# Divergent Energy Services Corp.

Management Discussion and Analysis
As at June 30, 2018 and for the three and six month periods ending June 30, 2018 and 2017

(Amounts are in USD $000's, except number of shares and per share data)

**Dated: August 20, 2018**

# Management Discussion and Analysis
# As at June 30, 2018 and for the Three and Six Month Periods Ended June 30, 2018 and 2017

## INTRODUCTION

Management's Discussion & Analysis ("MD&A") of the financial condition and results of operations of Divergent Energy Services Corp. ("the Corporation") for the period ended June 30, 2018, contains information current to and is dated August 20, 2018. It should be read in conjunction with the Unaudited Condensed Consolidated Interim Financial Statements for the three and six month periods ended June 30, 2018 ("Q2 2018") and the Audited Consolidated Financial Statements dated December 31, 2017, and notes thereto as well as other information which is available on SEDAR at www.sedar.com. All amounts contained herein are in thousands (000's) of United States Dollars unless otherwise indicated.

The Corporation's Unaudited Condensed Consolidated Interim Financial Statements have been prepared in accordance with International Accounting Standards ("IAS") 34 "Interim Financial Reporting". The Corporation's significant accounting policies under International Financial Reporting Standards ("IFRS") are included in Note 3 to the annual financial statements, with the addition of policies as noted in the Q2 2018 Unaudited Condensed Consolidated Interim Financial Statements; both can be found on SEDAR at www.sedar.com.

This MD&A contains certain statements that constitute forward-looking statements under the meaning of applicable securities laws. Please see "Forward-Looking Statements" at the end of this document, for a discussion concerning the Corporation's use of such information.

The following MD&A for the Corporation has been prepared by management as of August 20, 2018, and is a review of the financial condition and results of operations of the Corporation. This MD&A and Q2 2018 Unaudited Condensed Consolidated Interim Financial Statements were reviewed by the Audit Committee of the Corporation's Board of Directors on August 20, 2018, and approved by the Corporation's Board on August 20, 2018.

This MD&A has been prepared in accordance with the requirements of National Instrument 51-102 and covers the period from January 1, 2018, to June 30, 2018, unless otherwise noted.

## NON GAAP MEASURES

In this MD&A, we refer to financial measures that do not have any standardized meaning as prescribed by General Accepted Accounting Principles ("GAAP"). These non-GAAP financial measures are relevant to an understanding of the financial statements and are not presented elsewhere in the financial statements. These measures have been described and presented in order to provide shareholders and potential investors with additional measures for analyzing our ability to generate funds to finance our operations and information regarding our liquidity. Users are cautioned that non-GAAP financial measures presented by the Corporation may not be comparable with measures provided by other entities. Below are the non-GAAP measures that Divergent uses.

Adjusted EBITDA means earnings before interest, taxes, depreciation, amortization and accretion. EBITDA is not a recognized measure under GAAP. Management believes that in addition to net earnings, EBITDA is a useful supplemental measure as it provides an indication of the results of the Corporation's business prior to consideration to how the activities are financed, amortized or how the results may be taxed in various jurisdictions.

Readers should be cautioned, however, EBITDA should not be construed as an alternative to net earnings determined in accordance with GAAP as an indicator of Divergent's performance. Divergent's method of calculating EBITDA may differ from other organizations and, accordingly, EBITDA may not be comparable to measures by other organizations.

## CORPORATE PROFILE

Divergent is a publicly traded entity on the Canadian Venture Exchange (TSX-V) under the symbol "DVG". Except where the context otherwise requires, "Divergent" or the "Corporation", shall refer to Divergent Energy Services Corp. and its consolidated subsidiaries.

The Corporation's business consists of one operating segment namely Artificial Lift Systems.

Divergent's products are sold primarily into the US. The Corporation offers normal and customary trade terms to its customers, no significant part of which is of an extended nature. Special inventory requirements are not necessary, and customer merchandise return rights do not extend beyond normal warranty provisions. The market for the Corporation's products is highly competitive.

