SOURCE ENERGY SERVICES

# CONSOLIDATED FINANCIAL STATEMENTS

## AS AT AND FOR THE YEARS ENDED
## DECEMBER 31, 2018 AND 2017

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# Independent auditor's report

To the Shareholders of Source Energy Services Ltd.

## Our opinion

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of Source Energy Services Ltd. and its subsidiaries (together, the Company) as at December 31, 2018 and 2017, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards (IFRS).

**What we have audited**

The Company's consolidated financial statements comprise:

- the consolidated statements of financial position as at December 31, 2018 and 2017;
- the consolidated statements of operations and comprehensive income (loss) for the years then ended;
- the consolidated statements of changes in equity for the years then ended;
- the consolidated statements of cash flows for the years then ended; and
- the notes to the consolidated financial statements, which include a summary of significant accounting policies.

## Basis for opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report.

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

**Independence**

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

## Other information

Management is responsible for the other information. The other information comprises the Management's Discussion and Analysis.

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

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

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

## *Responsibilities of management and those charged with governance for the consolidated financial statements*

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

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

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

## *Auditor's responsibilities for the audit of the consolidated financial statements*

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

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

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Company to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

The engagement partner on the audit resulting in this independent auditor's report is Reynold Tetzlaff.

PricewaterhouseCoopers LLP

Chartered Professional Accountants

Calgary, Alberta
March 14, 2019

# SOURCE ENERGY SERVICES LTD.
## Consolidated Statement of Financial Position

(All amounts are in thousands of Canadian dollars, unless otherwise noted)

| | Note | | December 31, 2018 | | December 31, 2017 |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| **Current assets** | | | | | |
| Cash | | $ | 4,574 | $ | — |
| Accounts receivable | 4(c) | | 24,533 | | 54,114 |
| Prepaid expenses | | | 8,545 | | 5,455 |
| Inventories | 6 | | 67,353 | | 48,984 |
| **Total current assets** | | | 105,005 | | 108,553 |
| **Deferred income tax asset** | 9 | | 13,343 | | 8,009 |
| **Mineral resources** | 7 | | 31,054 | | 31,506 |
| **Property, plant and equipment** | 8 | | 370,939 | | 319,889 |
| **Total Assets** | | $ | 520,341 | $ | 467,957 |
| **Liabilities and Equity** | | | | | |
| **Current liabilities** | | | | | |
| Accounts payable and accruals | 4(d) | $ | 35,989 | $ | 38,765 |
| Contract liabilities | 15 | | 2,744 | | 278 |
| Derivative liability | 4(b) | | 760 | | 671 |
| Current portion of long-term debt | 10 | | 516 | | 33,692 |
| Current portion of decommissioning provision | 11 | | 2,011 | | 2,140 |
| **Total current liabilities** | | | 42,020 | | 75,546 |
| **Long-term debt** | 10 | | 147,983 | | 95,570 |
| **Contract liabilities** | 15 | | 3,155 | | — |
| **Derivative liability** | 4(b),10 | | 566 | | 2,128 |
| **Deferred income tax liability** | 9 | | 6,733 | | — |
| **Decommissioning provision** | 11 | | 15,218 | | 12,523 |
| **Total long-term liabilities** | | | 173,655 | | 110,221 |
| **Total liabilities** | | $ | 215,675 | $ | 185,767 |
| **Shareholders' Equity** | | | | | |
| Shareholders' equity | 12 | $ | 399,511 | $ | 400,812 |
| Contributed Surplus | | | 7,554 | | 5,432 |
| Accumulated Deficit | | | (117,425) | | (115,212) |
| Cumulative translation adjustment | | | 16,162 | | (8,358) |
| Shareholders' equity | | | 305,802 | | 282,674 |
| Non-controlling interests | 12 | | (1,136) | | (484) |
| **Total Equity** | | $ | 304,666 | $ | 282,190 |
| **Total Liabilities and Equity** | | $ | 520,341 | $ | 467,957 |

See accompanying notes to the consolidated financial statements.

Commitments and contingencies (Note 17)

Approved on behalf of the Board of Directors:

signed "Stew Hanlon"
Stew Hanlon
Director

signed "Brad Thomson"
Brad Thomson
Director

**SOURCE ENERGY SERVICES LTD.**
**Consolidated Statement of Operations and Comprehensive Income (Loss)**

(All amounts are in thousands of Canadian dollars, unless otherwise noted)

| | Note | | 2018 | | 2017 |
|---|---|---|---|---|---|
| **Sales** | | | | | |
| Sand revenue | 15 | $ | 342,428 | $ | 228,403 |
| Wellsite solutions | 15 | | 67,264 | | 54,911 |
| Terminal services | 15 | | 5,335 | | 6,184 |
| **Total sales** | | | 415,027 | | 289,498 |
| **Cost of sales** | 16 | $ | 325,738 | $ | 225,927 |
| **Cost of sales - depreciation and depletion** | | | 20,274 | | 11,948 |
| **Gross margin** | | $ | 69,015 | $ | 51,623 |
| Operating and general & administrative expense | 16 | $ | 33,323 | $ | 24,509 |
| Depreciation | | | 12,009 | | 6,560 |
| **Income from operations** | | $ | 23,683 | $ | 20,554 |
| **Other expense (income):** | | | | | |
| Loss (gain) on asset disposal | | $ | 4,640 | $ | (6) |
| Share based compensation expense | 13 | | 2,403 | | 6,625 |
| Finance expense | 19 | | 20,961 | | 28,342 |
| Loss (gain) on derivative liability | 4(b), 10 | | (1,503) | | (1,581) |
| Other income | | | (532) | | (1,266) |
| Management fees | | | — | | 417 |
| Foreign exchange (gain) loss | | | (590) | | (863) |
| **Total other expense** | | | 25,379 | | 31,668 |
| **Income (loss) before income taxes** | | $ | (1,696) | $ | (11,114) |
| **Income taxes** | | | | | |
| Current tax expense (recovery) | 9 | $ | — | $ | — |
| Deferred tax expense (recovery) | 9 | | 1,169 | | (2,179) |
| **Total income taxes** | | | 1,169 | | (2,179) |
| **Net income (loss)** | | $ | (2,865) | $ | (8,935) |
| Net income (loss) attributable to shareholders | | | (2,213) | | (8,515) |
| Net income (loss) attributable to non-controlling interests | | | (652) | | (420) |
| Total net income (loss) | | $ | (2,865) | $ | (8,935) |
| **Other comprehensive income (loss)** | | | | | |
| Foreign currency translation adjustment (subject to recycling) | | | 24,520 | | 13,959 |
| **Consolidated comprehensive income (loss)** | | $ | (27,385) | $ | (22,894) |
| **Loss per share (in dollars)** | | | | | |
| Basic | 14 | $ | (0.04) | $ | (0.19) |
| Diluted | 14 | $ | (0.04) | $ | (0.19) |

See accompanying notes to the consolidated financial statements.

## SOURCE ENERGY SERVICES LTD.
### Consolidated Statement of Changes in Equity

(All amounts are in thousands of Canadian dollars, unless otherwise noted)

| | Note | Common share capital | | Partner's Equity | Contributed Surplus | Cumulative Translation Adjustment | Accumulated Deficit | Non-controlling interests | Total Equity |
|---|---|---|---|---|---|---|---|---|---|
| | | Number of Shares | $ | | | | | | |
| **Balance at December 31, 2017** | | **62,852** | **$ 400,812** | **$ —** | **$ 5,432** | **$ (8,358)** | **$ (115,212)** | **$ (484)** | **$ 282,190** |
| Unrealized foreign exchange income (loss) | | | | | | 24,520 | | | **24,520** |
| Share based compensation expense | 13 | | | | 2,122 | | | | **2,122** |
| Repurchase and cancellation of shares under NCIB | | (615) | (1,301) | | | | | | **(1,301)** |
| Net income (loss) | | | | | | | (2,213) | (652) | **(2,865)** |
| **Balance at December 31, 2018** | | **62,237** | **$ 399,511** | **$ —** | **$ 7,554** | **$ 16,162** | **$ (117,425)** | **$ (1,136)** | **$ 304,666** |

| | Note | Partners Units | | Partner's Equity | Contributed Surplus | Cumulative Translation Adjustment | Accumulated Deficit | Non-controlling interests | Total Equity |
|---|---|---|---|---|---|---|---|---|---|
| | | Number of Units | $ | | | | | | |
| **Balance at December 31, 2016** | | **96,880** | **$ —** | **$ 41,941** | **$ —** | **$ 5,601** | **$ (106,761)** | **$ —** | **$ (59,219)** |
| Issuance of $10 share capital in SESL upon incorporation | | 1 | | | | | | | **—** |
| Exchange of partnership units for SESL shares | | (71,789) | 41,941 | (41,941) | | | | | **—** |
| Non-controlling interests | | | | | | | 64 | (64) | **—** |
| Common shares issued upon closing of IPO | 12 | 16,667 | 175,000 | | | | | | **175,000** |
| Common shares issued during year | 12 | 11,235 | 93,812 | | | | | | **93,812** |
| Share capital issuance costs | | | (13,443) | | | | | | **(13,443)** |
| Common shares issued on settlement of EEPP | | 53 | 554 | | | | | | **554** |
| Common shares issued on repayment of shareholder loans | | 3,587 | 37,658 | | | | | | **37,658** |
| Common shares issued on repayment of preferred share obligation | | 5,212 | 54,727 | | | | | | **54,727** |
| Issued on settlement of Relevant Transaction Rights | | 1,006 | 10,563 | | | | | | **10,563** |
| Unrealized foreign exchange loss | | | | | | (13,959) | | | **(13,959)** |
| Share based compensation expense | | | | | 5,432 | | | | **5,432** |
| Net loss | | | | | | | (8,515) | (420) | **(8,935)** |
| **Balance at December 31, 2017** | | **62,852** | **$ 400,812** | **$ —** | **$ 5,432** | **$ (8,358)** | **$ (115,212)** | **$ (484)** | **$ 282,190** |

See accompanying notes to the consolidated financial statements.

