

CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED
DECEMBER 31, 2018



TSX: PSK

HIGH MARGINS
ZERO CAPITAL

PRAIRIESKY
ROYALTY LTD



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INDEPENDENT AUDITORS' REPORT

To the Shareholders of PrairieSky Royalty Ltd.

Opinion

We have audited the consolidated financial statements of PrairieSky Royalty Ltd. (the "Company"), which comprise:

- the consolidated statements of financial position as at December 31, 2018 and December 31, 2017
- the consolidated statements of earnings and comprehensive income for the years then ended
- the consolidated statements of changes in shareholders' equity for the years then ended
- the consolidated statements of cash flows for the years then ended
- and notes to the consolidated financial statements, including a summary of significant accounting policies

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

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

Basis for Opinion

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

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

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

Other Information

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

- the information included in Management's Discussion and Analysis filed with the relevant Canadian Securities Commissions.



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

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

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

We have nothing to report in this regard.

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

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

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

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

Auditors' Responsibilities for the Audit of the Financial Statements

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

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

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

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

We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those



risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion.

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

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represents the underlying transactions and events in a manner that achieves fair presentation.
- Communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.
- Provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

The engagement partner on the audit resulting in this auditors' report is Anna Marie Alderson.

KPMG LLP

Chartered Professional Accountants

Calgary, Canada
February 11, 2019

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(millions)		As at December 31, 2018	As at December 31, 2017
Assets			
Current Assets			
Cash and cash equivalents		\$ -	\$ 45.1
Accounts receivable and accrued revenue	(Note 4)	15.7	43.0
Income tax receivable		4.0	-
Prepays		0.9	0.6
		20.6	88.7
Royalty assets, net	(Note 5)	756.5	820.2
Exploration and evaluation assets	(Note 6)	1,408.8	1,431.8
Goodwill	(Note 7)	631.0	631.0
Total Assets		\$ 2,816.9	\$ 2,971.7
Liabilities and Shareholders' Equity			
Current Liabilities			
Bank debt	(Note 8)	\$ 5.8	\$ -
Accounts payable and accrued liabilities	(Note 9)	10.0	17.0
Income tax payable	(Note 14)	-	11.3
Dividend payable	(Note 10)	15.2	14.7
		31.0	43.0
Share-based compensation payable	(Note 11)	1.1	5.0
Deferred income taxes	(Note 14)	211.2	203.7
Total Liabilities		243.3	251.7
Shareholders' Equity			
Shareholders' capital	(Note 10)	3,308.8	3,334.3
Paid in surplus		4.8	2.8
Deficit		(740.0)	(617.1)
Total Shareholders' Equity		2,573.6	2,720.0
Total Liabilities and Shareholders' Equity		\$ 2,816.9	\$ 2,971.7
Commitments	(Note 18)		

See accompanying Notes to Consolidated Financial Statements.

Approved on behalf of the Board of Directors of PrairieSky Royalty Ltd.:

(signed) "James M. Estey"

Director

(signed) "Margaret A. McKenzie"

Director

CONSOLIDATED STATEMENTS OF EARNINGS AND COMPREHENSIVE INCOME

(millions, except per share amounts)	For the year ended December 31	
	2018	2017
Revenues		
Royalty revenue (Note 12)	\$ 248.0	\$ 265.9
Other revenue (Note 12)	25.8	79.8
Revenues	273.8	345.7
Expenses		
Administrative (Note 13)	20.0	30.1
Production and mineral taxes	5.1	6.1
Depletion, depreciation and amortization (Note 5)	139.9	166.7
Exploration and evaluation (Note 6)	5.4	4.9
Net Earnings Before Finance Items and Income Taxes	103.4	137.9
Finance Items		
Finance income	(0.3)	(1.3)
Finance expense	0.8	0.1
Net Earnings Before Income Taxes	102.9	139.1
Income tax expense (Note 14)	23.5	18.5
Net Earnings and Comprehensive Income	\$ 79.4	\$ 120.6
Net Earnings per Common Share		
Basic and Diluted (Note 10)	\$ 0.34	\$ 0.51

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(millions)	Shareholders' Capital	Paid In Surplus	Deficit	Total Shareholders' Equity
Balance at December 31, 2017	\$ 3,334.3	\$ 2.8	\$ (617.1)	\$ 2,720.0
Net earnings	-	-	79.4	79.4
Common shares repurchased (Note 10)	(25.5)	-	(20.2)	(45.7)
Share-based compensation (Note 11)	-	2.0	-	2.0
Dividends on common shares (Note 10)	-	-	(182.1)	(182.1)
Balance at December 31, 2018	\$ 3,308.8	\$ 4.8	\$ (740.0)	\$ 2,573.6

(millions)	Shareholders' Capital	Paid In Surplus	Deficit	Total Shareholders' Equity
Balance at December 31, 2016	\$ 3,071.2	\$ 2.9	\$ (539.1)	\$ 2,535.0
Net earnings	-	-	120.6	120.6
Common shares issued:				
Pursuant to bought deal offering (Note 10)	288.9	-	-	288.9
Share issue costs, net of tax (Note 10)	(8.8)	-	-	(8.8)
Pursuant to stock option plan (Note 10)	1.2	(1.9)	-	(0.7)
Pursuant to acquisition (Note 6)	1.6	-	-	1.6
Common shares repurchased (Note 10)	(19.8)	-	(22.4)	(42.2)
Share-based compensation (Note 11)	-	1.8	-	1.8
Dividends on common shares (Note 10)	-	-	(176.2)	(176.2)
Balance at December 31, 2017	\$ 3,334.3	\$ 2.8	\$ (617.1)	\$ 2,720.0

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(millions)	For the year ended December 31	
	2018	2017
Operating Activities		
Net earnings	\$ 79.4	\$ 120.6
Depreciation, depletion and amortization (Note 5)	139.9	166.7
Exploration and evaluation (Note 6)	5.4	4.9
Deferred income taxes (Note 14)	7.5	6.9
Share-based compensation, net of cash settlements (Note 11)	(6.4)	3.4
Other non-cash items (Note 6)	-	(16.2)
Royalty note receivable (Note 4)	3.9	3.9
Funds from operations	229.7	290.2
Net change in non-cash working capital (Note 17)	5.5	8.4
Cash From Operating Activities	235.2	298.6
Investing Activities		
Royalty asset acquisitions (Note 5)	(19.6)	(55.7)
Exploration and evaluation acquisitions (Note 6)	(39.0)	(305.4)
Reclassification of deposit to asset acquisition	-	15.0
Net change in non-cash working capital (Note 17)	-	(0.2)
Cash Used in Investing Activities	(58.6)	(346.3)
Financing Activities		
Dividends on common shares (Note 10)	(181.6)	(175.2)
Share issuance, net of costs	-	276.9
Common shares repurchased (Note 10)	(45.7)	(42.2)
Stock option exercise	-	(0.7)
Bank debt (Note 8)	5.8	-
Financing costs	(0.3)	-
Net change in non-cash working capital (Note 17)	0.1	-
Cash From (Used in) Financing Activities	(221.7)	58.8
Increase (Decrease) in Cash and Cash Equivalents	(45.1)	11.1
Cash and Cash Equivalents, Beginning of Year	45.1	34.0
Cash and Cash Equivalents, End of Year	\$ -	\$ 45.1

See accompanying Notes to Consolidated Financial Statements.

