from the highs in the latter half of 2014. Beginning in September 2014 and continuing through to the end of 2016, increasing global supply of oil, including a decision by the OPEC to sustain its production levels in spite of the decline in oil prices, in conjunction with weakened demand from slowing economic growth in the Eurozone and China, created downward pressure on crude oil prices resulting in reduced demand for Source's products and pressure to reduce its product prices. Although such conditions have improved recently, if conditions deteriorate and persist, this will adversely impact Source's operations. Furthermore, the availability of key resources that impact drilling activity has experienced significant fluctuations and could impact demand for the Company's products. A prolonged reduction in oil and natural gas prices would generally depress the level of oil and natural gas exploration, development, production and well completion activity and would result in a corresponding decline in the demand for the proppants Source produces. Such a decline would have a material adverse effect on Source's business, results of its operations, and its financial condition. Furthermore, the commercial development of economically viable alternative energy sources (such as wind, solar, geothermal, tidal, fuel cells and biofuels) could have a similar effect. Any future decreases in the rate at which oil and natural gas reserves are discovered or developed, whether due to the passage of legislation, increased governmental regulation leading to limitations, or prohibitions on exploration and drilling activity, including hydraulic fracturing, or other factors, could have a material adverse effect on Source's business and financial condition, even in a stronger oil and natural gas price environment.

Downturn in business could result in potential impairment of property, plant and equipment

Although commodity prices have improved, the decrease in commodity prices since 2014 has had, and may continue to have, a negative impact on industry drilling and well completion activity, which affects the demand for frac sand. Should energy industry conditions deteriorate, there is a possibility that property, plant and equipment may be impaired in a future period. Any resulting non-cash impairment charges to earnings may be material. Specific uncertainties affecting Source's estimated fair value include the impact of competition, the prices of frac sand, future overall activity levels and demand for frac sand, the activity levels of Source's significant customers, and other factors affecting the rate of Source's future growth. These factors will continue to be reviewed and assessed going forward. Additional adverse developments with regard to these factors could have a further negative impact on Source's fair value.

Source relies on a small number of customers for the majority of its revenue

Source relies on a small number of large customers for most of its revenue, and the loss of one or more such customers would adversely affect Source's results of operations and cash flows. Source's five largest customers accounted for 82% of its revenue for the year ended December 31, 2017. Although a significant percentage of Source's customers are under contract, certain contracts do not provide for guaranteed volumes and can be terminated on short notice and, on occasion, certain customers may demand to renegotiate a contract prior to the end of its term. There can be no assurance that Source's current customers will continue their relationships with Source or that contracts that come up

for renewal will be renewed or, if they are renewed, that customers will contract for the same amounts or that they will pay the same prices as they have in the past. The loss of one or more major customers, the failure to renew customer contracts, or any decrease in products or services purchased or prices paid or any other changes to the terms of service under renewed contracts could have a material adverse effect on Source's business, financial position, results of operations and cash flows. A substantial portion of Source's customer contracts, including contract renewals, are subject to competitive tender processes, and there can be no assurance that Source will be successful in acquiring new business or retaining existing business subject to competitive tender. As a result of the limited number of customers that Source currently serves, Source's operations are subject to counterparty risk. The ability or willingness of each of Source's customers to perform its obligations under an agreement with Source will depend on a number of factors that are beyond Source's control and may include, among other things, the overall financial condition of the counterparty, the condition of the Canadian and United States oil and natural gas exploration and production industry, the continuing use of frac sand in hydraulic fracturing operations and general economic conditions. In addition, in depressed market conditions, Source's customers may no longer need the amount of frac sand for which they have indicated or agreed to, or may be able to obtain comparable products at a lower price. If Source's customers experience a significant downturn in their business or financial condition, they may attempt to renegotiate Source's agreements. In addition, as agreements expire, depending on market conditions at the time, Source's customers may choose not to extend, or to adjust the terms of, these agreements which could lead to a significant reduction of sales volumes and corresponding revenues cash flows and financial condition if Source is not able to replace these expected sales volumes with new sales volumes. Additionally, even if Source were to replace any lost volumes, under current market conditions, lower prices for its product could materially reduce its revenues, cash flow and financial condition.