## SOURCE ENERGY SERVICES LTD.
**Consolidated Statement of Cash Flows**

(All amounts are in thousands of Canadian dollars, unless otherwise noted)

| | Note | 2018 | 2017 |
|---|---|---|---|
| **Cash Flows Provided by (Used in) Operating Activities** | | | |
| Net income (loss) | | $ (2,865) | $ (8,935) |
| Adjusted for the following: | | | |
| provided by (used in) operating activities: | | | |
| Depreciation and depletion | | 32,283 | 18,508 |
| Share based compensation | 13 | 2,403 | 6,625 |
| Loss (gain) on sale of assets | | 4,640 | (6) |
| Finance expense | 19 | 20,961 | 28,342 |
| Onerous lease costs | | — | 324 |
| Gain on settlement of deferred revenue | | — | (703) |
| Deferred income taxes | 9 | 1,169 | (2,179) |
| Unrealized gain on derivative liability | | (1,503) | (1,581) |
| Proceeds on contract liabilities, net of satisfaction of performance obligations | | 5,026 | (861) |
| Payments for share based compensation | | (371) | — |
| Payment on foreign exchange collars | | (87) | — |
| Payments made for decommissioning provision | 11 | (2,142) | (1,226) |
| Net changes in non-cash working capital | 5 | 16,324 | (31,830) |
| Cash flows provided by (used by) operating activities | | $ 75,838 | $ 6,478 |
| **Investing Activities** | | | |
| Purchase of Preferred Sands assets | | $ — | $(110,149) |
| Purchase of Sand Products Wisconsin, LLC | | — | (59,914) |
| Purchase of property, plant and equipment | | (67,978) | (50,515) |
| Proceeds on disposal of property, plant and equipment | | 2,373 | 41 |
| Net changes in non-cash working capital | 5 | (3,713) | 6,168 |
| Cash flows used in investing activities | | $ (69,318) | $(214,369) |
| **Financing Activities** | | | |
| Proceeds on IPO, net of commissions | | $ — | $ 161,914 |
| Proceeds on share issuance, net of transaction costs | | — | 88,384 |
| Proceeds on (repayment of) long-term debt | | (34,289) | 20,569 |
| Repurchase and cancellation of shares under NCIB | 12 | (1,301) | — |
| Proceeds on (repayment of) senior secured notes | | 50,378 | (22,290) |
| Payments made to preferred shareholders | | — | (17,250) |
| Amount paid for EEPP | | — | (409) |
| Payment of Sand Royalty loan | | — | (4,670) |
| Repayment of finance lease obligations | | (1,148) | (1,227) |
| Financing expense paid | | (15,586) | (17,130) |
| Cash flows provided by financing activities | | $ (1,946) | $ 207,891 |
| Increase (decrease) in cash | | $ 4,574 | $ — |
| Cash and cash equivalents, beginning of period | | — | — |
| **Cash and cash equivalents, end of period** | | $ 4,574 | $ — |

See accompanying notes to the consolidated financial statements.

## 1. GENERAL DESCRIPTION OF BUSINESS

Source is a fully integrated producer, supplier and distributer of high quality Northern White frac sand. Source provides its customers with a full end-to-end solution supported by its Wisconsin mines and processing facilities, its Western Canadian terminal network and its "last mile" logistics capabilities. In addition to its industry leading frac sand transload terminal network and in-basin frac sand storage capabilities, Source also provides storage and logistics services for other bulk oil and gas well completion materials that aren't produced by Source. Source has also developed Sahara, a proprietary wellsite mobile sand storage and handling system. The Company's head and principal office is located at 500, 438 – 11$^{th}$ Avenue SE, Calgary, Alberta, T2G 0Y4.

On April 13, 2017, the Company completed an initial public offering ("IPO") and issued 16,666,667 common shares for proceeds of $175,000 and began trading on the Toronto Stock Exchange, under the symbol "SHLE". In connection with the IPO, the existing SES Canada LP and SES US LP partnership units were exchanged for units of SESL common stock, refer to Note 12 for further detail.

## 2. BASIS OF PRESENTATION

**Statement of compliance**

The consolidated financial statements were prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and interpretations of the International Financial Reporting Interpretations Committee ("IFRIC").

The policies applied in these consolidated financial statements are based on IFRS issued and outstanding as at March 14, 2019, the date of the final approval of the financial statements by the Board of Directors.

**Basis of measurement**

The consolidated financial statements have been prepared on a historical cost basis, except for the revaluation of certain financial assets and liabilities to estimated fair value.

**Use of estimates and judgments**

The preparation of the consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates. Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future years affected.

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***

The Company 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. A provision for doubtful accounts is established based on the expected credit loss model under IFRS 9.

***Inventories***

The Company 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 resources. Depletion is recorded on a per tonne basis as the reserves are mined.

***Decommissioning liabilities***

The amounts recorded for decommissioning liabilities are based on the Company's mining activities and the estimated costs to abandon and reclaim the land and facilities, the estimated time period in which these costs will be incurred in the future and the discount and inflation rates. Any changes to these estimates could change the amount of decommissioning liability and may materially impact the consolidated financial statements in future periods.

***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. Legislation and regulations in the various jurisdictions that the Company operates in are subject to change and differing interpretations require management judgment. Income tax filings are subject to audits, re-assessments and changes in facts, circumstances and interpretations of the standards could result in a material change in the Company's provision for income taxes. As such, income taxes are subject to measurement uncertainty.

**Share 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. At the annual general meeting on May 3, 2018, the Shareholders approved a long term incentive program that provides for the settlement of RSUs and PSUs in Common Shares or cash. DSUs, RSUs and PSUs can be settled for cash payments and accordingly are considered a liability settled award for accounting purposes.

***Cash-Generating Units (CGUs)***

The determination of CGUs is based on management's judgment regarding geographical proximity, shared equipment, and mobility of equipment. Management has determined that the Company's operations represent one CGU.

***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 (CGUs). Prior impairments of non-financial assets 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. Embedded derivatives are separated from the contract and accounted for as derivative liabilities or assets. Embedded derivatives are measured at Fair Value Through Profit or Loss (FVTPL). The fair value of the derivatives may be based on prices or valuation techniques that require inputs 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.

## 3. SIGNIFICANT ACCOUNTING POLICIES

### Inventories

Inventories represent unprocessed mined sand, work in process and sand available for shipment, as well as spare parts and supplies. The Company values inventory at the lower of cost or net realizable value.

Cost is determined using the weighted average cost method. Cost includes the cost of mining of the sand as well as the direct labor costs, utility costs, transportation costs, and other processing costs to wash and dry the sand, as well as depreciation directly attributable to production equipment and depreciation of capitalized stripping activities.

Net realizable value is the estimated selling price less applicable selling expenses. When the weighted average cost of inventories exceeds the net realizable value, inventory is written down to the net realizable value. All write downs are charged to cost of goods sold. The amount of the write down may be reversed (up to original amount of the write down) when there is a change in the economic circumstances.

### Foreign currency translation

The consolidated financial statements are presented in Canadian dollars, which is the Company's presentation currency. Each entity of the consolidated statements is measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The financial statements of the entities that have a different functional currency are translated into Canadian Dollars. Assets and liabilities are translated at the rate of exchange at the statement of financial position date, revenue and expenses are translated at the average exchange rate for the period (as this is considered a reasonable approximation of actual rates), and gains and losses in translation are recognized in shareholders' equity as a cumulative translation adjustment.

Foreign currency transactions in entities that have Canadian Dollars as the functional currency are translated into the functional currency using the exchange rate prevailing on the transaction date. Foreign exchange gains and losses resulting from the settlement of foreign currency translation and from the translation at period-end exchange rates of monetary assets and liabilities denominated in currencies other than an entity's functional currency are recognized in the Consolidated Statements of Operations and Comprehensive Income (Loss).

### Mineral resources

Mineral resources are recognized at cost, which approximates the estimated fair value as of the date of the acquisition. Fair value at the acquisition date is determined by estimating the present value of the raw resources over the life of the mine. These cash flows are discounted at a rate based on the time value of money and risks specific to the Company.

### Property, plant and equipment

All costs directly associated with the purchase and development of property, plant and equipment are capitalized and reflected at cost less accumulated depreciation and net impairment losses. Costs of replacing parts of property, plant and equipment are capitalized only when they increase the future economic benefits embodied in the specific assets to which they relate. All other expenditures are recognized in income as incurred. The carrying amount of any replaced or sold component is derecognized. The costs of the day-to-day servicing of property and equipment are recognized in the Consolidated Statements of Operations and Comprehensive Income (Loss) as incurred.

Exchanges or swaps of property, plant and equipment are measured at fair value unless the transaction lacks commercial substance or neither the fair value of the asset received nor the asset given up can be reliably estimated. When fair value is not used, the cost of the acquired asset is measured at the carrying amount of the asset given up. Any gains or losses from the divestiture of property and equipment are recognized in the Consolidated Statements of Operations and Comprehensive Income (Loss).

Depreciation of property, plant and equipment is provided using the straight line method at the following annual rates approximating their estimated useful lives in years:

| | |
|---|---|
| Buildings | 20 |
| Equipment | 7 - 15 |
| Vehicles | 5 - 7 |
| Computer hardware and software | 3 - 5 |

Depreciation of an asset or an asset under construction begins when it is available for use. Depreciation of an asset ceases at the earlier of the date that the asset is classified as held for sale and the date that the asset is derecognized. Depreciation does not cease when the asset becomes idle or is retired from active use unless the asset is fully depreciated.

The Company allocates the amount initially recognized in respect of an item of property and equipment to its significant components and depreciates separately each such component where applicable.

The Company adheres to IFRIC 20 "stripping costs in the production phase of a surface mine". During the production phase of the mine, stripping costs incurred that provide access to a component of reserves that will be produced in future periods and that would not have otherwise been accessible are capitalized. The costs qualifying for capitalization are those costs directly incurred to perform the stripping activity that improves access to the resource body. The stripping activity asset is included as part of the carrying amount of the mining property. Capitalized stripping costs are amortized on a straight-line basis over the production period it relates to.

**Impairment of non-financial assets**

The carrying amounts of the Company's non-financial assets, other than deferred tax assets, are reviewed for indicators of impairment at each reporting period. If indicators of impairment exist, the recoverable amount of the assets is estimated. For purposes of assessing impairment, property, plant and equipment and intangibles are grouped into cash-generating units ("CGUs"), defined as the lowest levels for which there are separately identifiable independent cash inflows.