NOTES TO THE DECEMBER 31, 2018 AND 2017 CONSOLIDATED FINANCIAL STATEMENTS

(TABULAR AMOUNTS IN \$ MILLIONS UNLESS NOTED OTHERWISE)

1. NATURE OF OPERATIONS

PrairieSky Royalty Ltd. (“PrairieSky” or the “Company”) has a geologically and geographically diverse portfolio of fee simple mineral title, crude oil and natural gas gross overriding royalty interests and other acreage spanning Alberta, Saskatchewan, British Columbia and Manitoba (collectively, the “Royalty Properties”). The Company is focused on encouraging third parties to actively develop the Royalty Properties, while strategically seeking additional petroleum and natural gas royalty assets that provide the Company with medium-term to long-term value enhancement potential. The Company does not directly conduct operations to explore for, develop or produce petroleum or natural gas; rather, third-party development of the titled or leased lands provides the Company with royalty revenue as petroleum and natural gas are produced from such properties.

The Company’s shares are publicly traded on the Toronto Stock Exchange (“TSX”) under the stock symbol “PSK”. The location of the head and registered office of the Company is Suite 1700, 350 – 7th Avenue S.W., Calgary, Alberta, T2P 3N9.

2. BASIS OF PRESENTATION

These consolidated financial statements (the “financial statements”) have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”).

These financial statements have been prepared on a historical cost basis, except for share-based payment transactions. The financial statements have been prepared on a going concern basis and amounts are in millions of Canadian dollars unless otherwise stated.

These financial statements were approved and authorized for issuance by the Company’s Board of Directors on February 11, 2019.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A) SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGMENTS

The timely preparation of financial statements requires management to make estimates and use judgment regarding the reported amounts of assets and liabilities, revenues and expenses and disclosures of contingent assets and liabilities as at the date of the financial statements. Such estimates primarily relate to fair value estimates and unsettled transactions and events as at the date of the financial statements and accordingly, actual results could differ from the estimates. Significant estimates and judgments made by management in the preparation of these financial statements are outlined below.

Identification of Cash Generating Units

The identification of cash generating units (“CGUs”) requires judgment. CGUs are defined as the lowest level of integrated assets for which there are separately identifiable cash flows that are largely independent of cash flows from other assets or groups of assets. The classification of assets and allocation of corporate assets into CGUs requires judgment and interpretation. Factors considered in the classification include how management monitors the entity’s operations, how management makes decisions about continuing or disposing of assets and operations, and the nature of the assets.

Crude Oil and Natural Gas Reserves

Reserves estimates are not recorded in the Company's financial statements but they do affect net earnings and assets and liabilities through their impact on depreciation, depletion and amortization ("DD&A"), amounts used for impairment calculations, deferred taxes and amounts used to determine fair values of assets acquired through acquisitions and business combinations. By their nature, the estimates of reserves, including the estimates of future prices, costs, discount rates and the related future cash flows, are subject to measurement uncertainty. Accordingly, the impact to amounts reported in the financial statements for future periods could be material. Reserves have been evaluated at December 31, 2018 by the Company's independent qualified reserves evaluators.

Recoverability of Asset Carrying Values

Judgments are required to assess when impairment indicators, or reversal indicators, exist and impairment testing is required with respect to the carrying value of long-lived assets and goodwill. Refer to Note 3(H) and 3(I).

The application of the Company's accounting policy to transfer assets from exploration and evaluation to royalty assets or to expense capitalized exploration and evaluation assets requires management to make certain judgments based on the estimated proved and probable reserves used in the determination of an area's technical feasibility and commercial viability.

Oil and Natural Gas Revenue Accruals

The Company follows the accrual method of accounting, making estimates in its financial and operating results. This may include estimates of production, royalty revenue and related expenses for the period reported, for which actual results have not yet been received. The Company has no operational control over the Royalty Properties and as a result, the Company uses historical production information to estimate revenue accruals. These accrual estimates are revised based on the receipt of actual production results and realized prices.

Share-based Compensation

The calculation of share-based compensation includes both judgments and estimates. Judgments include which valuation model is most appropriate to estimate the fair value of awards granted under the Company's Stock Option Plan, as well as the determination of the peer group used to calculate the total shareholder return under the Performance Share Unit ("PSU") Plan. Refer to Note 3(M).

Under the Stock Option Plan, the Company uses the Black-Scholes option pricing model which requires that management make estimates for the expected life of the option, the anticipated volatility of the share price over the life of the option, the dividend yield, the risk-free interest rate for the life of the option, and the number of options that will ultimately vest. Estimates of forfeiture rates are made through the vesting period for the Company's various long-term incentive plans. Estimates are based on past forfeitures and future expectations and are adjusted for actual forfeitures when stock options or units are exercised. Estimates and assumptions are then used in the valuation model to determine the fair value, including the number of share unit awards that will ultimately vest for both the PSU Plan and the Restricted Share Unit ("RSU") Plan. Fluctuations in share-based compensation may occur due to changes in the underlying share price or revised management estimates of relevant performance factors under the Company's PSU Plan. Estimates of the total shareholder return for PSUs are made at each period end.

Income Taxes

Tax provisions are based on enacted or substantively enacted laws. Changes in those laws could affect amounts recognized in the period of change and future periods. Deferred income tax assets are recognized

to the extent future recovery is probable in management's judgment. Deferred income tax assets are reduced to the extent that it is no longer probable that sufficient taxable earnings will be available to allow all or part of the asset to be recovered.

B) FUNCTIONAL AND PRESENTATION CURRENCY

These financial statements are presented in Canadian dollars, which is the functional currency of PrairieSky.

C) PRINCIPLES OF CONSOLIDATION

The financial statements include the accounts of the Company and all of its subsidiary companies. Subsidiaries are all entities over which the Company has control. Subsidiaries are consolidated from the date on which the Company obtains control. They are deconsolidated from the date that control ceases.

Control exists when the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. All intercompany balances and transactions, and any unrealized income and expenses, arising from intercompany transactions are eliminated upon consolidation.

D) CASH AND CASH EQUIVALENTS

Cash and cash equivalents include cash on hand and short-term investments, such as money market deposits or similar type instruments, with a maturity of three months or less when purchased.

E) ROYALTY ASSETS

Royalty assets are measured at cost less accumulated depletion, depreciation and amortization. All costs directly associated with fee simple lands and royalty interests are capitalized on an area-by-area basis. Costs include acquisitions of royalty interests with proved or probable reserves, transfers of exploration and evaluation assets and the carrying value of royalty assets acquired from Encana Corporation ("Encana") on May 27, 2014.

Costs accumulated within each area are depleted using the unit-of-production method based on proved plus probable reserves, as determined by independent qualified reserves evaluators.

For divestitures of properties, a gain or loss is recognized in net earnings. Exchanges of properties are measured at fair value, unless the transaction lacks commercial substance or fair value cannot be reliably measured. Where the exchange is measured at fair value, a gain or loss is recognized in net earnings.

Costs associated with office furniture, fixtures, leasehold improvements and information technology are carried at cost and depreciated on a straight-line basis over the estimated useful lives of the assets, which range from three to nine years.

F) EXPLORATION AND EVALUATION

Exploration and evaluation ("E&E") assets consist of expenditures incurred in an exploration area pending the determination of technical feasibility and commercial viability. These costs include unproved property acquisition costs, undeveloped land, mineral leases, and seismic. Assets classified as E&E are not amortized or depleted.