All of Source's frac sand is currently produced from the Sumner Facility, the Blair Facility, and the Preston Facility, and the delivery of that frac sand to Source's customers is primarily served by one rail line. Any adverse developments at a facility or on the rail line could have a material adverse effect on Source's business, financial condition and results of operations

All of Source's sand is currently derived from the Sumner Facility, the Blair Facility, and the Preston Facility which are served primarily by a single Class I rail line owned by CN. Any adverse development at the Sumner Facility, the Blair Facility, or the Preston Facility or on the rail line due to catastrophic events or weather, or any other event that would cause Source to curtail, suspend or terminate operations at its facilities, could result in Source being unable to meet its sand deliveries. Although Source maintains insurance coverage to cover a portion of these types of risks, there are potential risks associated with Source's operations not covered by insurance. There also may be certain risks covered by insurance where the policy does not reimburse Source for all of the costs related to a loss. Downtime or other delays or interruptions to Source's operations that are not covered by insurance could have a material adverse effect on Source's business, results of operations and financial condition. In addition, since Sumner Facility, the Blair Facility, and the Preston Facility are all served by a single Class I rail line, any adverse changes to the existing rail rates, rail car leases, or other logistics costs would adversely affect Source's business operations and financial position.

U.S. federal tax reform could have an adverse effect on Source

The U.S. administration recently introduced significant reform of the Internal Revenue Code, which includes, among other things, changes to U.S. federal tax rates, imposing significant additional limitations on the deductibility of interest, allowing for the expensing of capital expenditures, the migration from a "worldwide" system of taxation to a territorial system, and the use of certain border adjustments. The impact of the tax reform on our business and on holders of our Common Shares is uncertain and could be adverse.

Financial Instruments and Other Instruments

Risk Management Overview

Source's activities expose it to a variety of financial risks including credit risk, liquidity risk and market risk. Further quantitative disclosures are included in the Financial Statements. Source employs risk management strategies and polices to ensure that any exposures to risk are in compliance with Source's business objectives and risk tolerance levels. While the board of directors has the overall responsibility for Source's risk management framework, Source's management has the responsibility to administer and monitor these risks.

For additional information regarding the risks that Source is exposed to, see the disclosure provided under the heading "Risk Factors" in the AIF.

Fair Value of Financial Instruments

The fair values of cash, accounts receivable, overdraft, accounts payable and accrued liabilities approximate their carrying values due to the short-term maturity of those instruments. The fair value of the Credit Facilities approximate the carrying value as they bear interest at market floating rates consistent with market rates for similar debt. Based on the closing market price as of December 31, 2017, the fair value of the Notes is $119 million.

During the third quarter of 2017, Source had a customer contract that included foreign exchange rate collars. Under the terms of the contract, pricing would be adjusted if the daily US dollar to Canadian dollar closing exchange rate was below $1.25 or exceeded $1.40. The embedded derivative is separated from the contract and accounted for as a derivative liability and is measured at fair value through profit or loss. The fair value of the derivative is based on valuation techniques that are not based on observable market data.

Recently Issued Accounting Standards Not Yet Applied

Unless otherwise noted, the following revised standards and amendments are effective for annual periods beginning on or after January 1, 2018, with earlier application permitted.