## SUMMARY DESCRIPTION OF BUSINESS

### Artificial Lift Systems ("ALS")

The ALS division provides electric submersible pumping products including the commercialization of an electromagnetic reciprocating submersible pump technology. Divergent currently services Wyoming and Colorado from its facility in Gillette, WY, which generates 100% of the revenue for the division. There are three distinct product lines as follows:

- **Electric Submersible Pump Systems ("ESP")**

  ESP products and services primarily target production operations in the oil and gas industry. ESP products are designed to lift large volumes of fluid from both oil and gas wells.

- **Electric Submersible Progressing Cavity Pump Systems ("ESPCP")**

  ESPCP products and services primarily target production operations in the oil and gas industry. Divergent pioneered the introduction of ESPCP's to the Powder River Basin. ESPCPs are specially designed for abrasion resistance in tough pumping applications and able to move viscous fluids at high flow rates.

- **Linear Electromagnetic Submersible Pumps ("Linear Pump")**

  The Linear Pump uses permanent magnet motor technology that duplicates conventional rod pump movement without rod strings or surface lifting equipment. All moving parts are contained within the submersible pump housing, eliminating rod and tubing wear, making the Linear Pump ideal for placement into horizontal wellbores. The Linear Pump is installed similar to an ESP at the bottom of the well on production tubing with electric cable running to surface. Testing and product development has been conducted in a Saskatchewan oil well, and the product line is expected to begin generating revenue once proven commercially viable which is not expected to occur within fiscal 2018.

**QUARTERLY CONDENSED CONSOLIDATED FINANCIAL RESULTS**

**Selected Financial Information**

| | Three Months Ended June 30, 2018 | 2017 | Six Months Ended June 30, 2018 | 2017 |
|---|---|---|---|---|
| Revenue – continuing operations | $2,021 | $2,140 | $3,951 | $4,303 |
| Loss from continuing operations | (154) | (856) | (81) | (1,439) |
| Loss from discontinued operations | - | (87) | (316) | (167) |
| Net loss for the period | (154) | (943) | (397) | (1,606) |
| Total assets | 2,960 | 3,627 | 2,960 | 3,627 |
| Total liabilities | 8,924 | 8,955 | 8,924 | 9,121 |
| Shareholders' deficiency | (5,964) | (5,328) | (5,964) | (5,328) |
| Loss per share basic and diluted – continuing operations | (0.00) | (0.01) | (0.00) | (0.01) |
| Loss per share basic and diluted – discontinued operations | (0.00) | (0.00) | (0.00) | (0.00) |
| Loss per share – basic and diluted | (0.00) | ($0.01) | (0.00) | ($0.01) |

**RECENT DEVELOPMENTS**

In October 2017 Divergent signed a three-year exclusive services contract with a client in the Powder River Basin which continues to provide a strong base of activity and revenue from the methane-based market in Wyoming. To date, the contract has provided sufficient value to support the operating cash flows of the Corporation.

The exclusivity agreement with the supplier of the linear motor has not been executed and has now lapsed. Divergent's CEO recently met with a larger motor manufacturer whose business model is substantially more focused on product development and the parties have begun working towards having Divergent as their business partner in North America. The nature and structure of the agreement is under discussion and updates will be provided as they become available. The change in suppliers is not expected to impact any upcoming installations.

**QUARTER OVERVIEW**

**CONTINUING OPERATIONS**

**For the three month period ended June 30, 2018:**

- The Corporation recorded Adjusted EBITDA of $2 as compared to a loss of $707 in Q2 2017.
- G&A decreased 3% from the previous period of Q2 2017.

**For the six month period ended June 30, 2018:**

- The Corporation recorded Adjusted EBITDA of $179 as compared to a loss of $1,088 in Q2 2017.
- G&A decreased 10% from the previous period of Q2 2017.