Technical feasibility and commercial viability is considered to be determinable when proved and probable reserves are determined to exist and are capable of economic production. When an area is determined to be technically feasible and commercially viable, the accumulated costs are transferred to royalty assets. E&E assets are assessed for impairment prior to any such transfer. When an area is determined not to be

technically feasible and commercially viable, the unrecoverable costs are charged to net earnings as E&E expense.

G) BUSINESS COMBINATIONS

Business combinations within the scope of IFRS 3 are accounted for using the acquisition method. The acquired identifiable net assets are measured at their fair value at the date of acquisition. Deferred taxes are recognized for any differences between the fair value and the tax basis of net assets acquired. Any excess of the purchase price over the fair value of the net assets acquired is recognized as goodwill. Any deficiency of the purchase price below the fair value of the net assets acquired is recorded as a gain in net earnings. Associated transaction costs are expensed when incurred. When a business combination includes a non-controlling interest, the non-controlling interest is initially measured based on either its fair value or its proportionate share of the fair value of identifiable net assets acquired.

In connection with the acquired royalty business from Encana on May 27, 2014, the Company was a wholly owned subsidiary and controlled by Encana prior to closing the Initial Public Offering (“IPO”), and immediately subsequent to closing. Business combinations involving entities under common control are outside the scope of IFRS 3 “Business Combinations”. IFRS provides no guidance on the accounting for these types of transactions. As a result, the Company was required to develop an accounting policy. The three most common methods utilized are the purchase method, the predecessor values since inception method, and the predecessor values from date of transaction method. Management determined that the predecessor values from date of transaction method to be the most appropriate. This method requires the financial statements to be prepared using the predecessor carrying values without an adjustment to fair value. The difference between any consideration given and the aggregate carrying value of the assets and liabilities acquired, was recorded as a reserve from common control in shareholders’ equity and collapsed into retained earnings in 2015.

H) IMPAIRMENT OF LONG-TERM ASSETS

The carrying values of long-term assets, excluding goodwill, are reviewed at each reporting date for indicators that the carrying value of an asset or CGU may not be recoverable. E&E assets are also reviewed for impairment indicators and assessed for impairment upon reclassification from E&E assets to royalty assets. If indicators of impairment exist, the recoverable amount of the asset or CGU is estimated. If the carrying value of the asset or CGU exceeds the recoverable amount, the asset or CGU is written down with an impairment recognized in net earnings. A CGU is the lowest level at which there are identifiable cash inflows that are largely independent of the cash inflows of other CGUs. Based on the interdependency of the cash flows, costs capitalized in areas within royalty assets and E&E assets are aggregated into one CGU.

The recoverable amount of an asset or CGU is the greater of its fair value less costs of disposal or its value in use. Fair value less costs of disposal is the amount obtainable from the sale of assets in an arm’s length transaction less costs of disposal. Value in use is determined by estimating the present value of the future net cash flows expected to be derived from the continued use of the CGU.

Reversals of impairments are recognized when there has been a subsequent increase in the recoverable amount. In this event, the carrying amount of the asset or CGU is increased to its revised recoverable amount with an impairment reversal recognized in net earnings. The recoverable amount is limited to the original carrying amount less accumulated depletion as if no impairment had been recognized for the asset or CGU for prior periods.

I) GOODWILL

Goodwill represents the excess of consideration paid over the fair value of acquired assets and assumed liabilities recognized in a business combination. Subsequent measurement of goodwill is at cost less any accumulated impairments.

Goodwill is assessed for impairment at least annually. If the carrying amount for the CGU exceeds the recoverable amount of the CGU, including goodwill, the associated goodwill is written down with an impairment recognized in net earnings. The recoverable amounts are determined based on the greater of fair value less costs of disposal or value in use. Fair value less costs of disposal is the amount obtainable from the sale of assets in an arm's length transaction less costs of disposal. Value in use is determined by estimating the present value of the future net cash flows expected to be derived from the continued use of the CGU. Goodwill impairments are not reversed.

J) PROVISIONS AND CONTINGENCIES

Provisions are recognized when the Company has a present obligation as a result of a past event, it is probable that an outflow of resources will be required and a reliable estimate can be made of the amount of the obligation. Provisions are measured based on the discounted expected future cash outflows.

When a contingency is substantiated by confirming events, can be reliably measured and will likely result in an economic outflow, a liability is recognized in the financial statements as the best estimate required to settle the obligation. A contingent liability is disclosed where the existence of an obligation will only be confirmed by future events, or where the amount of a present obligation cannot be measured reliably or will likely not result in an economic outflow. Contingent assets are only disclosed when the inflow of economic benefits is probable. When the economic benefit becomes virtually certain, the asset is no longer contingent and is recognized in the financial statements.

K) FAIR VALUE MEASUREMENTS

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.

A number of the Company's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on the following methods. When applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

The fair value of royalty assets recognized in a business combination is based on market values. The market value of royalty assets is the estimated amount for which royalty assets could be exchanged on the acquisition date between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and with compulsion. The market value of royalty assets are estimated with reference to the cash flow multiples from production based on cash flow multiples of the same or similar assets, or are based on estimates of the reserves acquired. The market value of E&E assets are estimated with reference to the market values of current arm's length transactions in comparable locations. The assumptions and estimates with respect to determining the fair value of royalty and E&E assets in a business combination generally include estimates of reserves acquired, forecast benchmark commodity prices, and discount rates. Changes in any of the assumptions or estimates used in determining the fair value of acquired assets and liabilities could impact the amounts assigned to assets, liabilities and goodwill. Future net earnings can be affected as a result of changes in future DD&A, asset impairment or goodwill impairment.

L) PRODUCTION AND MINERAL TAXES

Production and mineral taxes relate to payments made to provincial governments based on acreage or production of crude oil and natural gas on non-government owned lands which is recognized when the product is produced.

M) SHARE-BASED COMPENSATION

The Company's long-term incentive plans include a Stock Option Plan and share unit award plans (RSU Plan, PSU Plan, and a Deferred Share Unit ("DSU") Plan). Obligations for payments of cash or common shares under the Company's long-term incentive plans are accrued over the vesting period using fair values.

For the equity-settled Stock Option Plan, fair values are determined at the grant date and are recognized over the vesting period as compensation costs with a corresponding increase to paid in surplus. When the awards are exercised, the associated paid in surplus is recognized in shareholders' capital. The assumptions used by the Company are discussed in Note 11.

For the cash-settled share unit awards, fair values are determined at grant date and subsequently revalued at each reporting date based on the market value of the Company's common shares and are recognized over the vesting period as compensation costs, with a corresponding change to liabilities. The valuation incorporates the period-end share price, dividends declared during the period, the number of units outstanding at each period end and certain management estimates, such as estimated forfeiture rates and a performance multiplier for PSUs. Classification of the associated short-term and long-term liabilities is dependent on the expected payout dates.

N) INCOME TAXES

Income tax is recognized in net earnings except for items directly related to shareholders' equity, in which case it is recognized in shareholders' capital or other comprehensive income. Current income tax is measured at the amount expected to be recoverable from or payable to the taxation authorities based on the income tax rates enacted or substantively enacted at the end of the reporting period.