IFRS 9 Financial Instruments

On January 1, 2018, the Company adopted IFRS 9 *Financial Instruments*, which is the result of the first phase of the International Accounting Standards Board ("IASB") project to replace IAS 39 "Financial Instruments: Recognition and Measurement". IFRS 9 introduces a single approach to determine whether a financial asset is measured at amortized cost or fair value and replaces the multiple rules in IAS 39. The approach is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. The IAS 39 measurement categories for financial assets will be replaced by fair value through profit or loss, fair value through other comprehensive income and amortized cost. The standard eliminates the existing IAS 39 categories of held to maturity, loans and receivables and available for sale. IFRS 9 retains most of the IAS 39 requirements for financial liabilities. However, where the fair value option is applied to financial liabilities, the change in fair value resulting from an entity's own credit risk is recorded in other comprehensive income rather than net earnings, unless this creates an accounting mismatch. A new expected credit loss model for calculating impairment on financial assets replaces the incurred loss impairment model used in IAS 39. The new model will result in more timely recognition of expected credit losses. In addition, IFRS 9 includes a simplified hedge accounting model, aligning hedge accounting more closely with risk management. The Company has assessed the impact of IFRS 9 on its financial statements and will be amending its 'allowance for doubtful accounts' policy to reflect adoption of this standard as of January 1, 2018. Adoption of this new policy is not expected to have a material impact on the Company's financial statements, given the nature of Source's customers and its historically modest credit losses.

IFRS 15 Revenue from Contracts with Customers

On January 1, 2018, the Company adopted IFRS 15 Revenue from Contracts with Customers ("IFRS 15"). IFRS 15 was issued in May 2014 and will replace IAS 11 Construction Contracts, IAS 18 Revenue Recognition, IFRIC 13 Customer Loyalty Programs, IFRIC 15 Agreements for the Construction of Real Estate, IFRIC 18 Transfers of Assets from Customers, and SIC-31 Revenue – Barter Transactions Involving Advertising Services. IFRS 15 provides a single, principle-based five-step model that will apply to all contracts with customers with limited exceptions, including, but not limited to, leases within the scope of IAS 17 Leases and financial instruments and other contractual rights or obligations within the scope of IFRS 9, IFRS 10 Consolidated Financial Statements and IFRS 11 Joint Arrangements. In addition to the five-step model, the standard specifies how to account for the incremental costs of obtaining a contract and the costs directly related to fulfilling a contract. The standard's requirements will also apply to the recognition and measurement of gains and losses on the sale of some non-financial assets that are not an output of the entity's ordinary activities. The Company has completed the analysis of its customer contracts and determined that there is no material impact to the timing of recognition or measurement of revenue under IFRS 15. However, the Company continues to work through the impact of the additional disclosures required for the quarterly and annual financial statements.

IFRS 16 Leases

On January 1, 2019, the Company will adopt IFRS 16 Leases ("IFRS 16"). The new standard requires lessees to recognize a lease liability reflecting future lease payments and a 'right-of-use-asset' for most lease contracts. The standard permits a simplified approach that includes certain reliefs related to the measurement of the right-of-use-asset and the lease liability, rather than full retrospective application. IFRS 16 must be applied for financial years commencing on or after January 1, 2019. Early adoption is permitted, but only in conjunction with IFRS 15. The Company is in the process of assessing the impact of IFRS 16, however, given the significant use of leased rail cars and heavy equipment the Company expects the standard will have a material impact on its financial statements.

Critical Accounting Estimates

The following discussion sets forth management's most critical estimates and assumptions in determining the value of assets, liabilities and equity.

Allowance for Doubtful Accounts

Source performs ongoing credit evaluations of its customers and grants credit based on a review of historical collection experience, current aging status, the customer's financial condition and anticipated industry conditions. Customer

payments are regularly monitored and a provision for doubtful accounts is established based on specific situations and overall industry conditions.

Inventories

Source evaluates its inventory to ensure it is carried at the lower of average cost and net realizable value. Allowances are made against obsolete or damaged inventories and charged to cost of sales. The reversal of any write-down of inventory arising from an increase in net realizable value would be recognized as a reduction in cost of sales in the period in which the reversal occurred.