The recoverable amount of a CGU is the greater of its fair value less costs to dispose and its value in use. Fair value is determined to be the amount for which the asset would be sold in an arm's length transaction between knowledgeable and willing parties. Value in use is determined by estimating the present value of the future net cash flows to be derived from the continued use of the cash-generating unit in its present form. These cash flows are discounted at a rate based on the time value of money and risks specific to the CGU.

An impairment loss is recognized if the carrying amount of an asset or its CGU exceeds its recoverable amount. An impairment loss recognized in respect of a CGU is allocated to reduce the carrying amounts of the assets in the CGU on a pro rata basis. Impairment losses are recognized in Consolidated Statements of Operations and Comprehensive Income (Loss).

Impairment losses recognized in prior years are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

**Provisions and contingent liabilities**

Provisions are recognized by the Company when all of the following apply: (i) it has a legal or constructive obligation as a result of past events, (ii) it is probable that an outflow of economic resources will be required to settle the obligation, and (iii) a reliable estimate can be made of the amount of that obligation. The obligation is not recorded and is disclosed as a contingent liability if any of the following apply: (i) it is not probable that an outflow will be required, (ii) the amount cannot be estimated reliably, or (iii) the existence of the outflow can only be confirmed by the occurrence of a future event.

**Decommissioning provision**

Decommissioning provision is recognized for decommissioning and restoration obligations associated with the Company's mining reserves. The best estimate of the expenditure required to settle the present obligations at the statement of financial position date is recorded on a discounted basis using the pre-tax risk-free interest rate at each reporting date. The future cash flow estimates are adjusted to reflect the risks specific to the liability. The value of the provision is added to the carrying amount of the associated property, plant and equipment asset and is depreciated over the useful life of the asset. The provision is accreted over time through charges to finance expenses. Changes in the future cash flow estimates resulting from revisions to the estimated timing or amount of undiscounted cash flows or the discount rate are recognized as changes in the decommissioning provision and related assets. Actual decommissioning expenditures up to the recorded liability at the time are charged against the provision as the costs are incurred. Any differences between the recorded liability and the actual costs incurred are recorded as a gain/loss in the Consolidated Statements of Operations and Comprehensive Income (Loss).

**Income taxes**

Current and deferred income tax expenses are recognized in the Consolidated Statements of Operations and Comprehensive Income (Loss) except to the extent that it relates to items recognized directly in equity or other comprehensive income.

Current income taxes for current and prior periods are measured at the amount expected to be payable or recoverable from the taxation authorities based on the income tax rates enacted at the end of the period

Deferred income tax is recognized using the liability method, providing for temporary differences between the carrying amounts of assets and liabilities and the carrying amounts used for taxation purposes. Deferred income tax liabilities are generally recognized for all taxable temporary differences. Deferred tax assets are recognized for all temporary differences deductible to the extent future recovery is probable. The carrying amount of deferred income tax assets is reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable income will be generated to allow for all or part of the asset to be recovered. Deferred income tax balances are calculated using enacted or substantively enacted tax rates. Deferred income tax balances are adjusted to reflect changes in income tax rates that are enacted or substantively enacted with the adjustment being recognized in the period the change occurs, except items recognized in equity.

Deferred tax assets and liabilities are offset if both of the following thresholds are met: (i) there is a legally enforceable right to offset, and (ii) the deferred tax assets and liabilities either relate to income taxes levied by the same taxation authority on the same taxable entity, or the deferred tax assets and liabilities relate to income taxes levied by the same taxation authority on different taxable entities where such different taxable entities either intend to settle current tax liabilities and assets on a net basis, or will have their tax assets and liabilities realized simultaneously.

Deferred income tax is not recognized on the initial recognition of assets or liabilities in a transaction that is not a business combination when, at the time of the transaction, such deferred income tax does not affect either accounting income or taxable income.

**Leases**

Leases that transfer substantially all of the benefits and risks of ownership to the Company are accounted for at the commencement of the lease term as finance leases and are recorded as property, plant and equipment at the fair value of the leased asset, or, if lower, at the present value of the minimum lease payments, together with an offsetting liability. Finance charges are allocated to each period so as to achieve a constant rate of interest on the remaining balance of the liability and are charged directly against income. Capitalized leased assets are amortized over the shorter of the estimated useful life of the asset or the lease term. All other leases are accounted for as operating leases and the lease costs are expensed as incurred.

**Revenue recognition**

The Company's revenue, which is comprised principally of sand sales and other services, is generally subject to contractual arrangements, which specify price and general terms and conditions. The Company recognizes sand sales when the risks and rewards of ownership of goods have been transferred to the customer and it is probable that the economic benefits associated with the transaction will flow to the Company. The Company also considers if it has retained any material involvement in the sand being sold and if the revenue and costs related to the sale can be measured reliably.

Revenue for third party sand and chemical distribution is recognized based on contractual arrangements or when services have been completed. Revenue for wellsite solutions is recognized when services are provided. Revenue for rental of tanks is recognized on a monthly basis.

**Finance income and expenses**

Finance income, consisting of interest income, is recognized as it accrues in the Consolidated Statements of Operations and Comprehensive Income (Loss), using the effective interest method.

Finance expense comprises interest expense on borrowings, costs incurred to obtain financing and impairment losses recognized on financial assets. Amounts paid to financial institutions for the purpose of borrowing funds are capitalized upon recognition and are offset against the outstanding obligation to the financial institution. These costs are amortized over the remaining term of the facility placed.

Borrowing costs are recognized in the Consolidated Statements of Operations and Comprehensive Income (Loss) in the period in which they are incurred using the effective interest method.

**Segment Reporting**

An operating segment is a component of the Company that engages in business activities from which it may earn revenues and incur expenses. The Company has one operating segment.

**Earnings (Loss) per Share**

Earnings (Loss) per Share is calculated by dividing the profit or loss attributable to common and Class B shareholders of the Company by the weighted average number of common shares and Class B shares outstanding during the period. Diluted earnings per share is calculated by adjusting the earnings and number of shares for the effects of dilutive options and other dilutive potential shares. The effects of anti-dilutive potential shares are ignored in calculating diluted earnings per share. All options are considered anti-dilutive when the Company is in a loss position.

**Common Control Transactions**

Business combinations involving entities under common control are excluded from IFRS 3, Business Combinations. As there is no specific guidance in IFRS, management has selected an accounting policy that is consistent with IAS 8, Accounting policies. 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.

**Basis of consolidation**

The consolidated financial statements include the accounts of Source Energy Services Ltd. and its subsidiaries, which are entities over which Source has control. Control exists when the Company is exposed to, or has right to, variable returns from its involvement with an entity and has the ability to affect those returns through its power over the entity. Subsidiaries are consolidated from the date of acquisition, being the date on which the Company obtains control, and continue to be consolidated until the date that such control ceases. The financial statements of the subsidiaries are prepared for the same reporting period as Source, and the accounting policies are aligned with the policies adopted by Source. All intercompany balances and income and expenses have been eliminated upon preparation of the consolidated financial statements. All subsidiaries are 100% owned, with the exception of Source Energy Services Canada LP, which has a 3.74% non-controlling interest.

**Non-controlling interests**

Non-controlling interests represent equity interests in subsidiaries owned by outside parties. The share of net assets of subsidiaries attributable to non-controlling interests is presented as a component of equity. Losses applicable to the non-controlling interests in a subsidiary are allocated to the non-controlling interests, even if doing so causes the non-controlling interests to have a deficit balance.

**Share-based payments**

The Company's Share Based Payment Plan, effective as of April 13, 2017, is available to directors, officers and certain employees as determined by the Company's Board of Directors. The Plan allows for the granting of options to purchase Common shares to a maximum number equal to 10% of the issued and outstanding Common Shares of the Company. The price of each share purchase option granted is set by the Company's Board of Directors based on the market value of the Company's shares on the date of the grant.

At each statement of financial position date before vesting, the cumulative expense is calculated, representing the extent to which the vesting period has expired and management's best estimate of the number of equity instruments that will ultimately vest.

The fair value of options is measured by using the Black-Scholes model. The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. The model requires the input of highly subjective assumptions. Expected volatility of the stock is based on a combination of the historical stock price of the Company and comparable companies in the industry. The expected term of options represents the period of time that options granted are expected to be outstanding. The risk-free rate is based on the Government of Canada's Canadian Bond Yields with a remaining term equal to the expected life of the options used in the Black-Scholes valuation model.

The Company has also granted Deferred Stock Units, Restricted Stock Units and Performance Stock Units ("DSUs", "RSUs" and "PSUs") to directors and certain employees. The DSUs, RSUs and PSUs are expected to be settled for cash payment and accordingly are considered a liability settled award for accounting purposes.

**Financial Instruments**

(i) ***Classification and measurement***

***Recognition***

Financial assets and liabilities are generally initially recognized at fair value when the Company becomes a party to the contractual provisions of the instrument. However, where the fair value differs on initial recognition from the transaction price and the fair value is not measured using entirely observable inputs the instrument is recognized at the transaction price. In the case of instruments not measured at fair value through profit and loss, incremental, directly attributable transaction costs are accounted for as an adjustment to the carrying amount and in all other cases such transaction costs are expensed as incurred.

The Company evaluates contracts to purchase non-financial items which are subject to net settlement (whether explicitly or in substance) to determine if such contracts should be considered derivatives or if they were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements (“Own Use”). If such contracts qualify as “Own Use” they are considered executory contracts outside the scope of financial instrument accounting.

The Company evaluates financial and non-financial contracts not measured at fair value through profit and loss to determine whether they contain embedded derivatives. An embedded derivative is a component of a hybrid (consolidated) instrument that also includes a non-derivative host contract with the effect that some of the cash flows of the consolidated instrument vary in a way similar to a stand-alone derivative. For such instruments, an embedded derivative is separated where the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract and a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative.

Financial assets and liabilities are not offset unless they are with a counterparty for which the Company has a legally enforceable right to settle the financial instruments on a net basis and the Company intends to settle on a net basis.

The fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Company discloses more details about fair value of financial instruments in Note 4.

***Derecognition***

Financial assets are derecognized when the rights to receive cash flows from the assets have expired or it transfers the financial instrument in a manner that qualifies for derecognition through transfer of substantially all risks and rewards or transfer of control.