The Company follows the asset and liability method of accounting for income taxes. Under this method, deferred income tax is recorded for the effect of any temporary difference between the accounting and income tax basis of an asset or liability. Deferred income tax assets are recognized to the extent future recovery is probable. Deferred income tax assets are reduced to the extent that it is no longer probable that sufficient taxable earnings will be available to allow all or part of the asset to be recovered.

Deferred income tax is calculated using the enacted or substantively enacted income tax rates expected to apply when the assets are realized or liabilities are settled. The effect of a change in the enacted or substantively enacted tax rates is recognized in net earnings or in shareholders' capital depending on the item to which the adjustment relates.

Deferred income tax liabilities and assets are not recognized for temporary differences arising on:

- the initial recognition of goodwill; or
- the initial recognition of an asset or liability in a transaction which is not a business combination and, at the time of the transaction, affects neither accounting net earnings nor taxable earnings.

O) NET EARNINGS PER SHARE AMOUNTS

Basic net earnings per common share is computed by dividing net earnings by the weighted average number of common shares outstanding during the period. Diluted net earnings per common share is calculated giving effect to the potential dilution that would occur if stock options were exercised or other

contracts to issue common shares were exercised, fully vested, or converted to common shares. The treasury stock method is used to determine the dilutive effect of stock options and other dilutive instruments. The treasury stock method assumes that proceeds received from the exercise of in-the-money stock options and other dilutive instruments are used to repurchase common shares at the average market price for the period.

P) CHANGES IN ACCOUNTING POLICIES

IFRS 15

The Company adopted IFRS 15, “Revenue from Contracts with Customers” on January 1, 2018. PrairieSky used the modified retrospective adoption approach to adopt the new standard. The Company reviewed its revenue streams and major contracts with customers using the IFRS 15 five-step model and there were no material changes to net earnings or the timing of royalty production revenue or other revenue recognized. Under this method, there was no effect to opening deficit from the application of IFRS 15 to revenue contracts in progress at January 1, 2018. The additional disclosures required by IFRS 15 are detailed in Note 12.

Revenue recognition policy:

PrairieSky receives royalties on production from third-party development of petroleum and natural gas pursuant to lease agreements on its fee simple lands. PrairieSky also collects royalties on production from gross overriding royalty interests (“GORR”) that are tied to an underlying third-party mineral lease.

The continuation of a lease is typically dependent on the holder thereof continuing to produce hydrocarbons and maintaining the lease in good standing. Accordingly, PrairieSky’s performance obligations with respect to production royalties are satisfied over time, as petroleum and natural gas are produced.

Royalty revenue from the sale of crude oil, natural gas liquids (“NGL”) and natural gas is recognized as it accrues in accordance with the terms of the royalty agreement, which is generally in the month when the product is produced with production volumes primarily marketed with lessees’ production. Revenue for royalty production that is taken-in-kind is recognized when the performance obligations are met, which is when control of the product and title are transferred to the purchaser. Royalty revenue is measured at fair value of the consideration received or receivable when management can reliably estimate the amount, pursuant to the terms of the royalty agreements. An accrual is included in revenue and accounts receivable for amounts not received at the reporting date based on historical trends, new wells on stream and current market prices. Differences between the estimates and actual amounts received are adjusted and recorded in the period when the actual amounts are received.

Other revenue is comprised of non-royalty production revenue, including revenue generated from lease rentals and mineral lease bonus consideration received when new leases are negotiated. The Company generates bonus consideration by leasing its mineral interests to exploration and production companies. The performance obligations for bonus consideration received for new leases and lease rentals for the term of the initial lease (“primary term”) are satisfied when the lease agreement is executed, consideration receivable from the third-party is determined to be collectible, and the Company has no obligation to return the consideration received. When a lease is extended past the primary term, lease rental payments are due and recognized annually on the anniversary of the lease execution.

IFRS 9

The Company adopted IFRS 9, “Financial Instruments” on January 1, 2018. The transition to IFRS 9 had no material effect on the Company’s financial statements.

IFRS 9 contains three principal classification categories for financial assets: amortized cost, fair value through other comprehensive income (“FVOCI”), and fair value through profit or loss (“FVTPL”). The classification of financial assets under IFRS 9 is generally based on the business model in which a financial asset is managed and its contractual cash flow characteristics. IFRS 9 eliminates the previous IAS 39, “Financial Instruments: Recognition and Measurement”, categories of held to maturity, loans and receivables and available for sale.

Impairment of financial assets: IFRS 9 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, and contract assets and debt investments at FVOCI. Under IFRS 9, credit losses are recognized earlier than under IAS 39. See Note 16 for additional disclosure on the Company’s credit risk.

Cash and cash equivalents and accounts receivable and accrued revenue continue to be measured at amortized cost and are now classified as “amortized cost”. There was no change to the Company’s classification of accounts payable and accrued liabilities, bank debt and dividends payable which are classified as “other financial liabilities” and are measured at amortized cost. The Company has not designated any financial instruments as FVOCI or FVTPL, nor does the Company use hedge accounting.

Q) RECENT ACCOUNTING PRONOUNCEMENTS

New Standards Issued Not Yet Adopted

On January 13, 2016, the IASB issued IFRS 16, “Leases”. The standard is required to be adopted either retrospectively or by recognizing the cumulative effect of initially applying IFRS 16 as an adjustment to opening equity at the date of initial application. IFRS 16 is effective for fiscal years beginning on or after January 1, 2019. Under the new standard, companies will recognize new assets and liabilities, bringing off-balance sheet leasing arrangements onto the balance sheet. The Company’s mineral leases are not within the scope of IFRS 16. The Company intends to adopt IFRS 16 in its financial statements for the annual period beginning on January 1, 2019. The Company does not expect the standard to have a material impact on the financial statements as the office lease (see Note 18) is the only lease that will be impacted by the new standard.

4. ACCOUNTS RECEIVABLE AND ACCRUED REVENUE

	As at December 31, 2018	As at December 31, 2017
Trade receivables and accrued revenue	\$ 16.2	\$ 39.0
Royalty note receivable	-	3.9
Production and mineral taxes receivable	0.5	-
Interest receivable	-	0.1
	16.7	43.0
Allowance for doubtful accounts	(1.0)	-
	\$ 15.7	\$ 43.0

Trade receivables and accrued revenue relate to lease and royalty production payments receivable.

The analysis of accounts receivable and accrued revenue that are past due but not impaired is as follows:

	Total	Neither past due nor impaired	Past due but not impaired	
			4 - 6 Months	7 - 12 Months
As at December 31, 2018	\$ 15.7	\$ 15.3	\$ 0.3	\$ 0.1
As at December 31, 2017	\$ 43.0	\$ 42.9	\$ -	\$ 0.1

In determining the recoverability of trade receivables that are past due but not impaired, the Company considers the age of the outstanding receivables and the credit worthiness of the counterparties. See Note 16 for further information about credit risk.

5. ROYALTY ASSETS, NET

	As at December 31, 2018	As at December 31, 2017
Cost		
Balance, Beginning of Year	\$ 1,270.5	\$ 1,141.2
Asset acquisitions	19.6	59.3
Transfers from exploration & evaluation assets (Note 6)	56.6	70.0
Balance, End of Year	1,346.7	1,270.5
Accumulated Depletion, Depreciation and Amortization		
Balance, Beginning of Year	(450.3)	(283.6)
Depletion, depreciation and amortization	(139.9)	(166.7)
Balance, End of Year	(590.2)	(450.3)
Net Book Value, End of Year	\$ 756.5	\$ 820.2

For the year ended December 31, 2018, royalty assets acquired totaled \$19.6 million (2017 - \$59.3 million) which are primarily acquisitions of fee simple land and various producing GORR interests.