Depreciation and Depletion

The amounts recorded for depreciation of property and equipment are based on estimates of the useful lives of the assets and residual values. This estimated residual value and useful lives of property and equipment are reviewed at the end of each reporting period and adjusted if required.

Mineral resources are depleted using the unit-of-production method based on indicated and inferred reserves. Depletion is recorded on a per tonne basis as the reserves are mined.

Decommissioning Liabilities

The amount recorded for decommissioning liabilities and accretion expense depends on estimates of current risk-free interest rates, future restoration and reclamation expenditures, and the timing of those expenditures.

Income Taxes

The amounts recorded for deferred income taxes are based on estimates as to the timing of the reversal of temporary differences and tax rates currently substantively enacted. They are also based on estimates of the probability of Source utilizing certain tax losses in future periods and tax rates applicable to those periods.

Stock-Based Compensation

The fair value of stock options to purchase Common Shares is estimated at the grant date using the Black-Scholes option pricing model, which includes underlying assumptions related to the risk-free interest rate, average expected unit life, estimated forfeitures, and estimated volatility of Source. In 2017 DSUs, RSUs and PSUs were expected to be settled for cash payments and accordingly were considered a liability settled award for accounting purposes. At the 2017 Annual General Meeting a proposal will be put forth for shareholder approval that commencing in 2018 RSUs and PSUs may be settled in Common Shares or cash.

Cash-Generating Units

The determination of cash-generating units is based on management's judgment regarding geographic proximity, shared equipment, and mobility of equipment. Management has determined that the Company's operations represent one cash-generating unit.

Impairment of Non-Financial Assets

Assets that are subject to depreciation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs of disposal and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are largely independent cash inflows, prior to impairments of non-financial assets and are reviewed for possible reversal at each reporting date.

Embedded Derivatives

An embedded derivative is a component of a contract that modifies the cash flows of the contract. In respect of the Notes, the relevant transaction rights and the prepayment option included in the Notes represents a hybrid contract. The embedded derivatives are separated from the Note payable and accounted for as derivative liabilities. The embedded derivatives are measured at fair value through profit or loss. The fair value of the derivatives is based on prices or valuation techniques that require inputs that are not based on observable market data. The Company has a customer contract that includes foreign exchange rate collars. Under the terms of the contract, pricing will be adjusted if the daily US dollar to Canadian dollar closing exchange rate is below $1.25 or exceeds $1.40. The embedded derivative is separated from the contract and accounted for as a derivative liability and is measured at fair value through profit or loss. The fair value of the derivative is based on valuation techniques that are not based on observable market data.

Fair Value of Assets and Liabilities Acquired in a Business Combination

Values are allocated to assets and liabilities acquired based on their estimated fair values at the date of acquisition. Determining the fair value of assets and liabilities acquired, as well as intangible assets that relate to such items is ultimately based on management's assessment of the value of the assets and liabilities acquired and, to the extent available, third party information and assessments. Any excess of the cost of the acquisition over the net fair value of the identifiable assets acquired is recognized as goodwill.

NON-IFRS MEASURES

This MD&A refers to certain financial measures that are not determined in accordance with IFRS. These financial measures do not have standardized meanings prescribed by IFRS and Source's method of calculating these measures may differ from the method used by other entities and, accordingly, they may not be comparable to similar measures presented by other companies. These financial measures should not be considered as an alternative to, or more meaningful than, net income (loss), Gross Margin and other measures of financial performance as determined in accordance with IFRS. Source believes that these non-IFRS measures are useful to both management and investors in providing relative performance and measuring changes in respect of Source as well as measuring Source's financial performance in the context of earnings generated to fund capital investments and meet financial obligations. More specifically, Adjusted EBITDA, Adjusted Gross Margin and Normalized Adjusted Gross Margin are considered key measures as they reflect the ability of Source to generate earnings necessary to meet its capital investments and financial obligations. Adjusted EBITDA per MT, Adjusted Gross Margin per MT and Normalized Adjusted Gross Margin per MT are calculated by taking the Non-IFRS Measures and dividing by sand volumes for period stated.