Financial liabilities are derecognized upon extinguishment. A modification of a financial liability with an existing lender is evaluated to determine whether the amendment results in substantially different terms in which case it is accounted for as an extinguishment.

***Classification***

The financial instruments of the Company are classified in the following categories: fair value through profit or loss (which includes financial assets and financial liabilities), loans and receivables, available-for-sale, derivative liabilities and other financial liabilities. The classification depends on the nature and purpose of the financial instrument and is determined at the time of initial recognition.

Financial assets and financial liabilities acquired principally for the purpose of selling or repurchasing in the short term are classified as “fair value through profit or loss” and are recognized initially at fair value with changes in fair value recognized in the Consolidated Statements of Operations and Comprehensive Income (Loss).

Financial assets classified as “loans and receivables” are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are initially measured at fair value and subsequently carried at amortized cost using the effective interest method of amortization. The Company’s loans and receivables are comprised of cash, accounts receivable, and due from (to) related parties.

Financial assets and liabilities classified as “available-for-sale” are measured at fair value, with changes in fair value recognized in other comprehensive income. Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. The Company has no available-for-sale financial assets.

Other financial liabilities include accounts payable and accruals and long-term debt. Financial instruments in this category are initially recorded at fair value, net of any transaction costs incurred, and subsequently carried at amortized cost using the effective interest method.

(ii) ***Equity instruments***
The Company's common units are classified as equity. Incremental costs directly attributable to the issue of common units are recognized as a reduction from equity. Company units which have redemption rights and include fixed annual returns have been classified as long-term liabilities.

(iii) ***Impairment***
At each statement of financial position date, the Company assesses whether there is objective evidence that financial assets, other than those designated as "fair value through profit or loss" are impaired. When impairment has occurred, the cumulative loss is recognized in the Consolidated Statements of Operations and Comprehensive Income (Loss). For financial assets carried at amortized cost, the amount of the impairment loss recognized is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate. When an available-for-sale financial asset is considered to be impaired, cumulative gains or losses previously recognized in other comprehensive income are reclassified to the Consolidated Statements of Operations and Comprehensive Income (Loss) in the period. Impairment losses may be reversed in subsequent periods.

**Newly Adopted Accounting Policies**

***Financial assets***

On January 1, 2018, the Company adopted IFRS 9 Financial Instruments, which replaced IAS 39 "Financial Instruments: Recognition and Measurement". The Company's trade receivables are subject to the expected credit loss model under IFRS 9. The Company applies the simplified approach of providing for expected credit losses, which requires the use of the lifetime expected loss provision for trade receivables. The adoption of IFRS 9 did not result in a significant change to the Company's consolidated financial statements.

The Company classifies and measures Financial Assets as follows:

*Classification*

The Company classifies its financial assets in the following measurement categories:

i. those to be measured subsequently at fair value (either through other comprehensive income, or through profit or loss), and

ii. those to be measured at amortized cost. The classification depends on the Company's business model for managing the financial assets and the contractual terms of the cash flows. For assets measured at fair value, gains and losses will either be recorded in profit or loss or other comprehensive income. The Company reclassifies debt investments and financial assets when and only when its business model for managing those assets changes.

*Measurement*

At initial recognition, the Company measures a financial asset at its fair value plus transaction costs that are directly attributable to the acquisition of the financial asset. Transaction costs of financial assets carried at fair value through profit or loss are expensed in profit or loss. Financial assets with embedded derivatives are considered in their entirety when determining their fair value. Subsequent measurement of financial assets depends on the Company's business model for managing the asset and the cash flow characteristics of the asset.

There are three measurement categories into which the Company classifies its financial assets:

i. Amortized cost: Assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest are measured at amortized cost. Interest income from these financial assets is included in finance income using the effective interest rate method. Any gain or loss arising on derecognition is recognized directly in profit or loss and presented together with foreign exchange gains and losses. Impairment losses are presented as separate line item in profit or loss.

ii. Fair value through other comprehensive income: Assets that are held for collection of contractual cash flows and for selling the financial assets, where the assets' cash flows represent solely payments of principal and interest, are measured at fair value through other comprehensive income. Movements in the carrying amount are taken through other comprehensive income, except for the recognition of impairment gains or losses, interest revenue and foreign exchange gains and losses which are recognized in profit or loss. When the financial asset is derecognized, the cumulative gain or loss previously recognized in other comprehensive income is reclassified from equity to profit or loss and recognized in other gains and losses. Interest income from these financial assets is included in finance income using the effective interest rate method.

Foreign exchange gains and losses are presented in other gains or losses and impairment expenses are presented as a separate line item in profit or loss.

iii. Fair value through profit or loss: Assets that do not meet the criteria for amortized cost or fair value through other comprehensive income are measured at fair value through profit or less. A gain or loss on a financial asset that is subsequently measured at fair value through profit or loss is recognized in profit or loss and presented net within other gains or losses in the period in which it arises.

***Revenue recognition***

On January 1, 2018, the Company adopted IFRS 15 *Revenue from Contracts with Customers* which replaced IAS 11 *Construction Contracts*, IAS 18, *Revenue Recognition*, IFRIC 13 *Customer Loyalty Programmes*, 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*. In accordance with the transition provisions in IFRS 15, the Company has adopted the modified retrospective approach. Under the new guidance, the Company now applies the universal five-step model (with limited exceptions – including leases within the scope of IAS 17, and financial instruments and other contractual rights or obligations that are within the scope of IFRS 9) to all its revenue transactions. The Company's revenue, which is comprised principally of sand sales and other services, is generally subject to contractual arrangements, which specify price and general terms and conditions. Under the new standard, the Company has not experienced a material impact in the timing of recognition or measurement of revenue, as revenue has consistently been recognized when each performance obligation is satisfied.

The Company recognizes sand sales when the contractual obligations are satisfied (typically when control of the product is transferred), while also considering if it has retained any material involvement in the sand being sold and if the revenue and costs related to the sale can be measured reliably. The Company has long-term revenue contracts in place with certain customers that include take-or-pay commitments over the term of the contracts, where the Company will recognize revenue as the product is sold, or in accordance with the terms of the contracts. Revenue for third party sand and chemical distribution is recognized based on contractual arrangements or when services have been completed. Revenue for wellsite solutions is recognized when services are provided.

Revenue for rental of storage facilities is outside of the scope of IFRS 15 and is recorded under IAS 17 *Leases*. The revenue is recognized on a monthly basis.

**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, 2019 with earlier application permitted.

***IFRS 16 Leases***

On January 1, 2019, the Company adopted IFRS 16 *Leases*. The new standard requires lessees to recognize a lease liability reflecting future lease payments and a 'right-of-use asset' ("RoU asset") for most lease contracts. The standard permits a 'simplified approach' where the liabilities will be measured at the present value of the remaining lease payments, discounted using the Company's incremental borrowing rate as of January 1, 2019. The associated RoU assets will be measured at the amount equal to the lease liability, with no impact on retained earnings. On initial adoption, the Company will use the following practical expedients permitted by the standard:

- The use of a single discount rate for a portfolio of leases with similar characteristics;
- The accounting of leases with a remaining lease term of less than twelve months as at January 1, 2019 as short-term leases for certain classes of assets;
- The accounting for lease payments as expenses on leases for which the underlying asset is of low dollar value;
- The use of hindsight in determining the lease term where the contract contains options to extend or terminate a lease; and
- The Company will not apply any grandfathering practical expedients.

Adoption of the standard will result in the recognition of additional RoU assets and lease liabilities for leases of approximately $71,000 as at January 1, 2019.

## 4. FINANCIAL INSTRUMENT AND RISK MANAGEMENT

### (a) Risk management overview

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

(All amounts are in thousands of Canadian dollars, unless otherwise noted)

### (b) Fair value of financial instruments

The fair values of cash, accounts receivable, accounts payable and accrued liabilities approximate their carrying values due to the short-term maturity of those instruments. The fair value of the Asset Backed Loan ("ABL") facility approximates the carrying values as it bears interest at market floating rates consistent with market rates for similar debt. Based on the closing market price at December 31, 2018, the fair value of the senior secured notes are $105,017 and $48,750 ($97.50 dollars per $100 dollars).

The Company analyzes financial instruments carried at fair value, by valuation method. The different levels have been defined as follows:

**Level 1:** Values based on unadjusted quoted prices in active markets for identical assets or liabilities, accessible at the measurement date.

**Level 2:** Values based on quoted prices in markets that are not active or model inputs that are observable either directly or indirectly for substantially the full term of the asset or liability.

**Level 3:** Values based on prices or valuation techniques that require inputs for the asset or liability that are not based on observable market data (unobservable inputs).

A financial instrument is classified as Level 3 if one or more of its unobservable inputs may significantly affect the measurement of its fair value. Appropriate inputs are chosen so that they are consistent with market evidence or management judgment. Due to the unobservable nature of the inputs, there may be uncertainty about the value of Level 3 financial instruments.

| | | | Fair Value | |
|---|---|---|---|---|
| December 31, 2018 | Carrying amount | Level 1 | Level 2 | Level 3 |
| **Financial liabilities at Fair value through profit and loss:** | | | | |
| Derivative Liability (Asset) | $ 1,326 | $ — | $ 2,336 | $ (1,010) |
| **Financial liabilities at amortized cost:** | | | | |
| $107.71M of Senior Secured First Lien Notes | $ 96,545 | $ 105,017 | $ — | $ — |
| $50M of Senior Secured First Lien Notes | $ 50,324 | $ 48,750 | $ — | $ — |
| Finance lease obligations – current | $ 516 | $ — | $ 516 | $ — |
| Finance lease obligations – long-term | $ 1,053 | $ — | $ 1,053 | $ — |

| | | | Fair Value | |
|---|---|---|---|---|
| December 31, 2017 | Carrying amount | Level 1 | Level 2 | Level 3 |
| **Financial liabilities at Fair value through profit and loss:** | | | | |
| Derivative Liability | $ 2,799 | $ — | $ 327 | $ 2,472 |
| **Financial liabilities at amortized cost:** | | | | |
| $107.71M of Senior Secured First Lien Notes | $ 93,727 | $ 119,020 | $ — | $ — |
| Finance lease obligations – current | $ 957 | $ — | $ 957 | $ — |
| Finance lease obligations – long-term | $ 726 | $ — | $ 726 | $ — |

### (c) Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations. Substantially all of the Company's accounts receivable are due from purchasers of proppants and logistics services and are subject to normal industry credit risk.