During the year ended December 31, 2017, asset acquisitions included the acquisition of a producing GORR on the SAGD thermal oil project at Lindbergh, Alberta (the "Lindbergh Acquisition") for \$34.7 million and \$23.0 million of producing royalty assets on fee simple lands and GORR interests.

6. EXPLORATION AND EVALUATION ASSETS ("E&E")

	As at December 31, 2018	As at December 31, 2017
Cost		
Balance, Beginning of Year	\$ 1,431.8	\$ 1,185.5
Asset acquisitions	39.0	321.2
Transfers to royalty assets (Note 5)	(56.6)	(70.0)
Land expiries	(5.4)	(4.9)
Balance, End of Year	\$ 1,408.8	\$ 1,431.8

Included in E&E asset acquisitions for the year ended December 31, 2018 are GORR interests acquired on non-producing assets and additional seismic, as well as \$25.6 million (December 31, 2017 - \$54.9 million) related to the acquisition of GORR interests on emerging oil plays.

Included in the \$321.2 million acquired in E&E assets during the year ended December 31, 2017, was \$215.2 million of value attributed to undeveloped drilling locations on current and future phases of the Lindbergh Acquisition, seismic, and non-producing royalty interests. A \$15.0 million deposit paid in December 2016 was used to fund a portion of the Lindbergh Acquisition purchase price.

During the year ended December 31, 2017, the Company also acquired a non-producing GORR interest in exchange for 53,616 common shares valued at \$1.6 million and provided a lease amendment in exchange for non-producing royalty interests valued at \$14.2 million.

7. GOODWILL

At December 31, 2018, Goodwill was \$631.0 million (December 31, 2017 - \$631.0 million). Goodwill is assessed for impairment at least annually. The recoverable amount of the Company's sole CGU was determined using fair value less costs of disposal with reference to the market capitalization of the Company. The impairment test of goodwill at December 31, 2018 concluded that the estimated recoverable amount exceeded the carrying amount of the CGU, including goodwill. As such, no goodwill impairment existed. At December 31, 2018, the market capitalization of the Company was \$4.1 billion.

8. BANK DEBT

At December 31, 2018, the Company had a \$200 million extendible revolving credit facility (the "Revolving Facility"), with a permitted increase to \$250 million, and a \$25 million extendible operating credit facility (the "Operating Facility", and together with the Revolving Facility, the "Credit Facility"), with a syndicate of Canadian banks. At December 31, 2018, \$5.8 million was drawn on the Operating Facility (December 31, 2017 - \$nil). The Revolving Facility remains undrawn. The effective interest rate for the year ended December 31, 2018 was 4.2% (December 31, 2017 - nil%).

The Credit Facility includes borrowing options of Canadian prime rate-based advances, U.S. base rate advances, LIBOR loans, bankers' acceptances and letters of credit, and will bear interest on a variable grid based on certain financial ratios, over the prevailing applicable rate for the type of loan. The Credit Facility is unsecured and does not have a borrowing base restriction. The Revolving Facility and the Operating Facility are each for three-year terms maturing on May 15, 2021 and, subject to certain requirements, are extendible annually. The Credit Facility has three financial covenants, whereby the Company's ratio of adjusted consolidated senior debt to EBITDA will not exceed 3.5:1.0, adjusted consolidated total debt to EBITDA will not exceed 4.0:1.0, and the adjusted consolidated total debt to capitalization ratio will not exceed 55%. EBITDA used in the covenant calculation is net earnings adjusted for non-cash items, interest expense and income taxes. As at December 31, 2018, the Company was compliant with all covenants provided for in the lending agreement.

9. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

	As at December 31, 2018	As at December 31, 2017
Trade payables	\$ 1.1	\$ 1.7
Production and mineral taxes payable	3.8	5.3
Accrued liabilities for cash settled share-based compensation (Note 11)	3.9	8.4
Other accrued liabilities	1.2	1.6
	\$ 10.0	\$ 17.0

10. SHARE CAPITAL

AUTHORIZED

The authorized share capital of the Company includes an unlimited number of common shares and an unlimited number of preferred shares issuable in series. The holders of the common shares are entitled to one vote in respect of each common share held at all meetings of shareholders, except meetings at which only holders of a specified class of share have the right to vote. The common shares have no par value.

ISSUED AND OUTSTANDING

	As at December 31, 2018		As at December 31, 2017	
	Number of Shares (millions)	Amount (\$ millions)	Number of Shares (millions)	Amount (\$ millions)
Common Shares Outstanding, Beginning of Year	236.0	\$ 3,334.3	228.0	\$ 3,071.2
Issued pursuant to bought deal offering	-	-	9.2	288.9
Share issue costs (net of \$3.2 million tax effect in 2017)	-	-	-	(8.8)
Issued pursuant to stock option plan (net of withholding tax)	-	-	0.1	1.2
Issued pursuant to an acquisition	-	-	0.1	1.6
Common shares repurchased	(1.8)	(25.5)	(1.4)	(19.8)
Common Shares Outstanding, End of Year	234.2	\$ 3,308.8	236.0	\$ 3,334.3

COMMON SHARES

On January 6, 2017, the Company completed a bought deal prospectus offering of common shares. Pursuant to the offering, the Company issued 9.2 million common shares, including 1.2 million common shares issued pursuant to the exercise in full of the over-allotment option granted to the underwriters at a price of \$31.40 per common share for aggregate gross proceeds of \$288.9 million and net proceeds, after fees and expenses, of \$276.9 million.

NORMAL COURSE ISSUER BID (“NCIB”)

On April 30, 2018, the Company announced the approval of the renewal of its NCIB by the TSX. The NCIB allows the Company to purchase for cancellation up to a maximum of 1,750,000 common shares over a twelve-month period which commenced on May 4, 2018 and expires no later than May 3, 2019. All common shares purchased under the NCIB are cancelled.

During the year ended December 31, 2018, the Company purchased for cancellation 1,804,480 common shares (December 31, 2017 - 1,402,300 common shares) at an average cost of \$25.31 per common share (December 31, 2017 - \$30.09 per common share) for total consideration of \$45.7 million (December 31, 2017 - \$42.2 million). The total cost paid, including commissions and fees, was first charged to share capital to the extent of the average carrying value of the common shares purchased and the excess of \$20.2 million (December 31, 2017 - \$22.4 million) was charged to the deficit for the period.

DIVIDENDS

During the year ended December 31, 2018, PrairieSky declared dividends of \$182.1 million (December 31, 2017 - \$176.2 million) or \$0.7750 per common share (December 31, 2017 - \$0.7450) and paid dividends of \$181.6 million (December 31, 2017 - \$175.2 million) or \$0.7725 per common share (December 31, 2017 - \$0.7425).

On February 26, 2018, the Company increased its annual dividend by \$0.03 per common share to \$0.78 per common share per annum. On December 11, 2018, the Board of Directors declared a dividend of \$0.065 per common share or \$15.2 million payable on January 15, 2019 to common shareholders of record on December 31, 2018.