Adjusted EBITDA represents earnings generated to fund capital investments and meet financial obligations. It represents, for the period presented, EBITDA as adjusted to add back or deduct, as applicable, the following expenses, costs, charges or benefits incurred in such period which in management's view are not indicative of the underlying business performance: (a) finance expense excluding interest expense; (b) management fee; (c) fair value adjustment of the shareholder loan; (d) loss (gain) on asset disposal; (e) loss (gain) on impairment; (f) transaction and professional fees; (g) Preferred Acquisition inventory acquired at fair value; (h) loss (gain) on derivative liability; (i) gain on settlement of deferred revenue; and (j) stock based compensation.

EBITDA represents, for the period presented, net income (loss) plus: (a) income taxes; (b) interest expense; (c) cost of sales – depreciation; (d) depreciation; and (e) amortization, in each case to the extent deducted from net income in such period determined on a combined basis in accordance with IFRS.

Adjusted Gross Margin represents, for the period presented, Gross Margin plus costs of sales – depreciation and depletion.

Normalized Adjusted Gross Margin represents, for the period presented, Adjusted Gross Margin plus sales mix impact of mine gate sales and the impact of Preferred Acquisition inventory being recorded at fair value. As reconciled to the IFRS measure Gross Margin in the Results Overview section of the MD&A.

This MD&A makes reference to these non-IFRS measures. These non-IFRS measures and other financial estimates of management are based upon variable components. There can be no assurance that these components and future calculations of non-IFRS measures will not vary. Investors are cautioned not to consider these non-IFRS measures in isolation or place undue reliance on ratios or percentages calculated using these non-IFRS measures.

Reconciliation of EBITDA and Adjusted EBITDA to Net Income

	Three months ended December 31		Year ended December 31	
($000's, except MT and per unit amounts)	**2017**	2016	**2017**	2016
Net income (loss)	**(1,102)**	**(9,103)**	**(8,935)**	**(43,402)**
Add:				
Tax expense	**(2,131)**	(597)	**(2,179)**	(512)
Interest expense	**3,631**	4,844	**16,621**	16,202
Cost of sales – depreciation and depletion	**3,998**	1,612	**11,948**	8,039
Depreciation	**2,081**	2,351	**6,560**	6,373
EBITDA	**6,477**	(893)	**24,015**	(13,300)
Add:				
Finance expense excluding interest expense	**1,944**	2,261	**11,721**	3,289
Stock based compensation expense	**1,770**	-	**6,625**	-
Management Fee	**-**	153	**417**	1,043
Loss (gain) on asset disposal	**(3)**	(1,788)	**(6)**	1,082
Loss on asset impairment	**-**	1,852	**-**	1,852
Loss (gain) on derivative liability	**1,316**	910	**(1,581)**	910

Transaction and Professional Fees	**-**	-	**849**	926
Preferred Acquisition inventory acquired at fair value	**1,568**	-	**1,568**	-
Gain on settlement of deferred revenue	**-**	(3,328)	**-**	(3,328)
Adjusted EBITDA	**13,072**	(833)	**43,608**	(7,526)

Reconciliation of Gross Margin to Adjusted Gross Margin

	Three Months Ended December 31		Year Ended December 31	
($000's, except MT and per unit amounts)	**2017**	2016	**2017**	2016
Gross Margin	**13,618**	5,230	**51,623**	7,903
Cost of Sales — depreciation and depletion	**3,998**	1,612	**11,948**	8,039
Adjusted Gross Margin	**17,616**	6,842	**63,571**	15,942