The Company's revenues are generally derived from a group of large and reputable oilfield exploration and production companies and oilfield services customers. Orders for proppants are subject to the Company's credit and collection programs. The five largest customers account for 84% of the revenue for the year ended December 31, 2018, with the three largest making up 74% of revenue (year ended December 31, 2017, five customers accounted for 82%, three customers accounted for 71%). Two of those customers respectively (two for the year ended December 31, 2017) account for 10% or more of total revenue individually in the year ended December 31, 2018.

Significant changes in industry conditions will increase the risk of not collecting receivables. Management believes the risk is materially mitigated by the size and reputation of the companies to which they extend credit. As at December 31, 2018 and December 31, 2017, the Company's Trade Receivables, net of loss allowances were comprised of the following:

(All amounts are in thousands of Canadian dollars, unless otherwise noted)

| As at | December 31, 2018 | December 31, 2017 |
|---|---|---|
| Not yet due | $ 18,172 | $ 26,244 |
| 0-30 days | 3,832 | 18,360 |
| 31 – 60 days | 2,092 | 5,643 |
| 61 – 90 days | 415 | 401 |
| 91+ days | 22 | 3,466 |
| Total Trade Receivables | $ 24,533 | $ 54,114 |

The Company's maximum exposure to credit risk is the fair value of accounts receivable on the balance sheet. The Company performs ongoing credit evaluations of its customers and establishes an allowance for doubtful accounts based on the lifetime expected loss provision. The Company uses an allowance matrix to estimate the credit losses of trade receivables from customers. The matrix considers historical default rates as well as the days past due.

No loss allowance was recorded on transition as the amount was immaterial. As shown by the matrix below, a loss allowance of $35 was recorded as at December 31, 2018.

| December 31, 2018 | Total | Not yet due | 0-30 days | 31-60 days | 61-90 days | 91+ days |
|---|---|---|---|---|---|---|
| Gross carrying amount | $ 24,568 | $ 18,190 | $ 3,840 | $ 2,097 | $ 419 | $ 22 |
| Expected loss rate | | 0.10% | 0.20% | 0.25% | 1.00% | 1.25% |
| **Loss allowance** | **$ 35** | **$ 18** | **$ 8** | **$ 5** | **$ 4** | **$ —** |

### (d) Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they are due. The Company's approach to managing liquidity risk includes preparing operating and capital budgets and forecasts and monitoring performance against the budgets and forecasts. The Company may seek additional financing based on the results of these processes. The Company's ongoing liquidity is impacted by various external events and conditions, including commodity price fluctuations, foreign currency fluctuations, and the global economic conditions.

The financial liabilities on the consolidated statement of financial position consist of accounts payable and accrued liabilities, long-term debt and senior secured notes. The Company manages this risk through detailed monitoring of budgeted and projected operating results and cash requirements.

The Company expects to repay its financial liabilities in the normal course of operations and to fund future operational and capital requirements through operating cash flow, as well as future debt and equity financings. The Company also has a credit facility to facilitate the management of liquidity risk.

The Company's contractual cash outflows relating to financial liabilities are outlined in the table below:

| As at December 31, 2018 | Total | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 and beyond |
|---|---|---|---|---|---|---|---|
| Accounts payable and accruals | $ 35,989 | $ 35,989 | $ — | $ — | $ — | $ — | $ — |
| Finance Leases[(b)] | $ 1,763 | $ 594 | $ 386 | $ 231 | $ 427 | $ 125 | $ — |
| Credit Facilities[(a)] | $ — | $ — | $ — | $ — | $ — | $ — | $ — |
| Notes Payable[(b)] | $ 206,664 | $ 16,560 | $ 16,560 | $ 173,544 | $ — | $ — | $ — |

**Notes:**
(a) The timing and amount of interest payments on such balances will fluctuate depending on balances outstanding and applicable interest rates.
(b) Includes interest for future periods.

### (e) Market risk

Market risk is the risk that changes in market prices, foreign exchange rates and interest rates will affect the Company's net earnings or the value of financial instruments and are largely outside the control of the Company. The objective of the Company is to manage and mitigate market risk exposures within acceptable limits, while maximizing returns. Primary market risks are as follows:

***Foreign currency risk***

The Company is exposed to currency price risk on sales denominated in U.S. dollars to the extent that the receipt of payment of the U.S. denominated accounts receivable are subject to fluctuations in the related foreign exchange rate. In addition, foreign currency risk exists on cost of manufacturing of 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, 2018 are $14,348 (December 31, 2017 - $34,136) and $24,467 (December 31, 2017 - $18,937) denominated in foreign currency respectively. The net effect of each 1% change in foreign exchange would impact net income (loss) by $516 for the year ended December 31, 2018 ($409 in 2017).

(All amounts are in thousands of Canadian dollars, unless otherwise noted)

The Company has a customer contract, expiring March 31, 2020, 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 or asset 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. The inputs used for the valuation are the notional value of the contract, the US dollar discount curve obtained from Bloomberg, and the US dollar to Canadian dollar foreign exchange forward curve, the US dollar to Canadian dollar foreign exchange volatility matrix and US dollar to Canadian dollar spot rate obtained from Thomson Reuters. The fair value of the derivative asset as at December 31, 2018 is $1,010 (December 31, 2017 - derivative liability of $2,472).

During the second quarter of 2018, the Company entered into the following foreign exchange rate collars to help mitigate the risk associated with the embedded derivative contained in the above customer contract. The fair value of the derivative is based on the US dollar to Canadian dollar foreign exchange forward curve.

| Notional amount of Contract (per month) | Exchange rate floor | Notional amount of Contract (per month) | Exchange rate ceiling | Contract expiry |
|---|---|---|---|---|
| USD $1,500 | 1.25 | USD $3,000 | 1.36 | April 30, 2020 |
| USD $1,500 | 1.25 | USD $3,000 | 1.40 | April 30, 2020 |

***Interest rate risk***

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Company is exposed to interest rate risk to the extent that changes in market interest rates impact its borrowings under the floating rate credit facility. The Company is exposed to interest rate price risk on the long-term debt that bear interest at floating rates. The net effect of each 1% change in market interest rates would impact the related interest expense (income) for the Company's floating rate borrowings by $nil at December 31, 2018 and $338 at December 31, 2017. The Company had no interest rate swaps or financial contracts in place as at or during the periods ended December 31, 2018 and December 31, 2017.

**(f) Capital management**

The Company's capital management policy is to maintain a strong capital base that optimizes the Company's ability to grow, maintain shareholder and creditor confidence and to provide a platform to create value for its common shareholders. The Company's management is responsible for managing the Company's capital and does so through regular reviews of financial information including budgets and forecasts. The Company's Directors are responsible for overseeing this process. The Company considers its capital structure to include equity, senior secured notes, and its credit facility.

The Company monitors capital based on its current working capital, available bank line, projected cash flow from operations and anticipated capital expenditures. In order to manage its capital structure, the Company prepares annual capital expenditure and operating budgets, which are updated as necessary. The annual and updated budgets are prepared by the Company's management and approved by the Company's Board of Directors.

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

The Company's share capital is not subject to external restrictions; however, the amount of the bank operating facility available for use is determined by levels of accounts receivable and inventory.

The Company is subject to externally imposed capital requirements for the asset backed loan facility, requiring the Company to maintain a springing fixed charge ratio of (a) 1.10:1 up to and including June 30, 2017, and then (b) 1.25:1 at all times thereafter to be measured when Source's excess availability is less than 20% of the lesser of the borrowing base and the operating facility. The fixed charge coverage ratio is defined as the ratio of (i) Earnings before interest, tax, depreciation and amortization for the twelve calendar months ending at such fiscal quarter end less unfinanced capital expenditures, cash taxes and distributions to (ii) the interest expense paid in cash plus the amount of debt which has a scheduled due date or is otherwise required to be repaid or paid for the twelve calendar months ending at such fiscal quarter end. As of December 31, 2018, the excess availability was greater than 20%.

The Company's capital management policy has not changed during the periods ended December 31, 2018 or December 31, 2017.

(All amounts are in thousands of Canadian dollars, unless otherwise noted)

## 5. SUPPLEMENTAL CASH FLOW INFORMATION

Changes in non-cash operating assets and liabilities for the years ended December 31, 2018 and 2017 are as follows:

| | | **2018** | | **2017** |
|---|---|---|---|---|
| Accounts receivable | $ | 31,905 | $ | (38,024) |
| Prepaid expenses and deposits | | (3,034) | | (1,251) |
| Inventory | | (10,371) | | (7,589) |
| Accounts payable and accrued liabilities | | (2,176) | | 15,034 |
| **Changes in non-cash working capital** | $ | 16,324 | $ | (31,830) |

Included in change in inventory is $4,785 for 2018 (2017 - $471) related to depreciation for sand producing equipment.

Changes in non-cash investing assets and liabilities for the years ended December 31, 2018 and 2017 are as follows:

| | | **2018** | | **2017** |
|---|---|---|---|---|
| Accounts payable and accrued liabilities | $ | (3,713) | $ | 6,168 |
| Changes in non-cash working capital | $ | (3,713) | $ | 6,168 |

| | | Senior Secured Notes | | Additional Senior Secured Notes | | Asset backed loan facility | | Finance lease obligations |
|---|---|---|---|---|---|---|---|---|
| As at December 31, 2017 | $ | 93,727 | $ | — | $ | 32,735 | $ | 1,683 |
| *Cash changes:* | | | | | | | | |
| Proceeds | | — | | | | 112,409 | | — |
| Proceeds, net of transaction costs and premium | | — | | 50,378 | | — | | — |
| Repayments | | — | | — | | (146,711) | | (1,148) |
| *Non-cash and other changes:* | | | | | | | | |
| Accretion | | 2,818 | | (54) | | 355 | | — |
| Finance lease additions | | — | | — | | — | | 964 |
| Unrealized foreign exchange (gain) loss | | — | | — | | 1,027 | | 70 |
| Financing costs incurred | | — | | — | | (292) | | — |
| As at December 31, 2018 | $ | 96,545 | $ | 50,324 | $ | (477) | $ | 1,569 |

## 6. INVENTORIES

Inventory consists of three main classifications

| As at, | | **December 31, 2018** | | **December 31, 2017** |
|---|---|---|---|---|
| Unprocessed sand and work in progress | $ | 37,944 | $ | 29,093 |
| Sand available for shipment | | 25,142 | | 16,258 |
| Spare parts and supplies | | 4,267 | | 3,633 |
| **Total inventories** | **$** | **67,353** | **$** | **48,984** |

Spare parts and supplies are for routine facilities maintenance. Included in the inventory balance is the depreciation expense related to sand producing properties of $8,514 as at December 31, 2018 (December 31, 2017 - $3,729). The total amount of inventory expensed through cost of sales during the year was $255,827 (December 31, 2017 - $171,451). No inventory write-downs or reversals of prior write-downs were recorded during the years ended December 31, 2018 and 2017.