NET EARNINGS PER COMMON SHARE

The following table presents the computation of net earnings per common share:

	Year ended December 31	
	2018	2017
Net Earnings	\$ 79.4	\$ 120.6
Number of Common Shares:		
Weighted Average Common Shares Outstanding - Basic	235.1	236.5
Effect of Dilutive Securities	0.3	0.2
Weighted Average Common Shares Outstanding - Diluted	235.4	236.7
Net Earnings per Common Share - Basic and Diluted	\$ 0.34	\$ 0.51

11. SHARE-BASED COMPENSATION PLANS

The Company has a number of share-based compensation arrangements under which the Company awards various types of long-term incentive grants to eligible employees, officers and directors. They include stock options, performance share units ("PSUs"), restricted share units ("RSUs"), and deferred share units ("DSUs").

The Company accounts for stock options granted to Company employees and officers as equity-settled share-based payment transactions and accrues compensation costs over the vesting period based on the fair values determined at the grant date.

The Company accounts for its share unit awards, PSUs, RSUs and DSUs, held by Company employees, officers and directors as cash-settled share-based payment transactions and accrues compensation costs and dividends over the vesting period based on the fair value at each reporting date. The Company may make an election to settle vested share unit awards with either a cash payment equal to the five-day weighted average trading price for the common shares multiplied by the number of common shares or issue the number of common shares. PSUs vest following the completion of a three-year performance period provided the officer remains actively employed with the Company on the vesting date. RSUs vest evenly over a three-year period, provided the officer or employee remains actively employed with the Company on the vesting date. DSUs are fully vested as of the grant date.

The Company has recognized the following share-based compensation costs:

	Year ended December 31	
	2018	2017
Compensation costs of transactions classified as equity-settled	\$ 2.0	\$ 1.8
Compensation costs (recovery) of transactions classified as cash-settled	(3.3)	8.0
Total share-based compensation expense (recovery)	\$ (1.3)	\$ 9.8

The Company has recognized the following liability for share-based payment transactions:

	As at	As at
	December 31, 2018	December 31, 2017
Liability for unvested cash-settled plans	\$ 3.0	\$ 10.5
Liability for vested cash-settled plans	2.0	2.9
Liability for cash-settled plans	\$ 5.0	\$ 13.4

As at December 31, 2018, \$3.9 million (December 31, 2017 - \$8.4 million) of the liability for cash-settled plans, which represents the value of the PSUs, RSUs and DSUs that are vested or will vest in the next twelve months, is included in accounts payable and accrued liabilities. The liability for vested cash-settled

DSUs of \$2.0 million (December 31, 2017 - \$2.9 million) included in accounts payable and accrued liabilities may or may not be paid in the next twelve months as it only becomes payable when a director is no longer a member of the Board. The remaining \$1.1 million (December 31, 2017 - \$5.0 million) is a long-term liability and is reported as share-based compensation payable.

A) STOCK OPTIONS

The Company has a Stock Option Plan that provides for granting of stock options to officers and certain employees. Stock options vest over a three-year period and expire five years after the date of the grant.

The following table summarizes the change in stock options outstanding:

	Number (thousands)	Weighted average exercise price (\$)
Issued and Outstanding, December 31, 2016	1,032.6	26.85
Granted	259.1	32.03
Exercised	(520.9)	(27.39)
Forfeited	(13.8)	(29.94)
Issued and Outstanding, December 31, 2017	757.0	29.28
Granted	279.7	32.06
Exercised	(4.8)	(22.55)
Forfeited	(33.7)	(29.39)
Issued and Outstanding, December 31, 2018	998.2	30.09

The weighted average share price on the dates that options were exercised was \$26.81 in 2018 (2017 - \$33.09).

The following assumptions were used to determine the fair value of stock options granted by the Company during the period:

	December 31, 2018	December 31, 2017
Risk free interest rate	1.89%	1.07%
Dividend yield	2.34%	2.25%
Expected volatility rate based on historical volatility	34%	34%
Forfeiture rate	6.4%	6.4%
Expected life	5 years	5 years
Weighted average grant price	\$32.06	\$32.03
Fair value per option on grant date	\$8.11	\$7.87

The following table summarizes information regarding stock options outstanding at December 31, 2018:

Range Of Exercise Prices Per Common Share	Number of options outstanding	Weighted average remaining life (years)	Weighted average exercise price for options outstanding (\$/share)	Number of options exercisable	Weighted average exercise price for options exercisable (\$/share)	Weighted average fair value for options outstanding (\$/share)
\$22.50-\$25.90	279,301	1.99	22.98	152,068	22.33	3.78
\$30.80-\$32.06	718,900	2.92	31.71	267,493	31.15	6.90

The following table summarizes information regarding stock options outstanding at December 31, 2017:

Range Of Exercise Prices Per Common Share	Number of options outstanding	Weighted average remaining life (years)	Weighted average exercise price for options outstanding (\$/share)	Number of options exercisable	Weighted average exercise price for options exercisable (\$/share)	Weighted average fair value for options outstanding (\$/share)
\$22.50-\$25.90	290,445	3.00	22.96	36,393	23.95	3.77
\$30.80-\$32.03	466,597	3.18	31.46	113,915	30.81	6.04

For the year ended December 31, 2018, administrative expense includes \$2.0 million (December 31, 2017 - \$1.8 million) of compensation costs related to stock options.

B) PERFORMANCE SHARE UNITS

PSUs have been granted to officers and entitle the officer to receive upon vesting a cash payment that is equal to the value of one common share of the Company for each PSU held, plus accrued dividends over the period from the date of grant to vesting, or the equivalent number of shares at the election of the Company.

The ultimate value of the PSUs will depend upon the Company's performance relative to predetermined corresponding performance targets measured over a three-year period. Performance is based on the Company's total shareholder return ("TSR"), defined as share price appreciation plus dividends, relative to the TSR for a predetermined performance peer group. Based on this assessment, a range of zero to two times the original PSU grant, at the discretion of the Board of Directors, may be eligible to vest in respect of the three-year trailing period being measured.

The following table summarizes information related to the PSUs:

<i>Outstanding PSUs (thousands of units)</i>	As at December 31, 2018	As at December 31, 2017
Issued and Outstanding, Beginning of Year	283.0	204.9
Granted	126.6	114.7
Exercised	(80.6)	(43.9)
Forfeited	(3.4)	-
Units, in lieu of dividends	11.4	7.3
Issued and Outstanding, End of year	337.0	283.0

For the year ended December 31, 2018, the Company recorded a compensation recovery of \$2.9 million (December 31, 2017 - expense of \$5.2 million) related to outstanding PSUs. The market common share price used in the PSU fair value calculation at December 31, 2018 was the closing price on the TSX of \$17.67 (December 31, 2017 - \$32.06). The remaining weighted average life is 1.2 years.

C) RESTRICTED SHARE UNITS

RSUs have been granted to eligible employees and entitle the employee to receive upon vesting a cash payment that is equal to the value of one common share for each RSU held, plus accrued dividends over the period from the date of grant to vesting, or the equivalent number of shares at the election of the Company.

The following table summarizes information related to the RSUs:

<i>Outstanding RSUs (thousands of units)</i>	As at December 31, 2018	As at December 31, 2017
Issued and Outstanding, Beginning of Year	140.7	246.3
Granted	46.9	50.6
Exercised	(80.3)	(132.5)
Forfeited	(12.1)	(26.6)
Units, in lieu of dividends	2.9	2.9
Issued and Outstanding, End of Year	98.1	140.7

For the year ended December 31, 2018, the Company recorded compensation costs of \$0.4 million (December 31, 2017 - expense of \$2.0 million) related to outstanding RSUs. The market common share price used in the RSU fair value calculation at December 31, 2018 was the closing price on the TSX of \$17.67 (December 31, 2017 - \$32.06). The remaining weighted average life is 0.6 years.