History of the Business

Source began operations in 1998 as a proppant transloading business and from 1998 to 2007 developed its geographic footprint by building proppant terminals in key oil and gas basins in Canada and the United States. In 2010 Source began developing its Northern White frac sand mine and related closed-loop wet processing plant located in east-central Barron County Wisconsin near the town of Sumner, Wisconsin (the "Sumner Facility") and a dry processing plant, storage and loadout facility located in Weyerhaeuser, Wisconsin (the "Weyerhaeuser Facility"). In October 2013, TriWest Capital Partners IV fund ("TriWest IV") invested in the Source business and became its majority unitholder. TriWest IV's investment facilitated the completion of the Sumner Facility, the Weyerhaeuser Facility and Source's unit train capable terminal located in Wembley, Alberta. Source commenced increased frac sand sales after completion of the Weyerhaeuser Facility in June 2014. Source maintained its frac sand sales volumes through the 2015 and 2016 downturn in commodity prices, but did experience a significant decline in frac sand prices during this period. Recovery in frac sand pricing did not start to occur until the fourth quarter of 2016. In December of 2016, Source issued $130 million principal amount of 10.5% Senior Secured First Lien Notes due December 15, 2021 ("the Notes").

On April 13, 2017, Source completed the Reorganization and the Company completed an initial public offering (the "IPO") of 16,666,667 of its common shares ("Common Shares") at an offering price of $10.50 per Common Share on the Toronto Stock Exchange (the "TSX") for gross proceeds of approximately $175 million. The Common Shares are listed on the TSX under the symbol "SHLE". The Company is authorized to issue an unlimited number of Common Shares, Class B Shares and preferred shares.

As the Reorganization was a related party transaction, the Company has used continuity of accounting, resulting in the prior year period being restated to the combined accounts of Source's combined financial statements with the Company. As a result of the Reorganization, the Company owns 100% of Source US LP and 96.26% of Source Canada LP and TriWest Capital Partners IV (US), L.P. indirectly owns 3.74% of Source Canada LP as a minority shareholder and holds all of the outstanding class B shares (the "Class B Shares") in the capital of the Company. The Class B Shares are voting shares that are redeemable into Common Shares at the option of the holder. See "Corporate Structure" in the AIF.

In conjunction with the IPO Source settled several balance sheet obligations including the preferred shares obligation, the shareholder loan amount and the due to related parties amount. The preferred shares obligation amount was settled with approximately $17.25 million of cash from the proceeds of the IPO and by issuing an aggregate of 5,212,081 Common Shares to the preferred shareholders. The shareholder loan amount was settled through the issuance of 3,586,517 Common Shares to the shareholder loan holders. The due to related parties amount was settled with approximately $4.66 million of cash from the proceeds of the IPO.

On April 18, 2017, the Company completed a purchase and sale agreement for all of the outstanding membership interests of Sand Products Wisconsin, LLC for approximately US$45 million. The transaction involved the purchase of a sand mine and associated washing, drying and rail facilities and other related assets, as well as, prepaid royalties, and the assignment of various land and mining leases, all located near the town of Blair, Wisconsin (collectively, the "Blair Facility"). The facilities had not been operated prior to the purchase.

On April 25, 2017, Source Canada LP and Source Energy Services Canada Holdings Ltd. (collectively, the "Note Issuers") provided notice to the holders of the Notes that an aggregate principal amount of $22,290,000 (the "Principal Amount") of the Notes outstanding would be redeemed for cash on June 6, 2017 (the "Redemption Date") upon payment of a redemption amount of 110.5% of the Principal Amount, plus all accrued and unpaid interest thereon to the Redemption Date. The accrued interest to be paid per $1,000 principal amount of Notes on the Redemption Date was $51.78. Further, as a result of the completion of the IPO, on May 29, 2017, the Company issued an aggregate of 1,005,831 Common Shares to the holders of record on May 19, 2017 of the Notes in connection with the relevant transaction rights attached to the Notes.