(All amounts are in thousands of Canadian dollars, unless otherwise noted)

## 7. MINERAL RESOURCES

| | December 31, 2018 | December 31, 2017 |
|---|---|---|
| **Balance, Beginning of period** | **$ 31,506** | **$ —** |
| Mineral resources acquired | — | 32,224 |
| Depletion | (1,554) | (114) |
| Exchange differences | 1,102 | (604) |
| **Balance, End of Period** | **$ 31,054** | **$ 31,506** |

Mineral resources were acquired as part of the asset purchase for certain assets and operations of Preferred Proppants, LLC. Depletion is based on the units of production method.

## 8. PROPERTY, PLANT AND EQUIPMENT

| | Land & Building | Equipment & Vehicles | Other | Construction in Progress | Total |
|---|---|---|---|---|---|
| **Cost** | | | | | |
| Balance as at December 31, 2016 | $ 113,870 | $ 80,584 | $ 5,166 | $ 16,792 | $ 216,412 |
| Additions | 80,518 | 59,390 | 286 | 33,933 | 174,127 |
| Disposals | — | (130) | — | (41) | (171) |
| Exchange Differences | (8,279) | (5,487) | (198) | (655) | (14,619) |
| Balance as at December 31, 2017 | $ 186,109 | $ 134,357 | $ 5,254 | $ 50,029 | $ 375,749 |
| Additions | 4,502 | 5,119 | 335 | 55,589 | 65,545 |
| Disposals | (4,670) | (2,995) | (69) | (1,510) | (9,244) |
| Completed Construction in Progress | 21,374 | 38,142 | 225 | (59,741) | — |
| Transfers | — | (9) | — | — | (9) |
| Exchange Differences | 13,509 | 10,116 | 260 | 1,972 | 25,857 |
| Balance as at December 31, 2018 | $ 220,824 | $ 184,730 | $ 6,005 | $ 46,339 | $ 457,898 |

| | | | | | |
|---|---|---|---|---|---|
| **Accumulated Depreciation** | | | | | |
| Balance as at December 31, 2016 | $ (17,598) | $ (21,764) | $ (3,560) | $ — | $ (42,922) |
| Depreciation | (6,762) | (7,887) | (512) | — | (15,161) |
| Disposals | — | 76 | — | — | 76 |
| Exchange Differences | 931 | 1,031 | 185 | — | 2,147 |
| Balance as at December 31, 2017 | $ (23,429) | $ (28,544) | $ (3,887) | $ — | $ (55,860) |
| Depreciation | (11,192) | (16,697) | (527) | — | (28,416) |
| Disposals | 323 | 1,234 | 30 | — | 1,587 |
| Transfers | — | 9 | — | — | 9 |
| Exchange Differences | (1,832) | (2,208) | (239) | — | (4,279) |
| Balance as at December 31, 2018 | $ (36,130) | $ (46,206) | $ (4,623) | $ — | $ (86,959) |
| **Carrying Amounts** | | | | | |
| December 31, 2017 | $ 162,680 | $ 105,813 | $ 1,367 | $ 50,029 | $ 319,889 |
| December 31, 2018 | $ 184,694 | $ 138,524 | $ 1,382 | $ 46,339 | $ 370,939 |

Assets under construction represent facilities that are being built at period end. Assets under construction are not amortized until the asset is deemed to be ready for use. Once deemed ready for use, the assets under construction will be allocated to their corresponding capital asset group and commence depreciating.

As there was an impairment indicator present at December 31, 2018, the Company performed an impairment analysis using both a discounted cash flow impairment analysis over five years as well as a review of comparable market multiples and concluded that there was no impairment (December 31, 2017 - $nil). The discounted cash flow projections were based on Board approved budgets and cash flow forecast, trailing twelve-month earnings before interest, taxes, depreciation and amortization, historical experience, actual operating results and industry trends and forecasts. Key assumptions included a terminal growth rate of 2%, implied multiples utilizing multiples of comparable public companies, a risk adjusted discount rate of 13% and cash flow projections assuming prior acquisitions are fully operational in 2019 as well as assessing current take or pay contracts in place. The Company performed a sensitivity analysis and noted no material impact under the following scenarios: a 2% change in discount rates and a 10% decline in EBITDA.

(All amounts are in thousands of Canadian dollars, unless otherwise noted)

## 9. INCOME TAXES

The only taxable entity of the Company prior to April 13, 2017 was Source Energy Services Canada Holdings Ltd. Upon the April 13, 2017 IPO, additional entities within the Company's structure were taxable entities.

Income tax expense for the Company is calculated by using the combined federal and provincial and state statutory income tax rates. The provision for income tax (deferred and current) differs from that which would be expected by applying statutory rates. A reconciliation of that difference is as follows:

| | Year ended December 31, 2018 | Year ended December 31, 2017 |
|---|---|---|
| Loss before income taxes | $ (1,696) | $ (11,114) |
| Statutory income tax rate | 27.00% | 27.00% |
| Expected income taxes | (458) | (3,000) |
| *Increase (decrease) in taxes from:* | | |
| Non-deductible expenses | 646 | 160 |
| Share based compensation | 570 | 1,467 |
| Unrealized foreign exchange and derivatives | 511 | 70 |
| Unrecognized deferred tax assets movement | (521) | (2,741) |
| Rate differential on foreign activities | 680 | 1,960 |
| Other | (259) | (95) |
| **Total income tax expense (recovery)** | **$ 1,169** | **$ (2,179)** |

Significant components of deferred income tax include:

| | December 31, 2018 | December 31, 2017 |
|---|---|---|
| Difference between tax and reported amounts for depreciable assets | $ (22,175) | $ (13,722) |
| Finance fees | 3,945 | 4,654 |
| Foreign exchange on loans | 2,831 | 2,425 |
| Tax loss carryforwards recognized | 16,027 | 8,019 |
| Decommissioning provision | 4,206 | 3,247 |
| Mine development costs | 902 | — |
| Accretion | — | 1,437 |
| Other | 874 | 1,949 |
| **Deferred income tax asset** | **$ 6,610** | **$ 8,009** |

The movements in deferred tax balances during the period are as follows:

| | December 31, 2018 | December 31, 2017 |
|---|---|---|
| **Opening deferred tax asset** | $ 8,009 | $ 597 |
| Recognized in other comprehensive income | — | 54 |
| Recognized in Equity | — | 5,070 |
| Recognized in Net income | (1,169) | 2,179 |
| Exchange differences | (230) | 109 |
| **Closing deferred tax asset** | $ 6,610 | $ 8,009 |

The deferred income tax assets (liabilities) by jurisdiction are:

| | December 31, 2018 | December 31, 2017 |
|---|---|---|
| Canada | 13,343 | 8,009 |
| Foreign | (6,733) | — |
| **Deferred income tax asset** | **$ 6,610** | **$ 8,009** |

(All amounts are in thousands of Canadian dollars, unless otherwise noted)

The Company has Canadian and foreign non-capital losses as at December 31, 2018 of $29,929 (December 31, 2017 - $6,365) and $27,880 (December 31, 2017 - $21,672) respectively. Canadian and foreign losses expire beginning in 2037.

## 10. LONG-TERM DEBT

| As at | | December 31, 2018 | | December 31, 2017 |
|---|---|---|---|---|
| $107.71M of Senior Secured First Lien Notes, due on December 15, 2021, bearing interest at 10.5% per annum | $ | 96,545 | $ | 93,727 |
| $50M of Senior Secured First Lien Notes, due on December 15, 2021, bearing interest at 10.5% per annum | | 50,324 | | — |
| Asset Backed Loan facility (the "ABL") due December 2020. Interest is based on floating rates dependent upon the amount of the facility used. | | — | | 33,271 |
| Unamortized debt issuance costs for the ABL | | (477) | | (536) |
| Finance Lease obligations related to equipment, bearing interest at rates ranging from 4.25% to 12% per annum, with final payments due between January 2019 and January 2023. | | 1,569 | | 1,683 |
| Other long-term debt | | 538 | | 1,117 |
| | **$** | **148,499** | **$** | **129,262** |
| Less: current portion | | (516) | | (33,692) |
| | **$** | **147,983** | **$** | **95,570** |

On December 8, 2016, the Company issued a $130,000 Senior Secured First Lien Notes (the "Notes") which bear interest at 10.5% per annum, and mature December 15, 2021. The Notes are secured by a fixed and floating charge over all of the assets of the business except Accounts Receivable and Inventory, over which the Notes have a second charge. Each original debt holder was entitled to a relevant right of 4% of the equity value of the Company upon various liquidation or change of control events. The IPO on April 13, 2017 represented a change in control event. The Company elected to settle the rights through share-based payments. On May 29, 2017, 1,005,831 shares were issued at the IPO offering price of $10.50 per share to the registered Noteholders. This issuance extinguished the relevant right derivative liability.

On May 31, 2018, Source issued an additional $50,000 in new senior secured first lien notes with identical interest and repayment terms to the original senior secured first lien notes. The Notes are secured by a fixed and floating charge over all of the assets of the business except Accounts Receivable and Inventory, over which the Notes have a second charge. The new notes were issued at a premium price of $105.75 per $100 to reflect the market premium the original notes were trading at.