D) DEFERRED SHARE UNITS

Directors receive an annual compensation amount in DSUs and have the option to receive Board and Committee retainers and fees in the form of DSUs, which vest immediately. These DSUs are equivalent to a common share plus accrued dividends over the period from date of grant and vesting to the date of redemption and are settled in cash. DSUs can only be redeemed following departure from the Company and must be redeemed prior to December 15th of the year following departure. For the year ended December 31, 2018, the majority of the Directors elected to receive their annual Board and Committee retainers and fees in the form of DSUs.

The following table summarizes information related to the DSUs:

<i>Outstanding DSUs (thousands of units)</i>	As at December 31, 2018	As at December 31, 2017
Issued and Outstanding, Beginning of Year	89.1	65.3
Granted	23.2	21.7
Units, in lieu of dividends	3.9	2.1
Issued and Outstanding, End of Year	116.2	89.1

For the year ended December 31, 2018, the Company recorded a compensation recovery of \$0.8 million (December 31, 2017 - expense of \$0.8 million) related to outstanding DSUs. The market common share price used in the DSU fair value calculation at December 31, 2018 was the closing price on the TSX of \$17.67 (December 31, 2017 - \$32.06).

12. REVENUES

The Company's royalty production revenue is determined pursuant to the terms of the royalty agreements. The transaction price for crude oil, NGL and natural gas is based on the commodity price in the month of production, adjusted for quality, location, allowable deductions, if any, or other factors. Commodity prices are based on market indices that are determined on a monthly or daily basis.

Royalty production revenue is generally received two months after the crude oil, NGL, and natural gas are produced. For royalty production volumes taken-in-kind, revenue is typically collected on the 25th day of the month following production. Lease rental revenue for the entire primary term is recorded when the lease is executed. Lease rental revenue for any subsequent period is recorded as due which is generally annually on the anniversary of the lease extension. Both the amount and timing of bonus consideration revenue can vary significantly from period to period as it is recorded when a new lease is executed and relates to the unique circumstances of each lease transaction.

Royalty Revenue by Product	Year ended December 31	
	2018	2017
Crude Oil	\$ 184.7	\$ 185.0
NGL	31.2	29.1
Natural Gas	32.1	51.8
	248.0	265.9
Other Revenue		
Lease Rental Income	\$ 7.9	\$ 10.7
Bonus Consideration	16.5	67.0
Other Income	1.4	2.1
	25.8	79.8
Total Revenues	\$ 273.8	\$ 345.7

Revenues by Classification	Year ended December 31	
	2018	2017
Lessor Interests on Fee Lands	\$ 177.2	\$ 200.3
GORR Interests	70.8	65.6
Royalty Revenue	248.0	265.9
Other Revenue	25.8	79.8
Total Revenues	\$ 273.8	\$ 345.7

At December 31, 2018, receivables from contracts with customers, which are included in accounts receivable and accrued revenue, were \$15.2 million (December 31, 2017 - \$39.0 million). For the year ended December 31, 2017, the Company provided a lease amendment in exchange for a GORR interest valued at \$15.2 million. There were no non-cash revenue transactions during 2018. For the year ended December 31, 2018, the Company recorded \$8.9 million (December 31, 2017 - \$13.7 million) of revenue relating to prior periods. The performance obligations for these prior period adjustments were satisfied in production periods prior to the current year.

13. ADMINISTRATIVE EXPENSES

	Year ended December 31	
	2018	2017
Salaries and benefits	\$ 13.4	\$ 14.3
Share-based compensation (recovery) <i>(Note 11)</i>	(1.3)	9.8
Office expense	4.3	2.5
Public company expense	1.3	1.4
Information technology and other	2.3	2.1
Administrative expenses	\$ 20.0	\$ 30.1

14. INCOME TAXES

	Year ended December 31	
	2018	2017
Current tax expense	\$ 16.0	\$ 11.6
Deferred tax expense	7.5	6.9
Income tax expense	\$ 23.5	\$ 18.5

The following table reconciles income taxes calculated at the Canadian statutory rate with actual income taxes:

	Year ended December 31	
	2018	2017
Net Earnings Before Income Taxes	\$ 102.9	\$ 139.1
Canadian Statutory Rate	27.0%	27.0%
Expected Income Taxes	27.8	37.6
Effect on Taxes Resulting From:		
Permanent Differences	(4.8)	(19.2)
Other	0.5	0.1
Income tax expense	\$ 23.5	\$ 18.5

The Company has not recognized tax deductible temporary differences of \$71.4 million as at December 31, 2018 (December 31, 2017 - \$91.0 million) related to the excess of tax pools acquired over the carrying value of net assets transferred from Encana on May 27, 2014 because the common control transaction is not a business combination and is therefore subject to the initial recognition exemption under IAS 12 "Income Taxes". Deferred income tax assets and liabilities are not recognized for temporary differences arising on the initial recognition of an asset or liability in a transaction which is not a business combination and, at the time of the transaction, affects neither accounting profit nor taxable earnings. The unrecognized deferred income tax asset is being amortized based on the net tax pool claims calculated for the period. The reversal of the unrecognized deferred tax asset for the year ended December 31, 2018 was \$5.3 million (December 31, 2017 - \$19.1 million).

The deferred income tax charged to net earnings and the net deferred income tax liability consists of:

	Balance, December 31, 2017	Recognized in net earnings	Recognized directly in equity	Other	Balance, December 31, 2018
Royalty and E&E assets	\$ 210.9	\$ 4.1	\$ -	\$ -	\$ 215.0
Share-based compensation	(3.6)	2.3	-	-	(1.3)
Share issue costs	(3.6)	1.1	-	-	(2.5)
Total	\$ 203.7	\$ 7.5	\$ -	\$ -	\$ 211.2

	Balance, December 31, 2016	Recognized in net earnings	Recognized directly in equity	Other	Balance, December 31, 2017
Royalty and E&E assets	\$ 203.7	\$ 5.6	\$ -	\$ 1.6	\$ 210.9
Non-capital loss carry forwards	(0.6)	0.6	-	-	-
Share-based compensation	(3.2)	(0.4)	-	-	(3.6)
Share issue costs	(1.5)	1.1	(3.2)	-	(3.6)
Total	\$ 198.4	\$ 6.9	\$ (3.2)	\$ 1.6	\$ 203.7

15. CAPITAL MANAGEMENT

The Company's objective when managing its capital structure is to maintain financial flexibility in order to distribute cash to shareholders in the form of dividends and share repurchases and cancellations after consideration of the Company's financial requirements for its business and future growth opportunities. As a royalty company, PrairieSky does not have capital expenditure commitments, which enhances its financial flexibility.

The Company's capital structure is comprised of shareholders' equity and working capital. The Company's capital structure is managed by taking into account operating activities, dividends paid to shareholders,

common share repurchases, taxes, available Credit Facility (Note 8), share issuance costs and other factors. The Company's operating results and capital structure are impacted by the level of development activity by third parties on the Royalty Properties and the resultant royalty production volumes, commodity prices and level of costs incurred by the Company.