**RESULTS FROM OPERATING OPERATIONS**

**FOR THE THREE AND SIX MONTHS ENDED JUNE 30,**

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | **2018** | **2017** | **2018** | **2017** |
| **Revenue** | $ 2,021 | $ 2,140 | $ 3,951 | $ 4,303 |
| **Cost of sales** | 1,490 | 1,545 | 2,750 | 3,054 |
| **Gross profit** | 531 | 595 | 1,201 | 1,249 |
| **General and administrative** | 681 | 699 | 1,355 | 1,500 |
| **Stock based compensation** | 23 | 69 | 52 | 110 |
| | (704) | (768) | (1,407) | (1,610) |
| **Results from operations** | $(173) | ($173) | $(206) | ($361) |
| **Adjusted EBITDA** | $2 | ($707) | $179 | ($1,088) |

**REVENUE, COST OF SALES AND GROSS PROFIT**

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | **2018** | **2017** | **2018** | **2017** |
| **Revenue** | $ 2,021 | $ 2,140 | $ 3,951 | $ 4,303 |
| **Cost of sales** | 1,490 | 1,545 | 2,750 | 3,054 |
| **Gross profit** | $ 531 | $ 595 | $ 1,201 | $ 1,249 |
| **Gross profit %** | 26% | 28% | 30% | 29% |

For the three and six month periods ended June 30, 2018, ALS

- Activity levels in April and May were better than expected given historic issues with spring storms in Wyoming. June's job count was negatively impacted by our largest client having a portion of their monthly operating budget directed to expenses not related to replacing ESP's.
- Gross profit margins were reduced from one transaction that sold a package of slow moving inventory for less than cost but generated cash flow. Outside of that one transaction the margins for the business were in line with expectations.

**General and administrative expenses ("G&A")**

| | 2018 | 2017 | % Change |
|---|---|---|---|
| For the three months ended March 31, | $674 | $801 | (16%) |
| For the three months ended June 30, | 681 | 699 | (3%) |
| For the six months ended June 30, | $1,355 | $1,500 | (10%) |

G&A expenses were in line with activity levels and management maintains a focus on cost reductions that do not hinder the operational and safety aspects of the corporation.

**Stock based compensation**

| | 2018 | 2017 | % Change |
|---|---|---|---|
| For the three months ended March 31, | $29 | $41 | (29%) |
| For the three months ended June 30, | 23 | 69 | (67%) |
| For the six months ended June 30, | $52 | $110 | (53%) |

Stock based compensation has decreased for the three and six months periods ended June 30, 2018 compared to those periods of 2017 due to reduction of grants offered in the past year and due to the reduction in volatility in the stock price as included in by the Black-Scholes model.

**Product development costs**

| | 2018 | 2017 | % Change |
|---|---|---|---|
| For the three months ended March 31, | $4 | $206 | (98%) |
| For the three months ended June 30, | - | 26 | N/A |
| For the six months ended June 30, | $4 | $232 | (98%) |

The Corporation incurred minimal product development costs related to the Linear Pump for the three months ended March 31, 2018. Although costs related to testing are expected to reduce over time as the Linear Pump approaches commercial viability we foresee additional costs exceeding the amount for Q1 2018 for the remainder of 2018.

**Net Finance Expense**

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| Foreign exchange gain (loss) | $144 | ($477) | $329 | ($519) |
| Interest expense | (114) | (138) | (230) | (244) |
| Accretion expense | (11) | (42) | (23) | (83) |
| Net finance (income) expense | $19 | ($657) | $76 | ($846) |

During the three month period ended June 30, 2018 the Corporation recorded a gain on foreign exchange of $144 compared to a loss of $477 in Q2 2017 primarily due to the movement in the rate of the Canadian dollar against the US Dollar. The USD denominated loans between the Corporation and its Mexican subsidiary is no longer being recognized as a net investments thus the foreign exchange losses are being recognized in net income versus accumulated other comprehensive income.

**Income Tax Expense**

The Corporation's current income tax expense and deferred income tax expense was $Nil and $Nil for the three and six month periods ended June 30, 2018. The Corporation has non-capital losses for income tax purposes of $6,218 which expire in 2028 through 2036. Those non-capital losses have not been recognized in the financial statements and are as follows:

| Year of Expiry | USA | Canada | Total |
|---|---|---|---|
| 2028 to 2033 | $3,151 | $- | $3,151 |
| 2034 | 195 | 2,066 | 2,261 |
| 2035 | 208 | 598 | 806 |
| 2036 | - | - | - |
| | $3,554 | $2,664 | $6,218 |