There are prepayment options, where the Company can redeem 35% of the aggregate principal amounts of the Notes with the net proceeds of an equity offering by Source at a redemption price of 110.5% of the principal amount. The Company could have also redeemed all or part of the Notes at any time prior to December 15, 2018 for 100% of the principal, accrued and unpaid interest, and the applicable premium as defined in the agreement. After December 15, 2018, 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. The prepayment options have been classified as derivative liabilities and are measured at fair value through profit or loss. The value of the derivative liabilities have been recorded as $nil for the $107,710 notes and $nil for the $50,000 notes as at December 31, 2018 as the Notes were valued below par (December 31, 2017 - $327). Changes in fair value of the derivative liability is recorded through the Consolidated Statements of Operations and Comprehensive Income (Loss). The Company has recorded a fair value gain of $361 on the prepayment option as of December 31, 2018 (December 31, 2017 - $202). The Company exercised a portion of the prepayment option as of June 5, 2017 and repaid $22,290 (17.15%) of the Notes using proceeds from the IPO offering. The $25,784 payment consisted of the principal of $22,290, accrued interest of $1,154 and a make whole premium of 10.5%.

As of May 18, 2018, the ABL was increased from $70,000 to $88,000. On September 14, 2018, the ABL facility was further amended to extend the term for another year to now mature on December 8, 2020 and also to cancel the US$5 million standby letter of credit facility. The $88,000 ABL facility is secured by floating first lien charge on the Accounts Receivable and Inventory of the Company under a general business security agreement and a second lien charge on all other assets of the business. The facilities bear interest based on the bank's prime lending rate, banker's acceptances or LIBOR rates, plus an applicable margin depending on the amount of excess availability. The amount available under the general operating facility is subject to a borrowing base formula applied to accounts receivable and inventories, at December 31, 2018 $nil was drawn under this facility (less unamortized finance costs of $477 for a net balance of $(477)) (December 31, 2017 - $33,765 drawn, less $536 in unamortized finance costs and cash on hand of $494 for a net balance of $32,735). $19,516 ($7,881 at December 31, 2017) was committed to supporting letters of credit under the facility, with $36,228 (December 31, 2017 - $13,019) remaining availability. The borrowing base is updated monthly.

The ABL facility includes a springing fixed charge ratio of (a) 1.10:1 up to and including June 30, 2017, and then (b) 1.25:1 at all times thereafter to be measured when the Company's excess availability is less than 20% of the lesser of the borrowing base and the operating facility. As of December 31, 2018, the excess availability was greater than 20%. Source deferred $1,233 in financing costs for the ABL facility, with $355 of these costs amortized for the year ended December 31, 2018 (December 31, 2017 - $191).

(All amounts are in thousands of Canadian dollars, unless otherwise noted)

Interest on the above facility amounted to $2,334 for the year ended December 31, 2018 (December 31, 2017 - $1,212). Interest on the above notes amounted to $14,382 for the year ended December 31, 2018 (December 31, 2017 - $12,874). Effective interest rate for the year ended December 31, 2018 is 11.9% (December 31, 2017 - 11.1%).

## 11. DECOMMISSIONING PROVISION

| As at | December 31, 2018 | December 31, 2017[(1)] |
|---|---|---|
| **Balance, Beginning of period** | **$ 14,663** | **$ 4,300** |
| Liabilities incurred | 3,470 | 9,695 |
| Liabilities settled | (2,142) | (1,226) |
| Accretion | 360 | 76 |
| Changes in estimate | (314) | 2,055 |
| Changes in F/X Rate | 1,192 | (237) |
| **Balance, end of period** | **$ 17,229** | **$ 14,663** |
| Less: current portion | **$ (2,011)** | **$ (2,140)** |
| **Long-term portion** | **$ 15,218** | **$ 12,523** |

(1) Certain prior year amounts have been reclassified to conform to current year presentation for the current portion of the provision.

The Company's decommissioning provision relates to reclamation of land and facilities where the mine operates. Management estimates the costs to abandon and re-claim its properties based on current reclamation technology, acres disturbed and the estimated time period in which these costs will be incurred in the future. The total future estimate of undiscounted cash flows required to settle the provision has been discounted using risk-free rate of 1.98% at December 31, 2018 (December 31, 2017 - 1.98%). These obligations are to be settled based on the economic lives of the underlying assets, which is currently estimated to be between 8 and 20 years.

## 12. SHAREHOLDERS' EQUITY

Upon closing of the Company's IPO on April 13, 2017, the Company issued 16,666,667 common shares at $10.50 per share for gross proceeds of $175,000. Total transaction costs incurred on the IPO were $13,086, which was recognized as a reduction in equity. Transaction costs consisted of underwriters' commission and fees, audit, legal, filing, printing, translation and miscellaneous fees. Prior to the IPO, share capital of $10 Canadian dollars existed in Source.

The existing SES Canada and SES US LP partnership units were exchanged for units of Source common stock, for a total of 23,845,618 common and 1,300,154 Class B shares, or $264,031, the fair value at the IPO share price. As at December 31, 2018, TriWest Capital Partners owned 26.8% of the outstanding shares of Source.

The Class B shares are held by SES Sand Holdings US, a subsidiary of TriWest which is a related party, who own 3.74% of the shares of Source Energy Services Canada LP, a subsidiary of Source, and may be converted at the option of the holder into common shares of Source on a one for one basis. Class B shares are entitled to vote at shareholder meetings, but are not entitled to dividends from Source. However, they are entitled to an equivalent distribution on a per share basis from Source Energy Services Canada LP. The Company also settled the below related party loans by issuance of common shares:

- $37,658 shareholder loan payable – which was made up of four promissory notes that were issued between March 27, 2014 and February 28, 2017, with varying interest terms up to 25% per annum and varying maturity dates. This liability was settled with 3,586,518 shares.
- $71,977 preferred share obligation – which was issued as part of a reorganization that took place on October 16, 2013, which were non-voting, but entitled to stepped interest return, with no specific terms of repayment. This was settled with $54,727 in common shares (5,212,081 shares) and $17,250 cash.

On November 7, 2017, the Company issued 11,235,000 common shares at $8.35 per share for gross proceeds of $93,812. Total transaction costs incurred on the equity offering were $5,428, which was recognized as a reduction in equity. The equity is made up of a $28,807 public bought deal equity financing, and a $65,005 concurrent private placement equity financing. 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, and the shares are included in the gross proceeds amount above.

### Normal Course Issuer Bid

The Company completed its 2018 Normal Course Issuer Bid ("NCIB") that was announced on October 5, 2018 and amended on November 2, 2018. Pursuant to the NCIB, the Company purchased and canceled the maximum allowable number of common shares of the Company, totaling 615,000 common shares for a total consideration of $1,301 at a weighted average price per share of $2.115 before broker commission.

| | | December 31, | |
|---|---|---|---|
| (stated in thousands, except share and per share amounts) | | **2018** | **2017** |
| Number of Common Shares repurchased | | 615,000 | — |
| Weighted-average price per share | $ | 2.115 | — |
| Amount of repurchase | **$** | **1,301** | **—** |

The following table outlines the issued and outstanding shares as at December 31, 2018:

| | Number of common shares | | Amount |
|---|---|---|---|
| Balance as at January 1, 2017 | 96,881,996 | $ | 41,941 |
| Issuance of share capital in SESL upon incorporation | 1 | | - |
| Exchange of partnership units for SESL shares | (71,789,000) | | - |
| Issuance upon closing of IPO | 16,666,667 | | 165,455 |
| Issuance upon equity offerings | 11,235,000 | | 89,914 |
| Issuance on settlement of EEPP | 52,772 | | 554 |
| Issuance on repayment of shareholder loans | 3,586,518 | | 37,658 |
| Issuance on repayment of preferred share obligation | 5,212,081 | | 54,727 |
| Issuance on settlement of relevant transaction rights | 1,005,831 | | 10,563 |
| **Balance as at December 31, 2017** | **62,851,866** | **$** | **400,812** |
| Shares repurchased and canceled under Normal Course Issuer Bid | (615,000) | | (1,301) |
| **Balance as at December 31, 2018** | **62,236,866** | **$** | **399,511** |

## 13. SHARE BASED COMPENSATION

The Company's Share Based Compensation Plan, effective as of April 13, 2017, is available to directors, officers and certain employees as determined by the Company's Board of Directors. The Plan allows for the granting of options to purchase Common shares to a maximum number equal to 10% of the issued and outstanding Common Shares of the Company. The price of each share purchase option granted is set by the Company's Board of Directors based on the market value of the Company's shares on the date of the grant.

The options issued to date were granted in connection with the IPO and therefore vest 1/3 on the grant date, and 1/3 on the anniversary date of the grant over a two-year period, and expire 5 years from the issue date. Future grants may not follow this vesting profile.

| In 000's | Options outstanding | Range of Exercise Price |
|---|---|---|
| Outstanding at April 13, 2017 | - | - |
| Granted | 2,581 | $10.50 |
| Exercised | - | - |
| Cancelled | - | - |
| Forfeited | - | - |
| Expired | - | - |
| Outstanding at December 31, 2017 and 2018 | 2,581 | $10.50 |

The stock options were valued using the Black-Scholes option pricing model, using the following inputs:

(All amounts are in thousands of Canadian dollars, unless otherwise noted)

| | |
|---|---|
| Forfeiture Rate (%) | 5% |
| Volatility (%) | 33% |
| Risk free interest rate (%) | 0.5% |
| Dividend yield (%) | 0% |
| Option life | 5 years |

The Company issued 51,426 DSUs to directors of the Company as of April 13, 2017 at $10.50. The DSUs vest and are expensed over the earlier of three years or when a director or other participant ceases in their role and are payable only when a director or participant leaves the Company. The DSUs are expected to be settled for cash payment and accordingly were considered a liability settled award for accounting purposes.

The Company issued 101,009 RSUs and 40,394 PSUs to certain employees of the Company as of August 2, 2017 at $10.50. The RSUs will vest 1/3 on the anniversary date of the grant over a three-year period and expire five years from issue date. Subject to achievement of performance criteria set out by the Board of Directors, the PSUs awarded will vest 1/3 on the anniversary date of the grant over a three-year period and expire five years from the issue date. The RSUs and PSUs are expected to be settled for cash payment and accordingly were considered a liability settled award for accounting purposes.