	As at December 31, 2018	As at December 31, 2017
Shareholders' equity	\$ 2,573.6	\$ 2,720.0
Working capital (deficiency)	(10.4)	45.7

The Company's capital structure is managed through its financial and operating forecast process. The forecast of the Company's future cash flows is based on estimates of production, crude oil, natural gas and NGL prices, production and mineral tax expense, administrative expenses and other investing and financing activities. The forecast is regularly updated based on changes in commodity prices, production expectations and other factors that in the Company's view could impact cash flow. The \$10.4 million working capital deficiency is primarily a result of lower accrued royalty revenue at December 31, 2018, as well as acquisitions made during the year. Lower benchmark commodity prices and wider Canadian light and heavy oil differentials to WTI impacted realized pricing, reducing royalty revenue in November and December 2018 which make up the majority of the accounts receivable and accrued revenue balance.

16. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

A) FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

The fair values of cash and cash equivalents, accounts receivable and accrued revenue, accounts payable and accrued liabilities and dividends payable approximate their carrying amount due to the short-term maturity of those instruments. Bank debt bears interest at a floating market rate with applicable variable margins, and accordingly the fair market value approximates the carrying amount.

B) RISKS ASSOCIATED WITH FINANCIAL ASSETS AND LIABILITIES

The Company is exposed to financial risks arising from its financial assets and liabilities. Financial risks include market risk (such as commodity price and interest rate risk), credit risk and liquidity risk.

Commodity Price Risk

Commodity price risk is the risk the Company will encounter fluctuations in its future royalty revenue with changes in commodity prices. Commodity prices for crude oil, NGL and natural gas are influenced by global and regional factors, including levels of supply and demand, weather and geopolitical factors. The Company does not hedge its commodity price risk.

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 Company's financial assets or liabilities.

Bank debt bears interest at a floating market rate with applicable variable margins.

Credit Risk

Credit risk arises from the potential that the Company may incur a loss if a counterparty to a financial instrument fails to meet its obligation in accordance with agreed terms. A substantial portion of the Company's accounts receivable are from royalty agreements with crude oil and natural gas industry

operators and are subject to normal industry credit risks. The Company's diversified revenue stream limits the size of any one property or industry operator with respect to total receivables. In addition, the Company takes certain of its production in-kind to mitigate credit risk.

As at December 31, 2018, there was one counterparty whose accounts receivable individually accounted for more than 10% of the total accounts receivable balance. The maximum credit risk exposure associated with accounts receivable and accrued revenue is the total carrying value. As at December 31, 2018, the Company has provided an allowance for doubtful accounts of \$1.0 million (December 31, 2017 - \$nil) calculated using a lifetime expected credit loss assessment for specifically identifiable customer balances which are assessed to be impaired.

Liquidity Risk

Liquidity risk is the risk that the Company will encounter difficulties in meeting a demand to fund financial liabilities as they come due. The Company manages its liquidity risk using cash and debt management programs. The Company has unused capacity under its Credit Facility, described below, for up to \$219.2 million.

The timing of expected cash outflows relating to bank debt of \$5.8 million, accounts payable and accrued liabilities of \$10.0 million and dividend payable of \$15.2 million is less than one year. Included in accounts payable and accrued liabilities is \$2.0 million related to vested cash settled DSUs which may or may not be paid in the next year. Management maintains a conservative approach to debt management that aims to provide financial flexibility with respect to acquisitions and the dividend rate. The Board of Directors reviews and determines the dividend rate annually after considering expected commodity prices, foreign exchange rates, economic conditions, production volumes, income taxes, and PrairieSky's capacity to fund operating expenses and investing opportunities.

17. SUPPLEMENTARY INFORMATION

NET CHANGE IN NON-CASH WORKING CAPITAL

	Year ended December 31	
	2018	2017
Source (use) of cash:		
Accounts receivable and accrued revenue	\$ 23.7	\$ (0.5)
Income tax receivable	(4.0)	-
Prepays	0.1	0.2
Accounts payable and accrued liabilities	(2.9)	(2.8)
Income tax payable	(11.3)	11.3
Changes in non-cash working capital	\$ 5.6	\$ 8.2
Related to operating activities	5.5	8.4
Related to investing activities	-	(0.2)
Related to financing activities	0.1	-
Changes in non-cash working capital	\$ 5.6	\$ 8.2

SUPPLEMENTARY CASH FLOW INFORMATION

	Year ended December 31	
	2018	2017
Taxes Paid	\$ 31.3	\$ -
Interest Paid	0.6	0.1
Interest Received	0.3	1.3

18. COMMITMENTS

The following table outlines the Company's commitments as at December 31, 2018:

(\$ millions) (undiscounted)	Expected Future Payments						Total
	2019	2020	2021	2022	2023	Thereafter	
Office lease commitments ⁽¹⁾	\$ 0.6	\$ 0.6	\$ 0.7	\$ 0.7	\$ 0.7	\$ 0.1	\$ 3.4

⁽¹⁾ Excludes operating costs

The Company has in place four royalty acquisition agreements with unrelated parties, all of which expire by October 31, 2020. At December 31, 2018, the total remaining commitment under these agreements is \$12.5 million.

19. RELATED PARTY TRANSACTIONS

Transactions with Key Management Personnel

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Company.

The following table summarizes compensation expense, cash and non-cash, all of which are included in administrative expenses, related to officers and directors of the Company:

	Year ended December 31	
	2018	2017
Salaries, bonuses, directors' fees and other benefits	\$ 3.6	\$ 3.8
Stock options	1.6	1.4
Share unit awards	(3.7)	6.8
Total Compensation	\$ 1.5	\$ 12.0

CORPORATE INFORMATION

BOARD OF DIRECTORS

James M. Estey⁽¹⁾⁽²⁾⁽³⁾⁽⁴⁾
Andrew M. Phillips
Margaret A. McKenzie⁽³⁾⁽⁴⁾
Myron Stadnyk⁽²⁾⁽⁴⁾
Sheldon B. Steeves⁽²⁾⁽³⁾⁽⁴⁾
Grant Zawalsky⁽²⁾⁽⁴⁾

- (1) Chair of the Board.
- (2) Member of the Governance and Compensation Committee. Mr. Estey is the Chair of the Governance and Compensation Committee.
- (3) Member of the Audit Committee. Ms. McKenzie is the Chair of the Audit Committee.
- (4) Member of the Reserves Committee. Mr. Steeves is the Chair of the Reserves Committee. Mr. Estey is an ex-officio non-voting member of the Reserves Committee.

OFFICERS

Andrew M. Phillips, President & Chief Executive Officer
Cameron M. Proctor, Chief Operating Officer
Pamela Kazeil, Vice President, Finance & Chief Financial Officer

AUDITORS

KPMG LLP

BANKERS

Toronto-Dominion Bank
Canadian Imperial Bank of Commerce

TORONTO STOCK EXCHANGE TRADING SYMBOL

PSK

INDEPENDENT RESERVE EVALUATORS

GLJ Petroleum Consultants Ltd.

TRANSFER AGENT

TSX Trust Company

ABBREVIATIONS

bbls – barrels
bbls/d – barrels per day
boe – barrels of oil equivalent (6 mcf = 1 bbl)
boe/d – barrels of oil equivalent per day
mcf – thousand cubic feet
mcf/d – thousand cubic feet per day
mmcf – million cubic feet
mmcf/d – million cubic feet per day
NGL – natural gas liquids
WTI – West Texas Intermediate

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