**DISCONTINUED OPERATIONS**

The Corporation's management commenced the winding down of operations in Mexico in December 2015, and during the fiscal year 2016 closed the PMF division. The operating results of the PMF segment are presented below as discontinued operations, and it should be noted that the comparative results from operations have been restated to show the discontinued operations separately from continuing operations.

| | **Three Months Ended June 30, 2018** | **2017** | **Six Months Ended June 30, 2018** | **2017** |
|---|---|---|---|---|
| Selling, general and administrative | $- | $82 | $- | $128 |
| Stock based compensation | - | 5 | - | 10 |
| Loss from discontinued operations before income taxes | - | (87) | - | (138) |
| Income tax expense – current taxes | - | (39) | (316) | (29) |
| **Loss from discontinued operations** | **$-** | **($126)** | **($316)** | **($167)** |

**Income tax expense**

The Corporation's income taxes for the three and six month periods ended June 30, 2018 were $Nil and $316 which relate to additional net liabilities upon dissolution of the Mexico subsidiary and the recovery of tax related interest. Divergent has taken certain tax positions in its Mexican tax filings using the best estimate based on a qualitative assessment of all relevant factors. These filings are subject to audit and potential reassessment after the lapse of considerable time. Accordingly, actual amounts realized may differ from that estimated and recorded by management.

The Corporation has recorded $1,493 (2017 - $1,179) of liabilities related to the discontinued operations of its Mexican subsidiary. The Mexican subsidiary was legally dissolved on February 19, 2018 however the liabilities will continue to exist for an additional five years from the date of dissolution.

**Cash flows from discontinued operations**

| | **Six Months Ended June 30, 2018** | **2017** |
|---|---|---|
| Cash from (used in) operating activities | $- | $185 |
| Cash generated from (used in ) investing activities | - | - |
| **Cash flows from discontinued operations** | **$-** | **$185** |

**SUMMARY OF QUARTERLY RESULTS (UNAUDITED)**

| USD | Q2-2018 | Q1-2018 | Q4-2017 | Q3-2017 |
|---|---|---|---|---|
| Revenue – continuing operations | $2,021 | $1,930 | $2,101 | $1,778 |
| Income (loss) for the period – Continuing operations | (154) | 73 | 816 | (1,127) |
| Loss for the period - Discontinued operations | - | (316) | (179) | (4) |
| Net loss for the period | (154) | (243) | (637) | (1,131) |
| Comprehensive loss per share – basic and diluted | ($0.00) | ($0.00) | ($0.02) | ($0.01) |

| USD | Q2-2017 | Q1-2017 | Q4-2016 | Q3-2016 |
|---|---|---|---|---|
| Revenues – continuing operations | $2,140 | $2,163 | $2,796 | $3,969 |
| Loss for the period – Continuing operations | (856) | (582) | (1,047) | (94) |
| Loss for the period – Discontinued operations | (87) | (80) | (603) | (70) |
| Net loss for the period | (943) | (662) | (1,650) | (164) |
| Comprehensive loss per share (basic and diluted) | ($0.01) | ($0.01) | ($0.02) | ($0.00) |

**OUTLOOK**

The Corporation's focus on increasing sales in our ESP division in Wyoming is getting traction and we have begun to generate sales from new clients. We anticipate sales with new clients to increase continually as we demonstrate our ability to deliver reliable products and outstanding service. The majority of our sales efforts are in Wyoming, with a smaller portion of time spent on clients in Colorado and Montana. Feedback from the sales team indicates a large number of smaller clients being dissatisfied with their current providers and motivated to try a new supplier. As our revenue stream grows and we are exposed to a wider array of wellbores and production rates, we anticipate needing to significantly increase the amount of inventory on hand. Nearly all the components for our motors and pumps are made overseas and are considered long lead time products meaning work can only be awarded if the product is already in stock domestically.

**PRODUCT DEVELOPMENT**

Active discussions are underway with two clients who are each interested in providing one wellbore to further evaluate the Linear Pump. The timing of the installations are not yet determined and are pending the selection of a suitable wellbore. The timeline to get back into a well and continue testing continues to extend beyond any timeline anticipated by management. The combination of weak oil pricing, reduced operating budgets, and a growing adversity to risk has kept many potential clients from approving a test despite their acceptance that the technology will save them money in the long run. Although oil prices have risen globally, that is not the case for Canadian crude and it is expected that Canadian producers may continue to demonstrate risk aversion to testing new technology until they return to profitability. Divergent's focus for expansion and ongoing testing has been focused on the industry partner previously involved with testing and in the United States due to its oil industry demonstrating more resilience than Canada's.