On November 7, 2017, Source completed an US$80.0 million asset purchase for certain assets and operations of Preferred Proppants, LLC (the "Preferred Acquisition"). Review of the Preferred Acquisition by the Canadian

Competition Bureau is underway. The Preferred Acquisition involved the purchase of, among other things, a Northern White proppant mine and associated washing, drying and rail facilities in Blair, Wisconsin (the "Preston Facility") and two frac sand terminals located in British Columbia.

The Preferred Acquisition was partially funded through $93.8 million of gross proceeds from equity offerings that closed on November 7, 2017, resulting in the issuance of 11,235,000 Common Shares at a price of $8.35. The remainder of the acquisition price was funded through a draw on the Credit Facilities. The underwriters were granted an option by the Company to purchase up to an additional 450,000 common shares at the offering price of $8.35, exercisable from time to time, in whole or in part, for a period of 30 days from the closing of the offering. The underwriters exercised this option, in full, with the option closing date being the same as the Preferred Acquisition and gross proceeds and issuance of Common Shares above include the exercise of this option.

All of Source's subsidiaries are 100% owned, except for Source Canada LP, which has a 3.74% non-controlling interest held by TriWest Capital Partners IV (US), L.P. As there is no specific guidance in IFRS, management has selected an accounting policy that is consistent with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors. Management has chosen to apply the predecessor value method since inception for common control transactions. The predecessor value method involves accounting for the acquired assets and liabilities at existing carrying values rather than at fair value, which results in no goodwill being recorded. The prior year equity was revised to combine the common control entities as part of the common control transactions.

FORWARD-LOOKING STATEMENTS

Certain statements contained in this MD&A constitute forward-looking statements relating to, without limitation, expectations, intentions, plans and beliefs, including information as to the future events, results of operations and Source's future performance (both operational and financial) and business prospects. In certain cases, forward-looking statements can be identified by the use of words such as "expects", "estimates", "forecasts", "intends", "anticipates", "believes", "plans", "seeks", "projects" or variations of such words and phrases, or state that certain actions, events or results "may" or "will" be taken, occur or be achieved. Such forward-looking statements reflect Source's beliefs, estimates and opinions regarding its future growth, results of operations, future performance (both operational and financial), and business prospects and opportunities at the time such statements are made, and Source undertakes no obligation to update forward-looking statements if these beliefs, estimates and opinions or circumstances should change. Forward-looking statements are necessarily based upon a number of estimates and assumptions made by Source that are inherently subject to significant business, economic, competitive, political and social uncertainties and contingencies. Forward-looking statements are not guarantees of future performance. In particular, this MD&A contains forward-looking statements pertaining, but not limited, to: expectations regarding the price of proppants and sensitivity to changes in such prices; outlook for operations and sales volumes; expectations regarding the ratio of rejected materials to the total amount excavated, expectations respecting future competitive conditions; industry activity levels; industry conditions pertaining to the frac sand industry; expectations regarding increased demand for and sales volumes of sand in 2018; increased activity levels and sand intensity levels in 2018; the ability of Source to meet its capital needs; increased drilling and well completion activity in 2018; the continued increase of sand sales volumes and sand spot pricing in 2018; increased sand intensities for Canadian well completions; the effectiveness of internal controls over Source's internal financial reporting; and Source's objectives, strategies and competitive strengths.

By their nature, forward-looking statements involve numerous current assumptions, known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of Source to differ materially from those anticipated by Source and described in the forward-looking statements.