The Company issued 236,501 RSUs and 112,434 PSUs to certain employees of the Company as of March 14, 2018. The fair value of RSUs and PSUs was determined using the five days volume-weighted-average share price prior to the date of the grant. The RSUs will vest 1/3 on the anniversary date of the grant over a three-year period and expire five years from issue date. Subject to achievement of performance criteria set out by the Board of Directors, the PSUs awarded will vest 1/3 on the anniversary date of the grant over a three-year period and expire five years from the issue date. The RSUs and PSUs may be settled in cash or shares and accordingly were considered a liability settled award for accounting purposes.

The Company issued 200,000 RSUs and 200,000 PSUs to certain employees of the Company as of May 2, 2018. The fair value of RSUs and PSUs was determined using the five days volume-weighted-average share price prior to the date of the grant. The RSUs will vest 1/3 on the anniversary date of the grant over a three-year period and expire five years from issue date. Subject to achievement of performance criteria set out by the Board of Directors, the PSUs awarded will vest 1/3 on the anniversary date of the grant over a three-year period and expire five years from the issue date. The RSUs and PSUs may be settled in cash or shares and accordingly were considered a liability settled award for accounting purposes.

The Company issued 75,000 DSUs to directors of the Company as of May 2, 2018. The fair value of DSUs was determined using the five days volume-weighted-average share price prior to the date of the grant. The DSUs are expensed upon grant and vest when a director or participant leaves the Company. The DSUs may be settled in cash or shares and accordingly were considered a liability settled award for accounting purposes.

The following table provides a summary of the status of the Company's compensation plans that are expected to be settled for cash payment:

| (number of units) | Restricted Share Units | Performance Share Units | Deferred Share Units |
|---|---|---|---|
| Balance at January 1, 2017 | - | - | - |
| Granted | 101,009 | 40,394 | 51,426 |
| Exercised | - | - | - |
| Forfeited | - | - | - |
| Balance at December 31, 2017 | 101,009 | 40,394 | 51,426 |
| Granted | 436,501 | 312,434 | 75,000 |
| Exercised | (44,054) | (15,733) | (8,571) |
| Forfeited | (33,103) | (8,388) | - |
| **Balance as at December 31, 2018** | **460,353** | **328,707** | **117,855** |

Total share based compensation for the Share Based Payment Plans for the year ended December 31, 2018 was $2,403 (December 31, 2017 - $6,625).

## 14. EARNINGS (LOSS) PER SHARE

### Basic earnings (loss) per share

The calculation of basic earnings (loss) per share for the year ended December 31, 2018 was based on the earnings (loss) available to common shareholders of $(2,213) (December 31, 2017 - $(8,515)), and a weighted average number of common shares outstanding for the year ended December 31, 2018 ended of 61,478,796 (December 31, 2017 - 44,454,714).

(All amounts are in thousands of Canadian dollars, unless otherwise noted)

| | 2018 | 2017 |
|---|---|---|
| **Common Shares outstanding, beginning of period** | **61,551,712** | **23,845,618** |
| Shares repurchased and canceled under Normal Course Issuer Bid | (72,916) | — |
| Issued upon closing of IPO | — | 12,009,133 |
| Issued on repayment of preferred share obligation | — | 2,584,258 |
| Issued on settlement of shareholder loan | — | 3,755,554 |
| Issued pursuant to November 7, 2017 equity offering | — | 1,662,164 |
| Issued on settlement of Relevant Transaction Rights | — | 597,987 |
| **Weighted average common shares outstanding, end of period** | **61,478,796** | **44,454,714** |
| Common shares issuable pursuant to conversion option of Class B Shares[(a)] | — | — |
| **Weighted average number of diluted common shares outstanding, end of period** | **61,478,796** | **44,454,714** |

**Notes:**
(a) Only attributable to NCI shareholders when in an income position.

### Diluted earnings (loss) per share

Diluted earnings per share is calculated by adjusting the earnings and number of shares for the effects of dilutive options and other dilutive potential shares. The effects of anti-dilutive options as well as exchangeable shares are ignored in calculating diluted earnings per share. The exchangeable shares were not considered dilutive at December 31, 2018 as the Company was in a loss position.

## 15. REVENUE

The following table presents the Company's sales, disaggregated by revenue source:

| | | 2018 |
|---|---|---|
| Revenue from contracts with customers: | | |
| Sand revenue | $ | 342,428 |
| Wellsite solutions | | 66,564 |
| Terminal Services | | 3,447 |
| Total revenue from contracts with customers | $ | 412,439 |
| Storage facilities | | 2,588 |
| **Total revenue** | **$** | **415,027** |

*Contract Liabilities*

The Company entered into an agreement with one of its customers, effective January 1, 2018, where the Company received $14,761 ($11,505 US) as a prepayment for future purchases of proppant. In consideration of the prepayment, the price per metric tonne to the customer was reduced for each tonne of sand sold to the customer. The cash price per tonne is also reduced for each tonne of sand sold to or pumped by the customer.

The Company expects the period between the transfer of the promised goods to the customer and payment by the customer to exceed one year. As such, the Company has adjusted the transaction price for the time value of money.

The following table provides a summary of the contract liability as of December 31, 2018:

| | | |
|---|---|---|
| Balance, Beginning of Period | $ | 278 |
| Cash proceeds | | 14,761 |
| Satisfaction of performance obligations | | (9,735) |
| Non-cash interest incurred | | 1,846 |
| Non-cash interest income | | (1,251) |
| Balance, End of Period | **$** | **5,899** |
| Less: current portion | | (2,744) |
| Long-term portion | | **3,155** |

(All amounts are in thousands of Canadian dollars, unless otherwise noted)

Minimum revenue estimated to be recognized based on take-or-pay commitments in long-term sales contracts as at December 31, 2018:

| | | |
|---|---|---|
| 2019 | $ | 6,750 |
| 2020 | | 25,168 |
| 2021 | | 6,750 |
| **Total** | $ | 38,668 |

## 16. OPERATING AND GENERAL & ADMINISTRATIVE COSTS

The Company presents its expenses on the Consolidated Statements of Operations and Comprehensive Income using the function of expense method whereby expenses are classified according to their function within the Company. This method was selected as it is more closely aligned with the Company's business structure. The Company's functions under IFRS are as follows:

- Cost of sales; and
- Operating, general and administrative

Cost of sales includes direct operating costs (including product costs, direct labour and overhead costs) and depreciation on assets relating to operations. Additional information on the nature of expenses is as follows:

| **Year ended December 31,** | | | **2018** | | | | | | **2017** | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | **COS** | | **OPEX & G&A** | | **Total** | | **COS** | | **OPEX & G&A** | | **Total** |
| Direct Material | $ | 184,820 | $ | — | $ | 184,820 | $ | 121,258 | $ | — | $ | 121,258 |
| Salary costs | | 33,665 | | 14,295 | | 47,960 | | 27,845 | | 11,913 | | 39,758 |
| Equipment costs | | 25,098 | | 1,528 | | 26,626 | | 16,394 | | 1,454 | | 17,848 |
| Transportation costs | | 71,503 | | — | | 71,503 | | 53,275 | | — | | 53,275 |
| Facility costs | | 10,652 | | 5,104 | | 15,756 | | 7,155 | | 3,973 | | 11,128 |
| Selling costs | | — | | 7,200 | | 7,200 | | — | | 3,975 | | 3,975 |
| Administration costs | | — | | 5,196 | | 5,196 | | — | | 3,194 | | 3,194 |
| **Total** | **$** | **325,738** | **$** | **33,323** | **$** | **359,061** | **$** | **225,927** | **$** | **24,509** | **$** | **250,436** |

## 17. COMMITMENTS AND CONTINGENCIES

The Company has various lease commitments regarding equipment, railcars, physical natural gas contracts, land leases and office space. The leases expire between February 2019 and September 2031. Estimated annual lease commitments are as follows:

| | | |
|---|---|---|
| 2019 | $ | 25,936 |
| 2020 | | 17,752 |
| 2021 | | 14,733 |
| 2022 | | 12,567 |
| 2023 | | 5,263 |
| Subsequent Years | | 11,162 |
| Total | $ | 87,413 |

In the ordinary course of conducting business, the Company 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 the Company believes that the outcome of any pending or threatened actions will not have a material adverse effect on the business or financial condition of the Company.

(All amounts are in thousands of Canadian dollars, unless otherwise noted)

## 18. RELATED PARTY TRANSACTIONS

Key management personnel are comprised of the Company's directors and executive officers. Key management personnel compensation comprised:

| | | 2018 | | 2017 |
|---|---|---|---|---|
| Short term employment benefits | $ | 2,177 | $ | 2,928 |
| Management Fees paid to common unit holders that are not executive officers | | — | | 414 |
| Share based payment | | 2,407 | | 5,758 |
| **Total** | **$** | **4,584** | **$** | **9,100** |

During the year ended December 31, 2018, 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. The company also performed various civil and mechanical construction tasks and provided construction materials. This company billed Source $2,074 for the year ended December 31, 2018 (December 31, 2017 - $2,876), of which $nil was included in Accounts payable and accruals as at December 31, 2018 (December 31, 2017 - $1,323).

## 19. FINANCE EXPENSE

| | | 2018 | | 2017 |
|---|---|---|---|---|
| Interest expense | $ | 17,103 | $ | 16,621 |
| Accretion | | 3,469 | | 8,745 |
| Finance expense | | 389 | | 2,976 |
| Total | $ | 20,961 | $ | 28,342 |

## 20. OPERATING SEGMENTS

The Company has operations in both the United States and Canada; the two geographic segments are summarized in the table below.

The Corporate Segment does not represent an operating segment and is included for informational purposes only.

| **Sales for the year ended December 31,** | | **Canadian Operations** | | **United States Operations** | | **Corporate** | | **Total** |
|---|---|---|---|---|---|---|---|---|
| 2018 | $ | 402,863 | $ | 12,164 | $ | — | $ | 415,027 |
| 2017 | $ | 272,194 | $ | 17,304 | $ | — | $ | 289,498 |

| **Total Assets** | | **Canadian Operations** | | **United States Operations** | | **Corporate** | | **Total** |
|---|---|---|---|---|---|---|---|---|
| December 31, 2018 | $ | 143,138 | $ | 356,160 | $ | 21,043 | $ | 520,341 |
| December 31, 2017 | $ | 140,722 | $ | 317,433 | $ | 9,802 | $ | 467,957 |