The exclusivity agreement with the supplier of the linear motor has not been executed and has now lapsed. Divergent's CEO recently met with a larger motor manufacturer whose business model is substantially more focused on product development and the parties have begun working towards having Divergent as their business partner in North America. The nature and structure of the agreement is under discussion and updates will be provided as they become available. The change in suppliers is not expected to impact any upcoming installations.

The next round of testing will be focused on delivering results of extending operating time and proving out the cost reduction benefits of the pump:

- Reduced power consumption using a high efficiency electromagnetic motor vs surface lifting equipment (pump jack). Data from the 2016 and 2017 tests have been analyzed and calculations indicate potential savings of up to 33%.
- Operating cost reductions through reduced service rig interventions to repair worn and broken sucker rods.
- Capital cost reductions through reduced tubing wear caused by the reciprocating motion of the sucker rods.
- Increased production rates when installed lower in the well - a challenging installation for conventional rod pumps. The linear pump can be installed vertically, slant, or horizontal which allows for the pump to be placed lower in the well. The deeper a pump is installed, the lower the fluid level can be drawn down resulting in increased oil production.
- Reduced environmental impact with the elimination of surface lifting equipment.
- Lower carbon footprint with the reduction of steel used.

The Corporation's vision is to be a premier supplier of submersible pumping products that increase production while reducing costs and carbon footprint. Divergent's Technical Advisory Committee continues to evaluate emerging artificial lift technologies and make determinations on whether Divergent can capture the intellectual property. A number of opportunities currently are under review by the committee. The commercialization of the Linear Pump remains a primary focus as the product is complementary to our existing electric submersible pump business, and will provide oil and gas companies the opportunity to capitalize on the Linear Pump's many benefits while differentiating Divergent within a competitive and growing market. The Corporation's Technical Advisory Committee continues to evaluate emerging technologies.

**Cash and Liquidity**

The Corporation had cash balances of $477 and $549 as at June 30, 2018 and December 31, 2017 respectively.

Cash used in operating activities was $49 for the six months ended Q2 2018. The changes in non-cash working capital items includes a decrease in trade receivables and advances of $223, an increase in inventories of $72, a decrease in prepaid expenses of $19, a decrease in accounts payable of $133 and an increase of liabilities relating to discontinued operations of $314.

The unaudited condensed consolidated interim financial statements have been prepared on a going concern basis. The going concern basis of presentation assumes that the Corporation will continue in operation for the foreseeable future and be able to realize its assets and discharge its liabilities and commitments in the normal course of business. The unaudited condensed consolidated interim financial statements do not reflect adjustments that would be necessary if the going concern assumption were not appropriate. If the going concern basis were not appropriate for these financial statements, then adjustments would be necessary to the classification and carrying amounts of the assets and liabilities and the reported revenues and expenses.

The material uncertainties that may cast significant doubt on the Corporation's ability to continue as a going concern are set forth below.

The Corporation has an accumulated deficit of $30,077 at June 30, 2018. The Corporation has experienced a history of net losses and using cash in its operations.

The Corporation has negative working capital at June 30, 2018, of $2,167. In addition, the Corporation has accounts payable in excess of a year old amounting to $1,100. There is material uncertainty as to whether the Corporation will be able to repay these obligations and future obligations without obtaining additional future debt or equity financings.

During the year ended December 31, 2017 the Corporation's Debentures, amounting to CAD $5,750 were extended to the maturity date of December 31, 2021 in exchange for 5,750,000 common share purchase warrants with an exercise price of CAD $0.13 expiring on December 31, 2021.

In addition, the Corporation has economic dependence on a single customer in the United States which comprises approximately 96% (2017 - 90%) of revenue and accounts receivable of $312 (December 31, 2017 - $311) for the three months ended June 30, 2018.

The Corporation's management and Board of Directors continue to seek alternative debt and equity financings in order to fund additional projects and operations in North America and to provide for the repayment of the debentures.