With respect to the forward-looking statements contained in this MD&A, assumptions have been made regarding, among other things: proppant market prices; future oil, natural gas and natural gas liquids prices; future global economic and financial conditions; future commodity prices, demand for oil and gas and the product mix of such demand; levels of activity in the oil and gas industry in the areas in which Source operates; the continued availability of timely and safe transportation for Source's products, including without limitation, rail accessibility; the maintenance of Source's key customers and the financial strength of its key customers; the maintenance of Source's significant contracts or their replacement with new contracts on substantially similar terms and that contractual counterparties will comply with current contractual terms; operating costs; that the regulatory environment in which Source operates will be maintained in the manner currently anticipated by Source; future exchange and interest rates; geological and engineering estimates in respect of Source's resources; the recoverability of Source's resources; the accuracy and veracity of information and projections sourced from third parties respecting, among other things, future industry conditions and product demand; demand for horizontal drilling and hydraulic fracturing and the maintenance of current techniques and procedures, particularly with respect to the use of proppants; Source's ability to obtain qualified staff and equipment in a timely and cost-efficient manner; the regulatory framework governing royalties, taxes and environmental matters in the jurisdictions in which Source conducts its business and any other jurisdictions in which Source may conduct its business in the future; future capital expenditures to be made by Source; future sources of funding for Source's capital program; Source's future debt levels; the impact of competition on Source; and Source's ability to obtain financing on acceptable terms.

A number of factors, risks and uncertainties could cause results to differ materially from those anticipated and described herein including, among others: the effects of competition and pricing pressures; risks inherent in key customer dependence; effects of fluctuations in the price of proppants; risks related to indebtedness and liquidity, including Source's leverage, restrictive covenants in Source's debt instruments and Source's capital requirements; risks related to interest rate fluctuations and foreign exchange rate fluctuations; changes in general economic, financial, market and business conditions in the markets in which Source operates; changes in the technologies used to drill for and produce oil and natural gas; Source's ability to obtain, maintain and renew required permits, licenses and approvals from regulatory authorities; the stringent requirements of and potential changes to applicable legislation, regulations and standards; the ability of Source to comply with unexpected costs of government regulations; liabilities resulting from Source's operations; the results of litigation or regulatory proceedings that may be brought against Source; the ability of Source to successfully bid on new contracts and the loss of significant contracts; risks the Commissioner of Competitions with authority under the Competition Act (Canada) may successfully challenge the Preferred Acquisition which may cause Source to not fully realize anticipated benefits of the Preferred Acquisition; uninsured and underinsured losses; risks related to the transportation of Source's products, including potential rail line interruptions or a reduction in rail car availability; the geographic and customer concentration of Source; the ability of Source to retain and attract qualified management and staff in the markets in which Source operates; labour disputes and work stoppages and risks related to employee health and safety; general risks associated with the oil and natural gas industry, loss of markets, consumer and business spending and borrowing trends; limited, unfavourable, or a lack of access to capital markets; uncertainties inherent in estimating quantities of mineral resources; sand processing problems; and the use and suitability of Source's accounting estimates and judgments.

Although Source has attempted to identify important factors that could cause actual actions, events or results to differ materially from those described in its forward-looking statements, there may be other factors that cause actions, events or results not to be as anticipated, estimated or intended. There can be no assurance that forward-looking statements will materialize or prove to be accurate, as actual results and future events could differ materially from those anticipated in such statements. The forward-looking statements contained in this MD&A are expressly qualified by this cautionary statement. Readers should not place undue reliance on forward-looking statements. These statements speak only as of the date of this MD&A. Except as may be required by law, Source expressly disclaims any intention or obligation to revise or update any forward-looking statements or information whether as a result of new information, future events or otherwise.

Any financial outlook and future-oriented financial information contained in this MD&A regarding prospective financial performance, financial position or cash flows is based on assumptions about future events, including economic conditions and proposed courses of action based on management's assessment of the relevant information that is currently available. Projected operational information contains forward-looking information and is based on a number of material assumptions and factors, as are set out above. These projections may also be considered to contain future oriented financial information or a financial outlook. The actual results of Source's operations for any period will likely vary from the amounts set forth in these projections and such variations may be material. Actual results will vary from projected results. Readers are cautioned that any such financial outlook and future-oriented financial information contained herein should not be used for purposes other than those for which it is disclosed herein. The forward-looking information and statements contained in this document speak only as of the date hereof and the Company does not assume any obligation to publicly update or revise them to reflect new events or circumstances, except as may be required pursuant to applicable laws.