**FINANCIAL INSTRUMENTS**

**Interest Rate Risk**

Interest rate risk arises from changes in market interest rates that may affect the fair value or future cash flows from the Corporation's financial assets or liabilities. The Corporation is exposed to interest rate risk on certain debt instruments and short term investments to the extent of changes in the underlying market interest rates. Cash flow exposure to interest rate risk is minimal at this time as substantially all of the Corporation's borrowings bear interest at fixed rates.

**Commitments**

**Long-Term Debt**

As at June 30, 2018, the Corporation had debentures of CAD $5,750 outstanding and maturing on December 31, 2021.

**Lease Commitments**

As at June 30, 2018, the Corporation had the following commitments outstanding in relation to its operating lease commitments:

| **Year**<br>(In 000's) | **Total** |
|---|---|
| 2018 | $254 |
| 2019 | 308 |
| 2020 | 281 |
| 2021 | 163 |
| Total | $1,006 |

**Summary of Share Capital**

As at June 30, 2018, the Corporation had 112,215,658 common shares issued and outstanding with stated share capital value of $17,634. 6,026,000 warrants and 7,760,000 stock options, of which 4,443,332 are exercisable, were outstanding at June 30, 2018. As at August 20, 2018, the common shares outstanding are 112,215,658.

**RELATED PARTY TRANSACTIONS**

The following transactions were in the normal course of operations and entered into and recorded at the agreed to exchange amount which reflects fair value:

Debenture interest was paid through the issue of common shares to a certain officer and directors amounting to $34 for the three month period ended and $46 for the six month period ended June 30, 2018 (for the three and six month periods ended June 30, 2017, $11 and $23, respectively).

Officers and directors advanced the Corporation CAD $195, of which CAD $70 was converted into common shares of the private placement (Note 6(b)). The remaining advances of CAD $125 is included in accounts payables and accrued liabilities. The advances are due on demand and bear interest at 10%. Interest of CAD $2 is included in accounts payable and accrued liabilities.

**RISKS AND UNCERTAINTIES - FINANCIAL RISK MANAGEMENT**

**Risk Management Framework**

The Board of Directors has overall responsibility for the establishment and oversight of the Corporation's risk management framework including developing and monitoring the Corporation's risk management policies. The Corporation's risk management policies are established to identify and analyze the risks faced by the Corporation, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Corporation's activities.

**Credit Risk**

Credit risk is the risk of financial loss to the Corporation if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Corporation's receivables from customers.

**Accounts receivable**

The Group's exposure to credit risk is influenced mainly by the individual characteristics of each customer. However, management also considers the demographics of the Group's customer base, including the default risk of the industry and country in which customers operate, as these factors may have an influence on credit risk, particularly in the current economic circumstances. Approximately 91 percent (Q1 2016: 98 percent) of ESP sales are attributable to one counterparty.

The Group has established allowances for impairment of trade receivables in 2018 - $Nil (2017 - $Nil).

**Liquidity Risk**

Liquidity risk is the risk that the Corporation may encounter difficulty in meeting the obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. The Corporation's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Corporation's reputation. See discussion on the Corporation's cash and liquidity above.

**Market Risk**

Market risk is the risk that changes in market prices, such as foreign exchange rates, interest rates and equity prices will affect the Corporation's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return. The level of market risk to which the Corporation is exposed to, depends on market conditions, expectations of future price or market rate movements and the composition of the Corporation's financial assets and liabilities. The Corporation regularly monitors market risk exposure, tolerances and control processes in order to manage the exposure related to changes in market risk to stay within acceptable market risk limits.

**Currency Risk**

The Corporation is exposed to currency risk on sales and purchases that are denominated in a currency other than the respective functional currencies of Corporation entities, primarily the US dollar, CDN dollar and Mexican Peso. The Corporation does not hedge its foreign currency transactions but does endeavor to contract its business to US dollar equivalency.

Interest on borrowings is denominated in the currency of the borrowing. Generally, borrowings are denominated in Canadian dollars.

**Interest Rate Risk**

Interest rate risk arises from changes in market interest rates that may affect the fair value or future cash flows from the Corporation's financial assets or liabilities. The Corporation is exposed to interest rate risk on certain debt instruments and short term investments to the extent of changes in the underlying market interest rates. Cash flow exposure to interest rate risk is minimal at this time as substantially all of the Corporation's borrowings bear interest at fixed rates.

**Contingencies**

From time to time, the Corporation is subject to legal proceedings, assessments and claims in the ordinary course of business. At this time, in the opinion of management, none of these matters are reasonably expected to have a material adverse effect on the Corporation's financial position.

**Capital Management**

The Corporation's objective when managing its capital is to strike a balance between maintaining investor, creditor and market confidence while sustaining future development of the Corporation.

The Corporation has identified the need for additional equity financing however it has not been successful in raising additional capital.

The Corporation's existing debt agreements do not require maintenance of any financial covenants. There were no changes to the Corporation's approach to capital management during the six month period ended June 30, 2018. The Corporation is not subjected to any internally or externally imposed capital requirements.

**Critical Accounting Policies and Estimates**

The Corporation prepares its interim condensed consolidated financial statements in accordance with IFRS. In preparing its financial statements, management is required to make various estimates and judgments in determining the reported amounts of assets and liabilities, revenues and expenses, as well as the disclosure of commitments and contingencies. Management bases its estimates and judgments on its own experience and various other assumptions believed to be reasonable at the time and under the circumstances in existence when the financial statements were prepared. Anticipating future events cannot be done with certainty; therefore, these estimates may change as new events occur, more experience is acquired or the Corporation's operating environment changes. More detailed information regarding the accounting estimates believed by management to require the most difficult, subjective or complex judgments and which are material to the Corporation's financial reporting results are discussed in the Corporation's financial statements for the year ended December 31, 2017.

In addition the following accounting standards and amendments have been issued and adopted (with the exception to Leases):

**Leases**
On January 13, 2016, the IASB issued IFRS 16, "*Leases*" ("IFRS 16"), which requires entities to recognize lease assets and lease obligations on the balance sheet. For lessees, IFRS 16 removes the classification of leases as either operating leases or finance leases, effectively treating all leases as finance leases. Certain short-term leases (less than 12 months) and leases of low-value assets are exempt from the requirements, and may continue to be treated as operating leases. IFRS 16 is effective for years beginning on or after January 1, 2019, with early adoption permitted. The Corporation is currently evaluating the impact of adopting IFRS 16 on the consolidated financial statements.

**Revenue**
In May 2014, the IASB issued IFRS 15, "*Revenue From Contracts With Customers"* ("IFRS 15") replacing IAS 11, "*Construction Contracts*", IAS 18, "*Revenue*" and several revenue-related interpretations. IFRS 15 establishes a single revenue recognition framework that applies to contracts with customers and was adopted on January 1, 2018. The Corporation recognizes revenue when it transfers control of the product or services to a customer which is on delivery and installation of the product at the customer site. Pricing is based on agreed contracted rates, and collectability is reasonably assured. The Corporation's revenue transactions do not contain financing components and payments are typically due within 30 days of revenue recognition. The Corporation assessed the impact of adopting IFRS 15 on the Consolidated Financial Statements and there have been no material differences identified as part of the Corporation's assessments.

**Financial Instruments**
The Corporation adopted IFRS 9, which replaced IAS 39 – Financial Instruments: Recognition and Measurement, in its financial statements beginning January 1, 2018. IFRS 9 largely retains the existing requirements in IAS 39 for the classification and measurement of financial liabilities, however it eliminates the previous IAS 39 categories for financial assets held to maturity, loans and receivables and assets available for sale. Under IFRS 9 there are three principle classification categories for financial assets: measured at amortized cost, fair value through other comprehensive income ("FVOCI") and fair value through profit and loss ("FVRPL"). The classification of financial assets under IFRS 9 is based on the business model in which a financial asset is managed and its contractual cash flow characteristics. Derivatives embedded in contracts where the host is a financial asset in the scope of the standard are never separated. Instead, the hybrid financial instrument as a whole is assessed for classification. IFRS replaces the 'incurred loss' model in IAS 39 with an 'expected credit loss' model. The new impairment model applies to financial assets measured at amortized cost, contract assets and debt investments at FVOCI, but not to investments in equity

instruments. Under IFRS 9, credit losses are recognized earlier than under IAS 39. The adoption of IFRS 9 did not have a material impact on the Corporation's financial statements.

**OFF BALANCE SHEET ARRANGEMENTS**

The Corporation has no off balance sheet arrangements, other than operating leases.

**RECONCILIATION OF NET LOSS TO ADJUSTED EBITDA**

| | 3 Months Ended June 30, 2018 | 3 Months Ended June 30, 2017 | 6 Months Ended June 30, 2018 | 6 Months Ended June 30, 2017 |
|---|---|---|---|---|
| Net loss from continuing operations | ($154) | ( $856) | ($81) | ($1,439) |
| Taxes | - | - | (53) | - |
| Interest | 120 | 110 | 230 | 216 |
| Depreciation | 25 | 27 | 58 | 53 |
| Accretion | 11 | 41 | 23 | 82 |
| | $2 | ($707) | $177 | ($1,088) |

**Forward-looking Statements**

*This MD&A contains certain statements that constitute forward-looking statements. These statements relate to future events or the Corporation's future performance. All statements, other than statements of historical fact, that address activities, events or developments that the Corporation or a third party expects or anticipates will or may occur in the future, are forward-looking statements. These include the Corporation's future growth, results of operations, performance and business prospects and opportunities; prevailing economic conditions; commodity prices; sourcing, pricing and availability of raw materials, components and parts, equipment, suppliers, facilities and skilled personnel; dependence on major customers; uncertainties in weather and temperature affecting the duration of the service periods and the activities that can be completed; regional competition; and other factors, many of which are beyond the Corporation's control. These other factors include future prices of oil and natural gas and oil and natural gas industry activity, including the effect of changes in commodity prices on oil and natural gas exploration and development activity, the ability to complete strategic acquisitions and realize the anticipated benefits of any acquisitions that are completed, the Corporation's outlook regarding the competitive environment it operates in, and the assumptions underlying any of the foregoing. Forward-looking statements are often, but not always, identified by the use of words such as "seek", "anticipate", "plan", "continue", "estimate", "expect", "may", "will", "project", "predict", "potential", "targeting", "intend", "could", "might", "should", "believe" and similar expressions. These statements involve known and unknown risks, uncertainties and other factors, many of which are beyond the Corporation's control, including those discussed under "Risks and Uncertainties" and elsewhere in this MD&A that may cause actual results or events to differ materially from those anticipated in such forward-looking statements. The Corporation believes that the expectations reflected in those forward-looking statements are reasonable, but no assurance can be given that these expectations will prove to be correct and such forward-looking statements included in this MD&A should not be unduly relied upon. These statements speak only as of the date of this MD&A. The Corporation does not intend, and does not assume any obligation, to update these forward-looking statements, whether as a result of new information, future events or otherwise, except as required under applicable securities laws. The forward-looking statements contained in this MD&A are expressly qualified by this cautionary statement.*

# Corporate Information

## DIRECTORS AND OFFICERS

## DIRECTORS AND OFFICERS

Ken Bagan (2) (3)
Chairman of the Board

Cam Barton (1) (2) (3)
Director

Don Luft (4)
Director

Martin Hall (1) (2)
Director

Rob Riecken (1) (3) (4)
Director

Ken Berg (4)
Chief Executive Officer
President, Director

Scott Hamilton
Chief Financial Officer

(1) Member of the Audit Committee, Mr. Hall is Chair.
(2) Member of the Governance and Nominating Committee, Mr Barton is Chair.
(3) Member of the HR and Compensation Committee, Mr. Riecken is Chair.
(4) Member of the Health, Safety and Environment Committee, Mr. Luft is Chair.

All members of the Board of Directors are independent with the exception of Ken Berg

## CORPORATE OFFICE

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**BANKER**
HSBC
Calgary, Alberta

**LAWYERS**
Burstall Winger Zammit LLP
Calgary, Alberta

**AUDITORS**
KPMG LLP
Calgary, Alberta

**STOCK EXCHANGE**
TSX Venture
Calgary, Alberta

**TRANSFER AGENT AND REGISTRAR**
Computershare
Calgary, Alberta